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BRAZIL

FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF ESPÍRITO SANTO
PROFISCO II – ES

(BR-L1517)

EIGHTH INDIVIDUAL LOAN OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP) FISCAL MANAGEMENT MODERNIZATION PROGRAM IN BRAZIL – PROFISCO II

(BR-X1039)

LOAN PROPOSAL

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ABBREVIATIONS

AWP	Annual work plan
CAPAG	Metodologia de Avaliação da Capacidade de Pagamento [Payment Capacity Assessment Methodology]
CCLIP	Conditional credit line for investment projects
CEE	Coordenação de Estudos Econômicos [Economic Studies Coordination Unit]
COFIEX	Comissão de Financiamentos Externos [External Financing Commission]
ECD	Escrituração contábil digital [digital accounting record)
EFD	Escrituração fiscal digital [digital tax record]
GDP-ES	State GDP of Espírito Santo
GEARC	Gerência de Arrecadação e Cadastro [Revenue and Registration Division]
GECOG	Gerência de Contabilidade Geral [General Accounting Division]
GEDEF	Gerência de Desenvolvimento Fazendário [Fiscal Development Division]
GEFIN	Gerência Geral de Finanças [General Finance Division]
ICAP	Institutional Capacity Assessment Platform
ICB	International competitive bidding
ICMS	Imposto sobre circulação de mercadorias e prestação de serviços [Goods and services sales tax]
ICT	Information and communication technologies
IEF	Instituto de Estudios Fiscales [Institute of Fiscal Studies]
IJSN	Instituto Jones dos Santos Neves [Jones dos Santos Neves Institute]
IMF	International Monetary Fund
IPEA	Instituto de Pesquisa Econômica Aplicada [Institute of Applied Economic Research]
IPVA	Imposto sobre la propriedade de veículos automotores [motor vehicle ownership tax]
IRR	Internal rate of return
ITCD	Imposto de transmissão causa mortis e doação [inheritance and gifts tax]
LOA	Lei do Orçamento Anual [Annual Budget Law]
LRF	Lei de Responsabilidade Fiscal [Fiscal Responsibility Law]
MD-GEFIS	Maturidade e desempenho da gestão fiscal [fiscal management maturity and performance assessment]
MEP	Monitoring and evaluation plan
NCB	National competitive bidding
NF-e	Nota fiscal electrônica [electronic tax invoice]
NPV	Net present value
PCR	Project completion report
PCU	Project coordination unit
PDTI	Plano Diretor de Tecnologia da Informação [Information Technology Master Plan]
PGE	Procuradoria Geral do Estado [Office of the State Attorney General]
PROFISCO	Programa de Apoio à Gestão e Integração dos Fiscos no Brasil [Program to Support the Management and Integration of Fiscal Administrations in Brazil]
QCBS	Quality- and cost-based selection
RFB	Receita Federal do Brasil [Brazilian Federal Revenue Service]
SEAIN	Secretaria de Assuntos Internacionais [Department of International Affairs]
SECONT/ES	Secretaria de Estado de Controle e Transparência do Estado do Espírito Santo [Oversight and Transparency Department of the State of Espírito Santo]
SEFAZ/ES	Secretaria de Estado de Fazenda do Estado do Espírito Santo [Finance Department of the State of Espírito Santo]

SEGER/ES	Secretaria de Estado de Gestão e Recursos Humanos do Estado do Espírito Santo [Management and Human Resources Department of the State of Espírito Santo]
SEGES	Sistema Estadual de Gestão Escolar [State School Management System]
SEP/ES	Secretaria de Estado de Economia e Planejamento do Estado do Espírito Santo [Economy and Planning Department of the State of Espírito Santo]
SIARH/ES	Sistema Integrado de Administração de Recursos Humanos do Estado do Espírito Santo [Integrated Human Resource Management System of the State of Espírito Santo]
SIGA	Sistema Integrado de Gestão Administrativa [Integrated Administrative Management System]
SIGEF/ES	Sistema Integrado de Gestão das Finanças Públicas do Estado do Espírito Santo [Integrated Public Finance Management System of the State of Espírito Santo]
SIT	Sistema de Informação Tributária [Tax Information System]
SPED	Sistema Público de Escrituração Digital [Digital Public Accounting System]
STN	Secretaria do Tesouro Nacional [National Treasury Department]
TCE/ES	Tribunal de Contas do Estado do Espírito Santo [State of Espírito Santo Audit Office]

PROJECT SUMMARY

BRAZIL
FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF ESPÍRITO SANTO
PROFISCO II – ES
(BR-L1517)
EIGHTH INDIVIDUAL LOAN OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP)
FISCAL MANAGEMENT MODERNIZATION PROGRAM IN BRAZIL – PROFISCO II
(BR-X1039)

Financial Terms and Conditions				
Borrower: State of Espírito Santo			**Flexible Financing Facility**[a]	
			Amortization period:	25 years
Guarantor: Federative Republic of Brazil			**Disbursement period:**	5 years
Executing agency: State of Espírito Santo, acting through its Finance Department (SEFAZ/ES)			**Grace period:**	5.5 years[b]
Source	**Amount (US$)**	**%**	**Interest rate:**	LIBOR-based
IDB (Ordinary Capital):	37.8 million	90%	**Credit fee:**	[c]
			Inspection and supervision fee:	[c]
Local:	4.2 million	10%	**Weighted average life:**	15.25 years
Total:	42 million	100%	**Currency of approval:**	U.S. dollars

Project at a Glance
Project objective/description: The project objective is to contribute to the state's fiscal sustainability through: (i) modernization of fiscal management; (ii) improvement of tax administration; and (iii) improvement of public expenditure management. This project is the eighth individual loan operation under the PROFISCO II CCLIP (BR-X1039), approved by the Executive Board through Resolution DE-113/17.
Special contractual conditions precedent to the first disbursement of the loan proceeds: (i) The borrower will adhere to the program Operating Regulations, previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) the project coordination unit has been established, and its members appointed (see paragraph 3.4). **Special contractual conditions for execution:** Prior to the start of execution of activities with outputs intended for the state's Management and Human Resources Department (SEGER/ES), Economy and Planning Department (SEP/ES), and Oversight and Transparency Department (SECONT/ES), SEFAZ/ES will sign cooperation instruments with the respective agencies, establishing the roles and responsibilities of the parties during execution (see paragraph 3.5).
Exceptions to Bank policy: None.

Strategic Alignment			
Challenges:[d]	SI ☐	PI ☑	EI ☐
Crosscutting themes:[e]	GD ☐	CC ☐	IC ☑

[a] Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account, when reviewing such requests.

[b] Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

[c] The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

[d] SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

[e] GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. Description and Results Monitoring

A. Background, problem addressed, rationale

1.1 This project is the eighth individual loan operation under the PROFISCO II conditional credit line for investment projects (CCLIP) (BR-X1039) approved by the Board of Executive Directors through Resolution DE-113/17, with a view to consolidating the progress made by the PROFISCO I CCLIP (BR-X1005) and to continue modernizing the states' fiscal management.

1.2 **Economic and fiscal features of Brazil**. Brazil is facing significant challenges in keeping its economy on a sustainable growth path. Its GDP contracted 3.8% in 2015 and 3.5% in the following year, before expanding by just 1.1% in 2017.[1] Economic recovery will be slow, with growth rates of 1.9% and 2.1% projected for 2018 and 2019, respectively.[2]

1.3 The decline in economic activity caused consolidated public-sector income to drop sharply by about three percentage points, from 34.5% of GDP in 2013 to 31.6% in 2017. Public expenditure, however, climbed steadily during this period, from 37.4% of GDP in 2013 to 41.6% in 2016. The primary balance deteriorated from an average surplus of 3.4% of GDP in 2002-2008, to one of 1.3% between 2009 and 2015., There were primary deficits of 2.5% and 1.9% of GDP in 2016 and 2017, respectively, and the country is not expected to post a structural primary surplus again until 2022.[3] The public debt also grew relative to GDP by almost a third in just three years, from 60% in 2013 to 78.6% in 2016; and it is projected to reach 96% of GDP in 2023.[4]

1.4 This recessionary environment has impaired fiscal performance in the Brazilian states. Total income shrank by an annual average of 1.5% in real terms between 2014 and 2016, with tax revenue dropping from 7.6% of GDP in 2008 to 6.9% in 2015. Receipts from the goods and services sales tax (ICMS), which is the states' main source of tax revenue, declined by an average of 6% in real terms. Moreover, federal government transfers slipped from 2.9% of GDP in 2008 to 2.5%[5] in 2015.

1.5 As state revenues faltered, current expenditure climbed, driven by rising personnel costs, which went from 10.2% of GDP in 2011 to 10.9% in 2015.[6] Investment fell by 16% on average in real terms in 2013-2016. Thus, the primary balance began to deteriorate in 2012, recording primary deficits in three of the last four years. In 2016, 10 of the 27 states ran primary deficits, including Espírito Santo.[7]

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1 IBGE, 2018.

2 International Monetary Fund (IMF), 2018. GDP growth rates of 2.18% and 3% are projected for 2018 and 2019 respectively (Focus, Central Bank of Brazil, 1 June 2018).

3 IMF, 2017.

4 IMF, 2018.

5 National Treasury Department (STN), 2016

6 Rossi, 2016.

7 STN, 2017.

1.6 **Fiscal position in Espírito Santo.**[8] The crisis in Brazil affected Espírito Santo's fiscal balance and is putting its fiscal sustainability at risk. The real growth rate of state GDP plummeted from an annual average of +4.9% between 2006 and 2013, to one of -2.7% in 2014-2016. Similarly, total revenues shrank at an average annual rate of -7% as from 2015; and ICMS revenue intake stalled abruptly, as a real annual growth rate of +3.6% between 2006 and 2014 became -4.7% in 2015-2017. This meant that the ICMS revenue share of the state's GDP shrank from an average of 8.4% to 7.5% in the periods analyzed (2006-2014 and 2015-2017).

