

BRAZIL

PROFISCO – MINAS GERAIS
INSTITUTIONAL STRENGTHENING PROJECT TO MODERNIZE
FISCAL MANAGEMENT IN THE STATE OF MINAS GERAIS
(PROFORT/SEF)

(PROFISCO/MG – BR-L1236)

PERFORMANCE-DRIVEN LOAN (PDL)

CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS
(CCLIP) FOR THE PROGRAM TO SUPPORT THE MANAGEMENT
AND INTEGRATION OF TAX ADMINISTRATIONS IN BRAZIL
(PROFISCO – BR-X1005)

LOAN PROPOSAL

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REQUIRED TECHNICAL REFERENCES	LINK
1. Project Monitoring and Evaluation System	IDBDOCS2066431
2. PROFISCO CCLIP Frame of Reference – Annex I to the PROFISCO Operating Regulations	IDBDOCS2063764
3. Plan of Action and Eligible Expenses – Appendix I to the PROFISCO Operating Regulations	IDBDOCS2063776
4. Execution Monitoring Matrix – Appendix II to the PROFISCO Operating Regulations	IDBDOCS2065943
ADDITIONAL TECHNICAL REFERENCES	LINK
1. SEF/MG institutional-fiscal macrodiagnostic assessment	IDBDOCS2058942
2. Map of problems, solutions, and outcomes	IDBDOCS2058951
3. Project financial analysis	IDBDOCS2058958
4. State Law 17,998/2008 – Authorization to contract the loan operation	IDBDOCS2058960
5. Service order creating the coordination unit and team	IDBDOCS2059146
6. SEF/MG – 2008 Results Agreement	IDBDOCS2059151
7. Targets agreed upon for SEF/MG – 2008	IDBDOCS2060178
8. Evaluation report on the SEF/MG – 2008 Performance Agreement	IDBDOCS2060179
9. SEF/MG 2007-2011 Master Plan (GERE)	IDBDOCS2060180
10. State Agreement on tax administration targets - 2009	IDBDOCS2060187
11. Environmental Classification and Safeguards	IDBDOCS2117437

ABBREVIATIONS

CadSin	Cadastro Sincronizado Nacional de Contribuintes [Synchronized National Taxpayer Registry]
CCLIP	Conditional credit line for investment programs
COGEF	Comissão de Gestão Fazendária [Financial Management Commission]
CONFAZ	Conselho Nacional de Política Fazendária [National Council on Financial Policy]
CT-e	Conhecimento de Transporte Eletrônico [Electronic shipping document]
DFT	Delegacia Fiscal de Trânsito [Inspection Agency for Goods in Transit]
ECD	Escrituração Contábil Digital [Digital bookkeeping system]
EFD	Escrituração Fiscal Digital [Digital tax accounting system]
ERAD	Regional Digital Audit Stations
GDP	Gross domestic product
ICMS	Imposto sobre a circulação de mercadorias e prestação de serviços [goods and services sales tax]
IPVA	Imposto sobre a Propriedade de Veículos Automotores [Motor vehicle ownership tax]
ITCMD	Imposto sobre a Transmissão Causa Mortis e por Doação [Inheritance and gifts tax]
LAUD	Laboratório da Auditoria Digital [Digital Audit Laboratory]
MG	Minas Gerais
NAD	Núcleo de Auditoria Digital [Digital Audit Unit]
NAP	Núcleo de Análise e Pesquisa [Analysis and Investigation Unit]
NCI	Net current income
NF-e	Nota Fiscal Eletrônica [Electronic tax invoice]
NRI	Net real income
OC	Ordinary capital
PAF	Programa de Reestruturação e Ajuste Fiscal [Fiscal Adjustment and Restructuring Program]
PAG	Plan of action and eligible expenses
PCU	Program Coordination Unit
PDL	Performance-driven loan
PNAFE	Programa Nacional de Apoio a Administração Fiscal para os Estados Brasileiros [National Fiscal Administration Program for the Brazilian States]
PPAG	Plano Plurianual de Ação Governamental [Multiyear Government Plan of Action]
PROFISCO	Programa de Apoio à Gestão e Integração dos Fiscos no Brasil [Program to Support the Management and Integration of Tax Administrations in Brazil]
SEF/MG	Secretaria de Estado da Fazenda de Minas Gerais [Finance Department of the State of Minas Gerais]
SEPLAG	Secretaria de Estado de Planejamento e Gestão [Planning and Sustainable Development Department]

SIAFI