1.7 Transfers also dwindled over the last three years (contracting by -7.4% per year on average, compared to average annual growth of 10% between 2006 and 2014). Transfers received from the State Revenue Sharing Fund also slipped back to their 2008-2010 level in 2017. This substantial loss of current income was made up for by borrowing and by exponential growth in royalties, which increased fifteen-fold up to 2014; but this latter income source made the state's finances more volatile and procyclical by fueling a permanent and inflexible increase in current spending.

1.8 In response to the decrease in income, total expenditure has been heavily restricted since 2014. Nonetheless, personnel and other current expenditures expanded from 76% of total expenditures in 2006 to 90% in 2017. Meanwhile, public investment slumped, with real annual growth in investment expenditure averaging 9.3% between 2006 and 2014 giving way to a contraction averaging 24.6% per year in 2015-2017, and thus serving as the main adjustment variable. As a result, Espírito Santo's investment level between 2014 and 2017 dropped below the Brazilian state average (5.5% of net spending).

1.9 The state's primary balance posted consecutive annual deficits between 2013 and 2016, before returning to positive territory only in 2017, largely as a result of the adoption of fiscal adjustment measures.[9] The state debt was cut to 17% of current income in 2017, well below the 200% limit set in the Fiscal Responsibility Law (LRF); and this also eased the debt service burden.

1.10 **Rationale**. Brazil's slow economic recovery and the state's vulnerability highlight the urgent need for new fiscal management modernization initiatives in Espírito Santo, with the aim of balancing the public accounts and consolidating fiscal sustainability. New complementary approaches are required to bolster the state's fiscal performance. PROFISCO I – ES placed a heavy emphasis on improving tax administration and promoting integration between the state treasury and other levels of government through the Digital Public Accounting System (SPED). These efforts enabled Espírito Santo to partly counteract the effects of the crisis, mainly by increasing its own revenue intake and simplifying tax compliance (see paragraph 1.20), which, in conjunction with the fiscal adjustment measures, have

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8 As the STN has not yet published the results of the 2017 fiscal year, the present analysis extends up to 2016, the last year available. Nonetheless, the Espírito Santo fiscal diagnostic assessment contains an analysis until 2017, based on data provided by the State, and shows that the situation and trends described in this section are still valid.

9 Through Complementary Laws 833 of 08/29/2016 and 839 of 12/15/2016; State Laws 10,549 of 06/30/2016 and 10,563 of 07/14/2016; and Decrees 3,755-R of 05/01/2015, 3,768-R of 01/22/2015, 3.922-R 04/01/2016 and 4,057-R of 02/01/2017, the State has established reducing the deficit and strengthening revenues, rationalizing administrative costs, and reducing discretionary spending in order to balance public accounts.

helped it to achieve an outstanding "A" rating (paragraph 2.7) under the Payment Capacity Assessment Methodology (CAPAG) used by the National Treasury Department (STN). This new project will take these strands of modernization deeper and will also promote: (i) the strengthening of public expenditure management; (ii) use of the SPED and digital technologies; and (iii) simplification of tax compliance to improve the state's business environment.

1.11 The effectiveness and efficiency of public institutions are hampered by the restrictions faced by their employees, access to information technologies, the availability of financial resources, and the legal framework (Arenas de Mesa, 2016; Finan et al, 2017). In this connection, Espírito Santo needs to address remaining weaknesses that hinder its fiscal performance. In terms of human resources, SEFAZ/ES has a payroll of about 833 employees;[10] but, for human resource planning and management, it lacks evaluation methodologies or procedures for determining the size of the workforce, which would make it possible to quantify and identify the profiles and composition of its staff. As a result, the allocation of civil servants does not meet current and future needs and does not make it possible to target training on the basis of competencies. In fact, although 41% of its staff received training between 2016 and 2017, this did not take account of their profiles and needs. Moreover, just 0.4% of SEFAZ's total budget is allocated to skill development and training programs. The Integrated Human Resources Management System (SIARH/ES), used to store and process data and cases relating to state employees, is technologically obsolete and its data are not properly integrated, digitized, and automated. As a result, there are currently some five million paper documents, which means that procedures take longer to complete.

1.12 In terms of technological constraints, although the SEFAZ/ES technology stock has recently been modernized,[11] this computer, telecommunications and security infrastructure is expected to be obsolete by 2021. Moreover, the exponential growth of electronic tax invoices (NF-e), of which about 1.3 billion are likely to have been issued and stored by 2020, requires ever greater expansion of the system's capacity. Lastly, the availability of emerging technologies to support tax and financial management, together with constant security threats, create the need, not only to upgrade infrastructure, but also to review the technology strategy, to make it possible to expand the technological infrastructure in a sustainable, secure, and efficient manner over the short and medium terms.

1.13 Lastly, in relation to the legal framework,[12] in addition to having a Tax Code and the various laws that have instituted state-level charges and taxes, several amendments have been made to this legislation in a multiplicity of normative documents which it has not yet been possible to catalogue, update, or consolidate. This makes the tax administration more complex and harder for auditors, accountants, and taxpayers to consult. Moreover, there are still some tax returns (e.g. the Declaration of Fiscal Economic Information and the Integrated System of Information on Interstate Goods and Services Transactions) in which some of the information is duplicated, when ideally a single return could be used.

[10] Technical note: Human resource management.

[11] Technical note: ICT management.

[12] Technical note: Tax expense management.

1.14 A more detailed diagnostic assessment of the state's fiscal management[13] reveals three specific problems:

1.15 **In fiscal management,** SEFAZ's corporate processes related to governance; strategic, personnel, and technology management; and its communication with citizens, are underdeveloped and poorly integrated,[14] which hampers its institutional performance.[15] The underlying causes of this problem are:

a. Difficulty for the various SEFAZ/ES areas to prioritize their targets and articulate them in a comprehensive vision for the institution, such that the strategic planning and decision-making process does not promote results-driven management. This is because: (i) SEFAZ/ES does not set fiscal management policies and guidelines and does not have support instruments to monitor them;[16] (ii) project management is dispersed across several areas, and deficient structuring means that projects do not meet the institution's needs;[17] and (iii) the staff does not have specialized knowledge in strategic planning and project management.[18]

b. Insufficient capacity to manage the state's administrative processes, given the exponential growth of documents issued by the various government agencies each year, since: (i) many of the corresponding work processes are performed manually; and (ii) the documents are not stored in a structured way, which makes it difficult to access and process the information they contain.[19]

c. Poor use of human resource potential, because: (i) staff career planning and training take no account of strategic information on their skills (ii) poor coverage and quality of staff training programs; and (iii) difficulties in consolidating and analyzing information for human resource decision-making based on SIARH/ES, since this information is dispersed across various systems and institutions.

d. Ineffective management of information and communication technologies (ICTs) to support SEFAZ's needs, as a result of: (i) lack of support tools for strategic ICT management; (ii) requests dealt with without prioritization criteria or evaluation of risk levels;[20] and (iii) insufficient installed capacity to cope with

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13 Fiscal management report and technical note.

14 Four of the six dimensions of fiscal management display an initial level of maturity, while the other two are only intermediate (Fiscal Management Maturity and Performance Assessment (MD-GEFIS)).

15 SEFAZ/ES is unaware of the goals planned and attained each year, a situation which, per se, shows its weakness in implementing strategic results-driven management.

16 There are 42 SEFAZ/ES priority areas that do not have performance indicators (Technical note: Fiscal governance).

17 None of the 32 SEFAZ/ES projects is structured according to best project management practices (Technical note: Fiscal governance).

18 SEFAZ/ES has not provided any training on strategic planning issues in the last five years (Technical note: Fiscal governance).

19 In addition to having 1,472,000 open cases, in 2017 Espírito Santo launched 410,000 new cases and closed only 285,000 (Technical note: Administrative case management model).

20 Of the 135 information technology projects initiated between 2010 and 2017, 45 were canceled (Technical note: ICT management).

the exponential growth in the volume of fiscal data and to make full use of the SPED and the NF-e to improve the institution's decision making.

e. Shortcomings in the management of internal oversight,[21] owing to: (i) difficulties in identifying high-risk processes and actors and the magnitudes thereof;[22] and (ii) limitations in the generation and dissemination of information to public bodies and to society at large, compounded by the slow and ineffective workings of the Office of the State General Ombudsperson (Ouvidoria Geral do Estado) in responding to the growing number of queries and complaints from society on the services provided by the state.[23]

1.16 **In the tax administration,** revenue intake is below potential,[24] owing to the following factors:

a. Ineffectiveness of current management instruments in supporting tax policy-making and oversight, due to: (i) insufficient control over the levels of tax concessions and exemptions granted,[25] with such management as there is being largely done manually and without methodologies or support systems; and (ii) the limited capacity of SEFAZ/ES to accurately estimate the fiscal gap and to project fiscal scenarios and the impacts of granting concessions.[26]

b. Inability to identify common and structured frauds in tax evasion effectively and on a timely basis, owing to: (i) deficient planning of audit actions and weak criteria for assigning auditors and prosecutors to investigations;[27] (ii) lack of capacity to perform large-scale controls, with global coverage of the taxpayer universe, taking advantage of the large volume of existing tax data and using criteria based on risk analysis;[28] and (iii) complexity of processes for dispatching merchandise in a timely manner and for making payments in foreign trade transactions,[29] as well as duplication in tax returns.

c. Inefficiency, slowness, and untimeliness in processing and resolving taxpayers' claims in tax litigation.[30] This is because the process of distributing

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[21] The Oversight and Transparency Department (SECONT/ES) was rated between levels 1 and 2 (on a scale of 1 to 5) in the Internal Audit Capacity Evaluation conducted in 2016 by the World Bank (Technical note: Internal control modernization).

[22] All internal audit and control procedures are performed manually and in person. In 2017, of the 46 existing bodies only 16 were audited (Technical note: Internal control modernization).

[23] In 2017, the audit received 9,375 queries and complaints, with an average response time of 14 days. Reponses to complaints can take up to 60 days, when the ideal would be one week (Technical note: Internal control modernization).

[24] The ICMS tax gap is estimated at roughly 24% of revenue intake (Technical note: Tax Expense Management).

[25] In 2017, the tax waiver benefited 1,172 firms (considering COMPETE firms only) and amounted to 13% of revenue intake (Technical note: Tax expense management).

[26] Of the 132 types of tax waiver agreements in force, only one has had its impact calculated (Technical note: Tax administration management).

[27] In 2017, inspection actions managed to recover just 0.39% of the collection (Technical note: Inspection).

[28] Of the 18,000 taxpayers in the ordinary regime, only 5.5% are audited (Technical note: Inspection).

[29] On average, in one third of import operations the cargo is only released on the next business day, when it should happen immediately (Technical note: Inspection).

[30] In 2017, the average time to obtain a ruling in an administrative case was 1,358 days in the first instance and 375 days in the second (Technical note: Online tax litigation procedure).

and reviewing tax claims is done manually, resulting in inconsistencies and delays. The current management system is based on an obsolete platform, does not have the required functionality, and is not integrated with the state's corporate systems (tax management information system, the State Council's tax appeals system, the electronic protocol system, document management, and electronic tax domicile). It is also difficult to keep tax laws up to date and consolidated, for internal and external consultations.

d. Poor service provided to taxpayers due to insufficient staff to handle a large number of tax administration queries.[31]

e. Weak performance of administrative collection because of the difficulty in identifying delinquent taxpayers in respect of the ICMS and the motor vehicle ownership tax (IPVA), while the collection process is performed entirely manually and only on installments that are past due, and without using clearly defined criteria to divide debts and classify taxpayer risk. Nor is there an automated and institutionalized collection mechanism for the IPVA.[32]

1.17 **Public expenditure management** suffers from deficiencies that give rise to major discrepancies between the priorities defined in the planning instruments, the budget programmed at the start of the fiscal year, and the budget actually executed.[33] This situation reflects an environment that makes it hard to achieve better results in terms of fiscal discipline, and in the efficiency and effectiveness of public spending. The causes are:

a. Ineffective fiscal planning and inefficient management of public investment, resulting from: (i) procedural, organizational and technological discoordination between strategic planning and multiyear results-driven budget formulation;[34] and (ii) procedural shortcomings in all stages of the investment cycle, which make it hard to prioritize, plan, prepare, execute, and monitor the state's investment projects.[35]

b. Inefficient use of the state's financial and nonfinancial resources, because: (i) there are mismatches between the budgetary and financial appropriations, which generates remainders payable for future periods;[36] (ii) financial programming is still done manually,[37] and it is impossible for the Integrated Public Finance Management System of the State of Espírito Santo (SIGEF/ES)

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[31] In 2017, 24,307 calls were made through the "Fale Conosco" [Talk With Us] system, in addition to 9,400 e-mails answered by call service staff (Technical note: Taxpayer service).

[32] It is estimated that in 2018 there are 25,000 cases of potential ICMS revenue collection totaling US$1 billion; and the stock of adjudicated tax claims amounted to US$24 billion. In the 2013-2017 period, IPVA arrears totaled US$115 million (20% of the annual intake) (Technical note: Administrative collection).

[33] In 2017, the deviation between the budget as planned and the budget as executed was 11%, while Public Expenditure and Financial Accountability (PEFA) recommends a maximum of 5% as an international best practice.

[34] In 2017, there were 617 additional changes in budget execution, representing 18% of the budget initially approved (Technical note: Planning and budget execution).

[35] In 2017, none of the 21 priority state projects in execution had preinvestment procedures (Technical note: Planning and budget execution).

[36] In 2017, a remainder payable (settled) of US$15 million was generated.

[37] In March 2018, a total of 2,216 hours of manual work were required to complete various financial management activities (Technical note: Financial programming).

to control commitments based on the financial appropriation; and (iii) ignorance of the total value of state assets and deficient asset management, with high opportunity costs in terms of generating nontax income.[38]

c. Underexploitation of potential economies in public procurement processes, because: (i) the current procurement model does not enable strategic planning that promotes economies of scale, and procurement execution is slow;[39] (ii) processes for reviewing and setting benchmark prices take too long and usually do not reflect market prices;[40] (iii) the product and vendor catalogues are not integrated, which results in a lack of standardization in off-the-shelf products procured by the departments and other agencies;[41] and (iv) the Integrated Administrative Management System (SIGA) does not have all the necessary functionality, is not integrated with the state management systems, and it lacks management reports to support procurement planning and management.[42]

d. Insufficiency and deficient quality and timeliness of accounting data for decision making and accountability, due to: (i) a large number of manual transactions used to record various asset procedures, resulting in delays and risks of errors;[43] (ii) difficulties in generating the accounting reports required by law;[44] and (iii) deficient accounting and integration of the data generated by the transactions of the Tax Information System (SIT), SIGA and SIARH/ES in the SIGEF/ES.[45]

e. Inefficient allocation and use of public resources, to the detriment of quality management of public expenditure and waste reduction,[46] since budget planning does not estimate the cost of providing public services,[47] and few evaluations are made of expenditure effectiveness and quality, without common cost indicators across the different management units.

1.18 **The Bank's experience in the country.** The Bank has supported several operations to improve fiscal management in Brazil, particularly at the state level,

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[38] It is estimated that in 2017 there were approximately US$980 million of financial assets that were not being properly optimized (Technical note: Financial programming).

[39] The last ten bidding processes took an average of 513 days from launch to approval by the Treasury Secretary (Technical note: Procurement management).

[40] 40% of the time taken by the procurement process is spent on the search for benchmark prices (Technical note: Procurement management).

[41] 75% of the procured products have multiple codes (Technical note: Procurement management).

[42] Upgrading system involves a function point gap of 35-40% (Technical note: Materials procurement management).

[43] The depreciation routine takes an average of one day to complete for each of the 46 agencies, when it should be done in real time (Technical note: Accounting management).

[44] Only 62% of the accounting standards required by the STN have actually been implemented.

[45] Payroll accounting takes about three days to be completed by each of the 46 bodies, when it could be done in real time (Technical note: Accounting management).

[46] Although the daily average transportation expense per student in Espírito Santo is US$5, in the Município of Conceição de Castelo, for example, it is 197% higher (Technical note: Public cost management).

[47] The state's five corporate systems (SIGEF/ES, the State School Management System (SEGES), SIGA, Hospital Information Management System, and SIARH/ES) do not have interfaces to provide the necessary data for public cost management (Technical note: Public cost management).

under the National Fiscal Administration Program for the Brazilian States (PNAFE) (loan 980/OC-BR) and the PROFISCO I CCLIP (BR-X1005). It also supported the Fiscal Modernization Project in the State of São Paulo, the Program to Support Fiscal Management Modernization and Transparency in the State of Bahia,[48] and fiscal stability consolidation projects in the states of Amazonas, Alagoas, Bahia, Pernambuco, and Rio Grande do Sul.[49] At other levels of government, the Bank supported the Fiscal Modernization Program in the Brazilian Federal Revenue Service (RFB)[50] and the Fiscal Management Program for the Brazilian Municípios (PNAFM I, II and III).[51]

1.19 The midterm evaluation of the PROFISCO I CCLIP reports that ICMS tax revenue intake as a percentage of GDP rose more in states with a PROFISCO project where execution was further along than in others where the level of execution was low. Between 2009 and 2013, this difference in intake averaged 6%. It was found that the SPED, including the electronic tax invoice (NF-e), digital tax record (EFD), and the digital accounting record, were the products that most contributed to the enhanced efficiency of state-level fiscal controls.[52]

1.20 Likewise, the final evaluation of PROFISCO I – ES (loan 2245/OC-BR) indicates that the project achieved satisfactory performance, meeting the planned targets for outcomes and outputs. Examples of project achievements include: (i) an increase in internally generated revenue, keeping the tax ratio almost constant in the midst of one of the worst economic crises through implementation of the new system for inspection of goods in transit and establishments, the electronic audit system, the SPED and forensic laboratory, and an increase in the tax claims recovery rate (from 0.21% to 8.20%) using the new administrative and tax litigation management model and electronic document management; (ii) facilitation of tax compliance and improvement of taxpayer services, reducing the bureaucracy involved by allowing all taxpayers to submit their accounting and tax documents in digital form, and increasing to 50 the number of services offered at the new SEFAZ/ES Virtual Agency; and (iii) control of public debt and public expenditure, mainly through development of management tools such as the Transparency Portal and the SIGEF/ES, which has become a national benchmark in integrated financial administration systems.

1.21 **Lessons learned from the Bank's operations in the country.** The main lessons learned from previous programs include:

a. The need for holistic action to address the issue of fiscal management and for a tool to identify these innovative solutions, aligned with best practices, that can support the design of fiscal modernization initiatives. The Fiscal Management Maturity and Performance Assessment (MD-GEFIS) methodology was developed to address this lesson and can be used to identify

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48 Loan 1727/OC-BR.

49 Policy-based loan programs: 2081/OC-BR; 2841/OC-BR; 2850/OC-BR; 3039/OC-BR; 3061/OC-BR; 3138/OC-BR; and 3139/OC-BR.

50 Brazilian Federal Revenue Service (RFB), 1996.

51 Loans 1194/OC-BR, 2248/OC-BR, and 3391/OC-BR.

52 McKinsey & Company, 2014: NF-e and SPED increased detection risk for evaders and helped reduce informal employment in Brazil from 55% to 40% over the last ten years.

the areas that need strengthening activities. The results of its application will be used as a baseline for project monitoring and evaluation.

b. The PROFISCO I project completion report (PCR) notes the following: (i) the importance of continuing to invest in technological innovation, so this operation will continue the SPED's development and seek to maximize its potential by expanding the use of the information it generates to automate tax auditing, simplify tax obligations, and improve public procurement, etc., by leveraging new digital technologies; (ii) the need for strategies to head off the obsolescence of technological solutions, so the project envisages actions to update and implement an ICT master plan for the planning and maintenance of software and hardware infrastructure in the medium term; (iii) the importance of advance planning to implement complex outputs, so an agreement has been made on this project with the executing agency that the technical specifications and terms of reference, principally for the technological innovation outputs, will be prepared before the startup mission with support from specialized consulting services; (iv) the importance of more effective knowledge transfer relating to the software developed by external consultants, so the executing agency will see that the software development contracts provide for SEFAZ/ES to have access to the source code; and (v) the difficulty of evaluating projects with very may different indicators, so the individual PROFISCO II projects will have a single, relevant outcome indicator for each component, shared by all operations.

c. Specifically, PROFISCO I – ES (loan 2245/OC-BR) found that the following factors slowed down the pace of project execution: (i) difficulty in the planning and execution of outputs due to lack of previous experience in project implementation, as well as difficulty in communicating with the various stakeholders; (ii) difficulty in preparing terms of reference and monitoring execution; and (iii) difficulty in executing a large number of outputs. Accordingly, activities have been added to the project to: (i) maintain the structure and personnel of the project coordination unit (PCU) that executed PROFISCO I – ES, with additional measures to enhance coordination and communication among output leaders and to train key actors in project management and Bank policies; (ii) hire support to prepare terms of reference and adopt project management tools; and (iii) reduce the number of components and outputs and consolidate procurement processes.

1.22 **The Bank's experience in other countries of the region.** This operation reflects recent Bank recent experience with tax administration reforms in Ecuador (loan 3325/OC-EC), El Salvador (loan 3852/OC-ES), Guatemala (loan 3786/OC-GU), Honduras (loan 3541/BL-HO), Jamaica (loan 2658/OC-JA), and Peru (loan 3214/OC-PE); experience with the modernization of financial administration systems in Guatemala (loans 2050/OC-GU and 2766/OC-GU), Guyana (loans 1550/SF-GY and 1551/SF-GY), Honduras (loan 2032/BL-HO), and Nicaragua (loan 2422/BL-NI); and experience with public investment management in Argentina (loan 3835/OC-AR), Bolivia (loan 3534/BL-BO), Chile (loan 1281/OC-CH), Ecuador (loan 2585/OC-EC), Mexico (loan 2550/OC-ME), Paraguay (loan 3628/OC-PR), Panama (loan 2568/OC-PN), and Peru (loan 2703/OC-PE). Some of the lessons learned, which are in line with international evidence, are described below.

1.23 Tax revenue performance is heavily dependent on institution-strengthening in tax administrations and their organizational structure, processes, and supporting tools: (i) improve the accessibility and quality of the information available;[53] (ii) implement data-intensive enforcement models;[54] (iii) simplify procedures to facilitate tax compliance;[55] and (iv) identify strategies to ensure that human resources are competent and motivated.[56] Several Latin American tax administrations, particularly those of Brazil and Uruguay, have strengthened these elements.[57] In the case of financial management strengthening, however, the available evidence indicates that automation without an improvement in processes does not yield the desired results.[58]

1.24 **The Bank's country strategy**. The project is aligned with the Bank's country strategy with Brazil 2016-2018 (document GN-2850) in relation to the objective of improving the business climate and enhancing efficiency in the management of public resources.

1.25 **Strategic alignment.** The project is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008), and strategically aligned with the development challenge of productivity and innovation, by reducing tax collection costs;[59] and with the crosscutting theme of institutional capacity and rule of law, by strengthening tax systems[60] and public resource management and planning systems.[61] The program contributes to the Corporate Results Framework 2016-2019 (document GN-2727-6) via the indicators for: (i) percent of GDP collected in taxes; and (ii) government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery, by strengthening the SIT, SIGEF/ES, SIGA, and SIARH/ES; (iii) accountability institutions strengthened (SECONT/ES audit and internal control); and (iv) subnational governments benefited by decentralization, fiscal management, and institutional capacity projects. The program is also aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) and is consistent with the Fiscal Policy and Management Sector Framework Document (document GN-2831-3) and the Decentralization and Subnational Governments Sector Framework Document (document GN-2813-3), under the dimensions of: (i) improving the efficiency and quality of expenditure and service delivery; (ii) improving own revenue collection; and (iii) working with greater transparency and accountability. Additionally, the operation is included in the Update of Annex III of the 2018 Operational Programming Report (document GN-2915-2).

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53 Slemrod et al. (2015); Pomeranz (2015); Kleven et al. (2011).

54 Almunia and López-Rodriguez (2016).

55 Hallsworth et al. (2014).

56 Khan et al. (2016).

57 PCR 1783/OC-UR. Barreix and Zambrano (2018).

58 See the PCRs for loans 1550/SF-GY and 1551/SF-GY.

59 Outcome indicator 2 of the Results Matrix.

60 Impact and outcome indicator 2 and output indicators 2.1 to 2.5 of the Results Matrix.

61 Outcome indicators 1 and 3 and output indicators 1.1, 1.3, and 3.1 to 3.5 of the Results Matrix.

B. Objectives, components, and cost

1.26 The project objective is to contribute to the state's fiscal sustainability through: (i) modernization of fiscal management; (ii) improvement of tax administration; and (iii) improvement of public expenditure management.

1.27 Enhancing the performance of public finance, increasing tax revenue intake, increasing the efficiency of public expenditure, and thus strengthening the fiscal sustainability of the State of Espírito Santo (ES) will benefit its citizens, corporate and individual taxpayers, and public sector and nongovernmental entities through better service delivery, easier and less costly tax compliance, and wider availability of information and data for public management and transparency of public accounts. This operation will finance the following components:

1.28 **Component I. Fiscal management and transparency (US$22.1 million).** This component seeks to improve management processes and instruments, modernize technological infrastructure, and enhance transparency in SEFAZ's dealings with the public while improving its institutional performance. It will finance the following activities:

a. **Implementation of a fiscal management governance model**, including: (i) implementation of SEFAZ/ES strategic planning supported by a strategic plan, performance indicator dashboards, a communication plan, and management tools; and (ii) creation of the Project Office based on consulting services to develop methodologies for project preparation, execution, and evaluation and risk management, IT support tools, and training.

b. **Implementation of an administrative process management model**, including a review of administrative processes and current legislation and regulations, adoption of process management methodologies, and the personalization of administrative processes and the respective documentation in a workflow-type process management tool, integrated into the state's management systems.

c. **Updating of the skills-based human resource management model**, including: (i) mapping of individual skills with analysis of the job description and disparities, as well as qualitative and quantitative sizing of the workforce and where they are assigned, supplemented by development plans and identification of areas of learning; (ii) technological upgrading of facilities for face-to-face and virtual training events; and (iii) update of SIARH/ES functionalities and their integration with other state management systems.[62]

d. **Update of the ICT management model**, including: (i) development and implementation of an Information Technology Master Plan (PDTI);[63] and (ii) expansion of the hardware and software infrastructure with increased storage capacity based on emerging technologies, telecommunications

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[62] Modules: (i) Personnel selection and entry; (ii) Training management; (iii) Promotion of military and civil police; (iv) Performance bonds; (v) Self-service procedures; (vi) Automation of personnel procedures; and (vii) Integration with SIGEF/ES

[63] The PDTI includes a diagnostic assessment, review of procedures and structures (including cybersecurity), hardware and software planning, networks, information systems, infrastructure, and personnel to meet the institution's current and future strategic, tactical, and operational needs.

network, servers and security, and training of managers and technicians in the area.

e. **Implementation of a new internal control model for the state**, including: (i) a review of internal control and audit procedures using a risk and integrity management model, supported by a computerized management system; and (ii) implementation of a new public information transparency model and new procedures for responding to information requests and complaints from the public.

1.29 **Component II. Tax administration and litigation (US$11.0 million).** This component seeks to increase the efficiency of tax collection, raise revenues, and simplify tax compliance. It will finance the following activities:

a. **Implementation of a management model for the tax policy support instruments**, including: (i) review, update, and consolidation of the legislation in force, supported by a consultation tool;[64] (ii) methodology and technology tool to estimate tax evasion;[65] and (iii) review of the operational procedures for granting tax concessions and updating the computerized support system.[66]

b. **Implementation of a new enforcement model**, through: (i) procedures and an IT system for the planning and processing of audit actions, identifying targets and indicators; (ii) procedures and an IT system for monitoring taxpayers based on their risk profile; and (iii) improvement of the Foreign Trade System and its integration into the Foreign Trade Single Portal, and procedures to simplify tax obligations.

c. **Implementation of the electronic litigation process**, including the review, design, implementation, and automation of the litigation appeals process in a workflow environment and its integration with the other SEFAZ/ES systems and those of the Office of the State Attorney General (PGE), enabling online consultation by taxpayers of tax violations and proceedings, as well as electronic storage of existing paper processes and access to updated and consolidated tax legislation.

d. **Implementation of the comprehensive service system**, which includes a taxpayer service model that employs an artificial intelligence tool for automated interaction with the citizen.

e. **Implementation of the model for administrative collection of taxes owed**, based on the ICMS and IPVA taxpayer recovery profile using risk analysis, supported by an IT system for collection management and its integration with the Traffic Department's DETRANNET system for the IPVA, where vehicle ownership data is stored.

1.30 **Component III. Financial administration and public expenditure (US$7.8 million).** This component seeks to enhance fiscal discipline and increase

[64] Includes mapping of the process for granting concessions and exemptions, survey of existing agreements, and review and amendment of the respective legislation.

[65] In addition to the methodology for estimating the fiscal gap, it includes corresponding monitoring and evaluation procedures.

[66] With functionality to estimate the impacts of concessions granted on the ICMS, IPVA, and the inheritance and gifts tax (ITCD).

the efficiency and effectiveness of public expenditure. It will finance the following activities:

a. **Implementation of a budget planning and execution and investment management model**, including: (i) implementation of a medium-term budgetary framework based on strategy, adjustments to the planning function, results-based medium-term budget programming, development of the monitoring and evaluation function, strengthening of macrofiscal programming, and the strengthening and integration of technological platforms; and (ii) development and implementation of a public investment management model targeting preinvestment based on the integration of priority projects and government strategies, methodologies and tools for the formulation and evaluation of projects, and supported by an IT system for investment management, integrated into the state's management systems.

b. **Implementation of a financial programming and execution model**, including: (i) review and adjustment of the methodology for the preparation of financial programming and execution, including strengthening of the expenditures committee and adjustments to the IT system for cash management; and (ii) implementation of a state asset management model based on risk analysis, including the legislation, procedures, and policy on investment and income generation.

c. **Implementation of a state procurement management model**, including: (i) review and adjustment of procurement management procedures supported by a public procurement policy and planning tools; (ii) implementation of a methodology for using information obtained from electronic tax documents to set benchmark prices; (iii) implementation of a methodology for updating and maintaining the catalogue of purchases and vendors; and (iv) updating of SIGA functionality and its integration with the state's other systems.

d. **Implementation of public sector accounting standards**, through: (i) consulting services for the design of accounting rules and policies for provisions, infrastructure assets, assets obtained from intergovernmental transfers, and adjustments for losses on tax credits and adjudicated tax claims; and (ii) accounting customization of the SIT, SIGA, and SIARH/ES systems and integration with the SIGEF/ES.

e. **Implementation of a public cost management model**, through: (i) mapping of the processes for cost control, definition of expenditure units, and implementation of a cost evaluation methodology for these units; and (ii) development of a system for gathering information and calculating unit costs from interfaces with the state's various management systems, as well as a computer tool for cross-referencing and analyzing information.

1.31 The project will finance US$16.7 million in consulting services (individual consultants and firms) for all components, including actions to redesign processes and procedures, update and implement existing and new core systems of the state, and institutional change management; US$7.1 million in other nonconsulting services; US$14.7 million in goods to modernize the SEFAZ/ES information technology infrastructure; and US$2.7 million in training for most of the modernization processes supported by the project.

C. Key results indicators

1.32 The expected impacts are: (i) a decrease in the state's ratio of primary fiscal deficit to GDP; (ii) an increase in the state's ratio of tax revenue intake to GDP; and (iii) a decrease in the state's ratio of net current debt to GDP. The expected outcomes are: (i) an increase in the ratio of strategic planning targets met to total planned targets; (ii) a decrease in the ratio of the cost of tax collection to tax revenue intake; and (iii) a narrowing of the gap between the budget as planned and as executed.

1.33 **Economic analysis**. An economic analysis of the project was done, based on the outcomes associated with more efficient management of public revenues and expenditures, including: (i) a decrease in tax collection costs; (ii) a decrease in the cost of taxpayer audits; and (iii) a narrowing of the discrepancy in unit prices used by different departments in their procurement processes. By end-2028, the project is projected to generate a net present value (NPV) of US$12 million with an internal rate of return (IRR) of 41%. A sensitivity analysis was also done for a scenario involving execution delays, where the three assumptions should start generating benefits by 2023 at the latest (rather than in 2022 as under the baseline scenario). In this case, the IRR would be 12% at end-2028, and the NPV would be US$30,257.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 This operation was designed as a specific investment loan under the PROFISCO II CCLIP (BR-X1039) with an estimated total cost of US$42 million, to be financed by an investment loan of up to US$37.8 million from the Bank's Ordinary Capital resources, and a local counterpart contribution of US$4.2 million. The following table shows the distribution of resources by category and source of financing:

Table 1. Total budget (US$)

Categories	Bank	Local contribution	Total	%
1. **Direct costs**	**36,809,520**	**4,200,000**	**41,009,520**	**97.64%**
1.1. Component I. Fiscal management and transparency	21,644,469	530,537	22,175,006	**52.80%**
1.2. Component II. Tax administration and litigation	9,876,332	1,127,525	11,003,857	**26.20%**
1.3. Component III. Financial administration and public expenditure	5,288,719	2,541,938	7,830,657	**18.64%**
2. **Project administration, monitoring, and evaluation**	257,143	-	257,143	**0.61%**
3. **Contingencies**	733,337	-	733,337	**1.75%**
Total	**37,800,000**	**4,200,000**	**42,000,000**	**100%**
%	**90%**	**10%**	**100%**	

2.2 **Disbursement schedule.** Disbursements will be made over a five-year period, as follows:

Table 2. Disbursement schedule (US$)

Sources	Year 1	Year 2	Year 3	Year 4	Year 5	Total
IDB	6,762,015	8,858,960	13,262,977	7,645,320	1,270,728	37,800,000
Local	881,408	1,303,412	1,580,869	434,311	-	4,200,000
TOTAL	**7,643,423**	**10,162,372**	**14,843,846**	**8,079,631**	**1,270,728**	**42,000,000**
%	18%	24%	35%	20%	3%	100%

2.3 **Compliance with the eligibility conditions for the PROFISCO II CCLIP (BR-X1039).** This project is the eighth individual loan operation under the PROFISCO II CCLIP (BR-X1039), approved by the Board of Executive Directors pursuant to Resolution DE-113/17. The project meets the eligibility criteria of the CCLIP policy (document GN-2246-9) and its operational guidelines (document GN-2246-11) for individual loan operations, given that: (i) the project falls within the fiscal sector and is compatible with all components of the PROFISCO II CCLIP; (ii) the project has a recommendation from the External Financing Commission (COFIEX) and is included in the Update of Annex III of the 2018 Operational Programming Report (document GN-2915-2) and in the Brazil country program document;[67] (iii) the state will implement the operation through the State of Espírito Santo Finance Department (SEFAZ/ES), which was the same executing agency as for the first individual operation under the PROFISCO I CCLIP (loan 2245/OC-BR), which was fully disbursed in 2018; and (iv) the findings of the institutional analysis show that the performance level of the SEFAZ/ES has not deteriorated, the same project execution and monitoring tools can be used for this new operation as for the previous one, and the project coordination unit (PCU) staff will be the same. The final report for loan 2245/OC-BR showed that: (i) the project's objectives were satisfactorily met; and (ii) the execution unit satisfied the contractual requirements and followed the Bank's disbursement policies, and its accounts were audited and met the required quality standards.

B. Environmental and social safeguard risks

2.4 In accordance with the Bank's Environment and Safeguards Compliance Policy (Operational Policy OP-703) and the results of the safeguard policy filter, this operation is classified as category "C." The project will support the strengthening of taxation and financial processes, so no socioenvironmental risks are envisaged.

C. Fiduciary risks

2.5 The following were identified and classified as risks potentially leading to delays in project procurements, accountability report delivery, and disbursements. As high risks: (i) lack of capacity at SEFAZ/ES to price services and products properly, which will be mitigated by forming a working group at SEFAZ/ES to review and propose solutions in the case of price comparisons; and (ii) delays at oversight agencies—the Information and Communication Technology Institute (PRODEST), Oversight and Transparency Department (SECONT/ES), and Office of the State Attorney General (PGE)—in conducting prior review, which will be mitigated by creating

[67] The operation was included in the aide-mémoire of the 2019 update to the country programing with Brazil, signed with the Department of International Affairs (SEAIN) of the Ministry of Planning on 26 December 2018.

groups and mechanisms at these oversight agencies to give prompt attention to project processes, and by providing training in Bank policies for all members of the project execution team. As a medium-low risk: insufficient knowledge of Bank policies on the part of SEFAZ/ES and the agencies involved, which will be mitigated by hiring a specialist with experience in procurement management to work at the PCU.

D. Other key risks and issues

2.6 A risk management workshop was conducted, following the Bank's methodology, and determined that the operation carries medium risk. The risks are as follows:

a. **Public management and governance**. There is a medium-high risk that insufficient integration among the various departments and/or units involved in the project could lead to delays in execution or failure to achieve the expected outcomes. This risk will be mitigated through: (i) formal cooperation agreements among the project's beneficiary entities, specifying the authority and responsibilities of each; and (ii) preparation of information and process flowcharts. Another medium-high risk is that, with the elections at the end of the year, a government turnover could lead to changes in the portfolio of outputs and/or delays in project execution. This risk will be mitigated by moving ahead with preparation of the terms of reference and technical specifications for the project's priority outputs.

b. **Development**. There is a high risk that delays could occur in acquisition, development, and maintenance of the new project processes and systems, if SEFAZ/ES does not have: (i) the knowledge and ability to specify its needs; and (ii) the ability to assign, motivate, and train output leaders. These risks will be mitigated through: (i) a specialized consulting engagement to support the technical teams in preparing technical specifications and terms of reference; and (ii) development of a system of incentives for project leaders based on training and technical visits, among other measures.

2.7 **Financial analysis**. The analysis of Espírito Santo's financial conditions confirms its payment capacity to service the debt incurred. The loan represents less than 0.1% of the state's GDP, and only 1% of net current income in 2017. Moreover, Espírito Santo has an "A" rating, the highest awarded by the National Treasury Department (STN) under the Payment Capacity Assessment Methodology (CAPAG), which attests to its fiscal capacity. The state has also been meeting the requirements of the Fiscal Responsibility Law (LRF) and the conditions of the Fiscal Adjustment Program.

2.8 **Program sustainability.** To ensure that the capacities generated by the project are sustainable after execution, the project includes the following outputs which, in conjunction with the expected improvements in the economy and in Espírito Santo's fiscal condition, will help make tax administration and public expenditure more efficient, resulting in a higher revenue intake and savings in state procurement (economic analysis): (i) tax auditing and intelligence, which will identify a larger number of potential tax evaders and encourage self-regulation; (ii) use of fiscal documents to set benchmark prices for public procurement, which will save time and resources in the corresponding bidding processes; and (iii) strategic management of state assets, which could generate additional nontax revenues or optimize current income, among other things. As regards technology investments, SEFAZ/ES will mainly use its permanent staff, supported by consulting services, for in-house development and the necessary maintenance. The project will also finance the improvements to data protection and cybersecurity measures, as well as development and implementation of the PDTI, which also contributes to the sustainability of the investments.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The borrower will be the State of Espírito Santo, which will execute the project through its Finance Department (SEFAZ/ES). The Federative Republic of Brazil will guarantee the borrower's financial obligations arising from the loan. A project coordination unit (PCU) will be established for project execution, staffed by a coordinator, along with procurement, financial management, monitoring, and planning specialists (with project management experience). The PCU will coordinate activities related to project planning, monitoring, evaluation, and audit.

3.2 The PCU's main functions will be to: (i) plan and coordinate the execution of activities; (ii) prepare, implement, and update the project's operational tools, including the multiyear execution plan, annual work plan (AWP), procurement plan, and monitoring and evaluation plan (MEP); (iii) supervise execution and deliver status reports; (iv) coordinate and conduct the processes for preparing terms of reference and bidding processes for goods procurement and the selection and contracting of services; (v) submit disbursement requests and supporting documentation to the Bank; (vi) prepare the audited financial statements; and (vii) deliver the project evaluation. The borrower will comply with the program Operating Regulations approved by the Bank for the PROFISCO II CCLIP, which specify: (i) eligibility criteria for the projects and outputs to be financed; (ii) project execution roles, procedures, and rules; and (iii) operational and contractual relationships between the parties involved in the project.

3.3 **Interagency coordination mechanism.** SEFAZ/ES will work with the state's Management and Human Resources Department (SEGER/ES), Economy and Planning Department (SEP/ES), Oversight and Transparency Department (SECONT/ES), and the Office of the State Attorney General (PGE) for the execution of activities benefiting them. Leaders will be appointed for the corresponding outputs at those institutions, who will coordinate their actions with the PCU and supervise their technical development and implementation. For the coordination of these activities related to human resource management, procurement, public expenditures, tax litigation, and internal oversight and communication with society, and primarily for their respective procurements, information flows will be mapped and defined among the beneficiaries, the PCU, and the Special Bidding Committee (CEL), clarifying roles, responsibilities and time frames that will be built into the institutional structure through cooperation instruments (see paragraph 3.5).

3.4 **Special contractual conditions precedent to the first disbursement of the loan proceeds: (i) the borrower will adhere to the program Operating Regulations, previously approved by the Bank for all individual operations under the PROFISCO II CCLIP**. This condition is justified by the need for rules governing operational, fiduciary, and institutional responsibility issues in order to launch and execute the project in an orderly way. The Operating Regulations will be a dynamic document, subject to periodic reviews, and may be modified with the express approval of the Bank; **and (ii) the PCU has been established, and its members appointed.** This condition is justified by the fact that formal establishment of the PCU is fundamental for mitigating the risk of execution delays and for conducting the project's operational and fiduciary processes exclusively and with the required experience.

3.5 **Special contractual conditions for execution**. Prior to the start of execution of activities with outputs intended for SEGER/ES, SEP/ES, and SECONT/ES, SEFAZ/ES will sign cooperation instruments with the respective agencies, establishing the roles and responsibilities of the parties during execution. This condition serves as a coordination mechanism and is crucial for ensuring that the activities' beneficiary entities extend the necessary cooperation to SEFAZ, which will be responsible for executing them.

3.6 **Procurement.** Project procurement and contracting will comply with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-9) and Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-9), together with the provisions of the procurement plan. No advance procurement or retroactive financing is envisaged.

3.7 **Single-source selection**.[68] Under condition 3.10(d) of the Policies for the Selection and Contracting of Consulting Services Financed by the IDB (document GN-2350-9), "when only one firm is qualified or has experience of exceptional worth for the assignment," the following will be engaged via single-source selection: (i) schools and government entities (since they have extensive experience and adequate infrastructure to train civil servants), along with government data processing entities, and federal and state universities that provide technical assistance in new information technology solutions (the "unique and exceptional nature" of government education and research centers, as envisaged in paragraph 1.11 (c)); (ii) the Inter-American Center of Tax Administrations (CIAT), as a specialized agency of exceptional value for technical assistance in modernizing the region's tax administrations (paragraph 3.15); and (iii) Instituto de Pesquisa Econômica Aplicada [Institute of Applied Economic Research] (IPEA), which is Brazil's leading research center with an international reputation in the production of scientific data and studies, and Instituto de Estudios Fiscales [Institute of Fiscal Studies] (IEF), which is part of Spain's Ministry of Finance and Public Administration and promotes training activities for civil servants to improve their skills for the performance of their duties.

3.8 **Audited financial statements.** The borrower will deliver audited financial statements to the Bank annually within 120 days following each fiscal year-end. The audit may be performed by the State of Espírito Santo Audit Office (TCE/ES) or by an external audit firm acceptable to the Bank.

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[68] For more detail see Annex III, Chapter V.

B. Summary of arrangements for monitoring results

3.9 **Monitoring** will be based on: (i) the multiyear execution plan and annual work plan (AWP); (ii) the procurement plan; (iii) the Results Matrix; and (iv) the monitoring and evaluation plan (MEP). At the end of February and August each year, the PCU will prepare six-monthly reports on progress toward the outcome, output, and financial targets for the Bank's approval. The Bank will conduct inspection visits and ex post reviews as part of project monitoring.

3.10 **Evaluation**. The project will be evaluated against the annual targets and indicators for outcomes and outputs specified in the Results Matrix, by comparing results before and after. The MEP provides for a midterm and a final independent evaluation. If the Bank considers it necessary, the borrower will prepare and deliver a midterm evaluation report to the Bank 90 days after the date on which 50% of the loan proceeds have been disbursed, or after 36 months of execution, whichever occurs first. It will also deliver a final evaluation to the Bank 90 days after the date of the final disbursement, which will serve as an input for the PCR. The MEP includes an impact evaluation that uses the controlled experiment methodology to identify and quantify the public procurement efficiency gains resulting from the use of electronic tax documents to determine benchmark prices.

Development Effectiveness Matrix		
Summary		
I. Corporate and Country Priorities		
1. IDB Development Objectives	**Yes**	
Development Challenges & Cross-cutting Themes	**-Productivity and Innovation -Institutional Capacity and the Rule of Law**	
Country Development Results Indicators	**-Percent of GDP collected in taxes (%) -Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Subnational governments benefited by decentralization, fiscal management and institutional capacity projects (#)* -Accountability institutions strengthened (#)***	
2. Country Development Objectives	**Yes**	
Country Strategy Results Matrix	**GN-2850**	**The Project will contribute to the objectives of i) improving the business climate, by increasing the number and quality of services offered to businesses and taxpayers, and by simplifying the processes to open new businesses and to pay taxes; and ii) improving the efficiency of public resources management, by creating and strengthining public investment systems and implementing medium-term expenditure frameworks.**
Country Program Results Matrix	**GN-2915-2**	**The intervention is included in the 2018 Operational Program.**
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		**Evaluable**
3. Evidence-based Assessment & Solution	**10.0**	
3.1 Program Diagnosis	**3.0**	
3.2 Proposed Interventions or Solutions	**4.0**	
3.3 Results Matrix Quality	**3.0**	
4. Ex ante Economic Analysis	**9.0**	
4.1 Program has an ERR/NPV, or key outcomes identified for CEA	**3.0**	
4.2 Identified and Quantified Benefits and Costs	**3.0**	
4.3 Reasonable Assumptions	**1.0**	
4.4 Sensitivity Analysis	**2.0**	
4.5 Consistency with results matrix	**0.0**	
5. Monitoring and Evaluation	**9.7**	
5.1 Monitoring Mechanisms	**2.2**	
5.2 Evaluation Plan	**7.5**	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	**Medium**	
Identified risks have been rated for magnitude and likelihood	**Yes**	
Mitigation measures have been identified for major risks		
Mitigation measures have indicators for tracking their implementation		
Environmental & social risk classification	**C**	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	**Yes**	**Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit. Procurement: Information System, Price Comparison.**
Non-Fiduciary	**Yes**	**Strategic Planning National System.**
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	**Yes**	**The IDB team developed and applied a methodology (MD-GEFIS) to assess the state of public finances and fiscal management processes in the State of Espirito Santo, to design the project and to monitor future performance against the baseline.**

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

Evaluability Assessment Note:

The main goal of the operation is to contribute to the fiscal sustainability of the State of Espiritu Santo. To achieve this end, the proposal defines three specific areas on which the project will intervene. The first area is fiscal management and transparency. The second area is tax administration and litigation. The third area is financial administration of public expenditure. Each of these areas define a component. The document includes a description of the process gaps that lead to weaknesses in each of these three areas. The project is a child of a series of operations under the Conditional Credit Line for Investment Projects (CCLIP) parent BR-X1039.
The project proposal diagnoses a primary balance as a share of the State PIB of 0.42 percent, and a Current Net Debt as a share of the State PIB of 1.7 Percent in 2017 (Instituto Jones De los Santos, 2017). The diagnosis is based on the MD-GEFIS tool which analyzes processes in the three main areas which define the components. The Ministry of Finance provides a diagnosis for a total of seventeen sub areas. Each diagnosis identified the main restrictions for the Ministry to increase tax revenue, decrease running costs or improve efficiency in expenditures, and improve service delivery to citizens. Overall, the diagnosis identifies gaps in institutional arrangements (such as weak coordination and outdated legal documents), deficits in personnel management and training, and gaps in capital investments (resulting in outdated technological infrastructure, limited availability of information, and lack of mechanisms to communicate with citizens). The quantification of these needs is disaggregated for each of 15 processes.
The economic analysis provides a quantification of savings to the State through technological tools which allow for efficiency gains. The quantification of benefits is associated to savings in management by automatizing the monitoring of fiscal receipts. Benefits are also associated to savings in procurement. The costs include investment in technology and maintenance. The analysis concludes with a net present value of US$12 million.
The monitoring relies on reports by the Ministry of Finance. The ex post evaluation plans for an impact evaluation on the effect on of providing public organisms with procurement reference prices on savings. Reference prices will be based on fiscal data. This evaluation relies on a randomized control trial. The project plans for a before-after and qualitative evaluations.
There is are four risks out of nine classified as high. The main risks identified for the program to succeed are associated to human or institutional shortcomings which lead delays in execution. There are no mitigating measures identified.

RESULTS MATRIX

Project objective:	To contribute to the state's fiscal sustainability through: (a) modernization of fiscal management; (ii) improvement of tax administration; and (iii) improvement of public expenditure management.

EXPECTED IMPACT

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Impact 1: Decrease in the state's ratio of primary fiscal deficit to GDP											
Primary balance/ GDP-ES	% (R$/R$)	0.42	2017	0.42	0.42	0.42	0.45	0.50	0.50	Annual accounts, Economic Studies Coordination Unit (CEE)/Jones dos Santos Neves Institute (IJSN)	**Calculation formula:** Primary balance / GDP **Baseline:** 0.42 Primary balance (2017) = R$512 billion GDP (2017) = R$120.845 billion
Impact 2: Increase in the state's ratio of tax revenue intake to GDP											
Tax revenue/ GDP-ES	%	9.0	2017	9.0	9.0	9.0	9.5	10.0	10.0	Annual accounts, CEE/IJSN	**Calculation formula:** Value of tax revenue intake at the end of the project / GDP for the corresponding year **Baseline:** Tax revenue intake (2017) = R$10.864 billion GDP (2017) = R$120.845 billion

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Impact 3: Decrease in state's ratio of net current debt to GDP											
Net current debt/GDP-ES	%	1.75	2017	1.75	1.75	1.70	1.65	1.60	1.60	Annual accounts, CEE/IJSN	**Calculation formula:** Net current debt/GDP **Baseline:** Net current debt (2017) = R$2.114 billion GDP (2017) = R$120.845 billion

EXPECTED OUTCOMES[1]

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Outcome 1: Increase in the ratio of strategic planning targets met to total planned targets											
Number of targets met/ Total planned targets	%	0	2017	0	0	40	60	80	80	Strategic management report, Fiscal Development Division (GEDEF)	**Calculation formula:** Number of targets met/Total number of targets planned **Baseline**: 0 SEFAZ does not set or monitor strategic planning targets. The project envisages the implementation of strategic planning 1 (Output 1.1).

[1] Expected outcomes are cumulative.

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Outcome 2: Decrease in the ratio of cost of tax collection to tax revenue intake											
SEFAZ operating budget/Tax revenue intake	%	1.71	2017	1.71	1.71	1.65	1.60	1.50	1.50	Integrated Public Finance Management System of the State of Espírito Santo (SIGEF/ES) management report, Budget Group	**Calculation formula:** SEF executed budget/ Tax revenue intake **Baseline:** 0.45% SEFAZ operating budget (2017) = R$185.321 billion ICMS tax revenue intake (2017) = R$10.864 billion
Outcome 3: Narrowing of the gap between the budget as planned and as executed											
Budget as executed/Budget as planned	%	11.1	2017	11.1	11.1	8.0	6.0	5.0	5.0	Annual Budget Law (LOA) and State Balance Sheet posted on the SEFAZ/ES website	**Calculation formula:** 1 - (budget as executed/budget as planned). **Baseline (2016): 11,1%** Planned budget (LOA)= R$16.192 billion Executed expenditure budget = R$14.392 billion

OUTPUTS[2]

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification
Component 1: Fiscal management and transparency										
1.1 Fiscal management governance model implemented[3]	Model	0	2017	0	0	0	1	0	1	GEDEF report
1.2 Administrative process management model implemented	Model	0	2017	0	0	0	0	1	1	SEGER report
1.3 Skills-based human resource management model updated	Model	0	2017	0	0	0	1	0	1	GEDEF report
1.4 ICT management model updated	Model	0	2017	0	0	0	1	0	1	Report of the ICT Division
1.5 Internal control model of the state implemented	Model	0	2017	0	0	0	0	1	1	Report of the Oversight and Transparency Department
Component 2: Tax administration and litigation										
2.1 Management model for tax policy support instruments implemented	*Software*	0	2017	0	0	0	0	1	1	Report of the Revenue and Registration Division (GEARC)
2.2 Enforcement model implemented	Model	0	2017	0	0	0	1	0	1	Report of the Fiscal Division
2.3 Electronic litigation process implemented	*Software*	0	2017	0	0	0	1	0	1	Report of the Tax Division
2.4 Comprehensive service system implemented	System	0	2017	0	0	1	0	0	1	Report of the Taxpayer Service Division

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[2] The description of the scope of each output in this matrix can be found in the monitoring and evaluation plan. The results quoted are annual.

[3] Model includes: (i) procedures and business rules defining its functioning; (ii) software application or IT system supporting its operationalization; (iii) training in software operation and procedures; and (iv) in many cases, the necessary expansion in processing capacity with more servers, user PCs, storage devices (given the increase in data volumes), and improved communications for remote users.

Indicator	Unit of measure	Baseline	Base year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification
2.5 Model for administrative collection of taxes owed implemented	Model	0	2017	0	0	1	0	0	1	GEARC report
Component 3: Financial administration and public expenditure										
3.1 Budget planning and execution and investment management model implemented	Model	0	2017	0	0	0	0	1	1	Report of the Economy and Planning Department
3.2 Financial programming and execution model implemented	Model	0	2017	0	0	0	0	1	1	Report of the General Finance Division (GEFIN)
3.3 State procurement management model strengthened	Model	0	2017	0	0	0	0	1	1	SEGER report
3.4 Public sector accounting standards implemented	Standards	6	2017	0	0	0	2	2	10	Report of the General Accounting Division (GECOG)
3.5 Public cost management model implemented	Software	0	2017	0	0	0	0	1	1	GECOG/GEFIN report

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country	Brazil
Project number:	BR-L1517
Name:	Fiscal Management Modernization Project for the State of Espírito Santo. PROFISCO II – ES
Executing agency:	State of Espírito Santo, acting through its Finance Department (SEFAZ/ES)
Fiduciary team:	Edwin Tachlian, Fábia Bueno, and Karina Diaz (VPC/FMP)

I. EXECUTIVE SUMMARY

1.1 The institutional evaluation for the project's fiduciary management was based on: (i) the country's current fiduciary context; (ii) the findings of the assessment of principal fiduciary risks; (iii) the Fiscal Management Maturity and Performance Assessment (MD-GEFIS) report; (iv) the Institutional Capacity Assessment Platform (ICAP); (v) prior experience under PROFISCO I; and (vi) working meetings with the Project Team and SEFAZ/ES.

1.2 Brazil has robust country fiduciary systems that enable sound management of administrative, financial, oversight, and procurement processes, in accordance with the principles of transparency, economy, and efficiency. The executing agency's systems related to its planning and organization, execution, and control capacity have a medium level of development and represent a medium risk.

1.3 SEFAZ/MS has the legal capacity and experience to execute the project activities, considering that this is PROFISCO's second phase. The structure implemented and strengthened will be utilized, drawing on lessons learned from execution of the first phase.

II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

2.1 The organizational structure of SEFAZ/ES consists of the following: (i) the Office of the Treasury Secretary, the Coordination Unit of the Fiscal Management Development Plan; and the Treasury Technical Advisory Unit, which serve as advisory bodies; (ii) the Office of the Undersecretary for Public Revenue, the Office of the Undersecretary for Administrative Affairs, and the Office of the Undersecretary for the Treasury, which serve as management bodies; and (iii) programmatic and instrumental implementation units.

2.2 In addition to benefiting SEFAZ/ES as executing agency, other project beneficiaries will include Espírito Santo's Economy and Planning Department (SEP/ES), Management and Human Resources Department (SEGER/ES), and Oversight and Transparency Department (SECONT/ES).

2.3 Project activities will be executed by SEFAZ/ES through its program coordination unit (PCU), which is responsible for institutional and technical coordination. Procurement processes will be implemented by a standing bidding committee assigned to the program with sufficient capacity to meet the demand generated by it.

2.4 The executing agency uses the Integrated Administrative Management System (SIGA) to process and control competitive bidding. The procurement module is used to register bidding processes, and a transactional module is available for the execution of electronic reverse auctions. The SIGA also has a contract registration system.

2.5 Internal control of the executing agency is performed by SECONT/ES through internal control coordination units for all state entities. External control is exercised by the State of Espírito Santo Audit Office (TCE/ES), which audits all state entities and is duly accredited to audit the Bank's operations.

III. INSTITUTIONAL CAPACITY ASSESSMENT, FIDUCIARY RISK, AND MITIGATION MEASURES

3.1 The institutional capacity assessment and its validation with staff of SEFAZ/ES concluded that the executing agency has sufficient and adequate institutional capacity, albeit with specific areas for improvement in executing operations with the Bank.

3.2 The following were identified and classified as risks potentially leading to delays in project procurements, accountability report delivery, and disbursements. As high risks: (i) lack of capacity at SEFAZ/ES to price services and products properly, which will be mitigated by forming a working group at SEFAZ/ES to review and propose solutions in the case of price comparisons; and (ii) delays at oversight agencies—the Information and Communication Technology Institute (PRODEST), Oversight and Transparency Department (SECONT/ES), and Office of the State Attorney General (PGE)—in conducting prior review, which will be mitigated by creating groups and mechanisms at these oversight agencies to give prompt attention to project processes, and by providing training in Bank policies for all members of the project execution team. As a medium-low risk: insufficient knowledge of Bank policies on the part of SEFAZ/ES and the agencies involved, which will be mitigated by hiring a specialist with experience in procurement management to work at the PCU.

IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

A. Procurement execution

4.1 **Procurement of works, goods, and nonconsulting services.** The contracts will be subject to international competitive bidding (ICB) and will be executed using the standard bidding documents (SBDs) issued by the Bank. Bidding processes subject to national competitive bidding (NCB) will be executed using the country bidding documents agreed upon with the Bank.

4.2 **Selection and contracting of consultants.** The contracts will be executed using the standard request for proposals (RFP) issued by the Bank. The sector specialist will be responsible for reviewing terms of reference for the contracting of consulting services. Consultants will be selected and contracted in accordance with the Policies for the Selection and Contracting of Consultants Financed by the Inter-American Development Bank (document GN-2350-9).

4.3 **Use of country procurement system.** The *Pregão Eletrônico* electronic reverse auction system, including SIGA, which is the country procurement (sub)system approved by the Bank, will be used for the procurement of off-the-shelf goods up to an amount of US$5 million. Any system or subsystem subsequently approved will be applicable to the operation. The procurement plan and its updates will state which procurement processes will be executed using the approved country systems.

4.4 **Advance procurement / retroactive financing.** No advance procurement or retroactive financing is envisaged.

B. Single-source selection

4.5 **Schools and government entities.** Given the way treasury and finance departments are organized in Brazil, outside entities are responsible for the development of knowledge, skills, and competencies. At the federal level, these are: (i) Escola de Administração Fazendária [School of Finance Administration] (ESAF); and (ii) Escola Nacional de Administração Pública [National School of Public Administration] (ENAP) of the Ministry of Planning, Development, and Management (MPDG); and at the state level: (i) government schools for the training of public officials; and (ii) data processing companies, responsible for IT development in the states. To ensure the sustainability of the outputs developed and financed by the project, single-source selection will be used to engage federal and state entities devoted to the training of public officials, given their unique and exceptional nature as government training and research centers, under paragraphs 1.11.c and 3.10 of document GN-2350-9.

4.6 **Specialized international agencies.** The Inter-American Center of Tax Administrations (CIAT), an international agency specializing in technical assistance for the refresh and modernization of tax administrations, will also be engaged under paragraphs 3.10 and 3.15 of document GN-2350-9, as specialized agency of exceptional worth.

4.7 **Research and study institutes**. Instituto de Pesquisa Econômica Aplicada [Institute of Applied Economic Research] (IPEA) and Instituto de Estudios Fiscales [Institute of Fiscal Studies] (IEF) will be engaged under paragraph 3.10.d of document GN-2350-9, as qualified or having experience of exceptional worth. IPEA is Brazil's leading research center in Brazil with an international reputation in the production of scientific data and studies. IEF is part of Spain's Ministry of Finance and Public Administration and promotes training activities for civil servants to improve their skills for the performance of their duties.

Table1. Thresholds for ICB and international short list

Method	ICB Works	ICB Goods and nonconsulting services	International short list for consulting services
Threshold	US$25 million	US$5 million	US$1 million

Table 2. Main procurements

Contract purpose	Selection method	Estimated date	Estimated amount (US$ million)
Goods and nonconsulting services			
Automated online fiscal management process (workflow)	Electronic reverse auction	02-2019	1.5
Oracle data bank hardware	Electronic reverse auction	06-2019	1.8
Disaster/recovery environment solution for the Oracle hardware	Electronic reverse auction	02-2019	1.2
Hyperconvergence solution for server virtualization	Electronic reverse auction	09-2019	1.4
Big data system	Electronic reverse auction	02-2020	2.0
Storage	Electronic reverse auction	02-2019	2.3
Consulting firms			
Software development firm to develop IT systems	Quality- and cost-based selection (QCBS)	06-2019	9.0
Integrated artificial intelligence system for online taxpayer service	QCBS	02-2020	0.8
Process automation	QCBS	06-2020	1.5

* Click here to access the procurement plan.

C. Procurement supervision

4.8 The supervision method will be ex post, except where ex ante supervision, and single-source selection, is justified. When the country system is used for procurement, the country system will also be used for supervision.

4.9 The supervision method must be identified for each selection process. Ex post reviews will be conducted every twelve months in accordance with the project supervision plan. The ex post review reports will include at least one physical inspection visit, selected from among the procurement processes subject to ex post review.

Table 3. Threshold for ex post review

Works	Goods	Consulting services
NCB and Shopping	NCP and *Pregão Eletrônico*	Less than US$1 million

D. Records and files

4.10 The PCU will be responsible for process documentation and will retain the necessary documentation for supervision and auditing purposes.

V. FINANCIAL MANAGEMENT

5.1 **Programming and budget.** The SEP/ES will coordinate the planning of PROFISCO II activities, and the PCU will be responsible for execution and oversight of the activities as set out in the project execution plan (PEP) and in the annual work plan (AWP). State entities use the following planning instruments: Multiyear Plan (PPA), Budgetary Guidelines Law (LDO), which lays down budget directives, and Annual Budget Law (LOA). The project budget will form part of the LOA.

5.2 The PCU will ensure that the budgetary resources for the project, Bank, and local contribution are budgeted annually and earmarked for execution in accordance with the project schedule. Budgetary resources must be recorded in the year of execution in the Sistema Integrado de Gestão das Finanças Públicas do Estado do Espírito Santo [Integrated Public Finance Management System of the State of Espírito Santo] (SIGEF/ES) as an external source. The LOA must include the funds necessary for implementation, including both the external loan and the local counterpart contribution.

5.3 **Accounting and information systems.** Public entities in Espírito Santo use the SIGEF/ES, which integrates the State's financial, accounting, and budgetary management. This system, developed with resources from PROFISCO I, is auditable and has access profiles and security guidelines. The PROFISCO I financial reports were prepared in Excel, based on SIGEF/ES data. The possibility of these reports being generated directly by this system is being considered for PROFISCO II.

5.4 **Disbursements and cash flow**. The project will use the SEFAZ/ES cash management system of the state. Expenditures will be subject to the budgetary and financial implementation processes and duly recorded in the SIGEF/ES system

5.5 As under PROFISCO I, the Bank resources will be administered through an exclusive account so that the loan proceeds can be identified and reconciled, including deposits and payments.

5.6 Disbursements will be made in U.S. dollars under the advance of funds modality. Advances will be based on a projection of financial resources for up to 180 days. Future advances will require accounting for at least 80% of the cumulative total amount for which supporting documentation has not been provided.

5.7 Expenditures deemed ineligible by the Bank must be repaid from local contribution resources or other resources, at the Bank's discretion, depending on the nature of the ineligibility.

5.8 The exchange rate agreed upon with the executing agency for the purpose of accounting for expenditures paid with resources from the advances of funds under the loan will be the "internalization rate." To determine the equivalency of expenditures incurred as local contribution or as reimbursement of expenditures chargeable against the loan, the agreed exchange rate will be the rate on the date the expenditure is paid.

5.9 **Internal control and internal audit**. The state's internal control is exercised the government internal oversight agency, SECONT/ES, which was restructured pursuant to Complementary Law 478 of 17 March 2009. Its functions include internal control and government audit, as well as corruption prevention and anticorruption, with the guiding principles of public input, public transparency, and government and business integrity. The project's activities will be subject to its oversight.

5.10 **External control and reports**. External control will be exercised by the State of Espírito Santo Audit Office (TCE/ES) or a firm of external auditors eligible for the Bank.

5.11 The audited annual financial statements will be delivered, in accordance with terms of reference agreed with the Bank within 120 days after the close of each fiscal year.

5.12 **Financial supervision plan**. This plan may be amended during execution to reflect changes in risk levels or the need for additional oversight.

Table 4. Supervision plan

Nature and scope	Frequency	Responsibility	
		Bank	Executing agency
Ex post review of disbursements and procurement	Annual	Fiduciary team	PCU – External Auditor or TCE/ES
Annual audit	Annual	Fiduciary team	PCU – External Auditor or TCE/ES
Review of disbursement requests	Periodic	Fiduciary team	
Supervision visit	Annual	Fiduciary specialist	

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/19

Brazil. Loan ____/OC-BR to the State of Espirito Santo. Fiscal Management Modernization Project for the State of Espirito Santo – PROFISCO II - ES. Eight Individual Operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 - Fiscal Management Modernization Program in Brazil – PROFISCO II

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the State of Espirito Santo, as Borrower, and with the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing aimed at cooperating in the execution of the Fiscal Management Modernization Project for the State of Espirito Santo – PROFISCO II - ES, which constitutes the eight individual operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 - Fiscal Management Modernization Program in Brazil – PROFISCO II, approved by Resolution DE-113/17, on December 8th, 2017. Such financing will be in the amount of up to US$37,800,000, from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on __ ____________ 2019)

LEG/SGO/CSC/EZSHARE-620307903-34399
Pipeline: BR-L1517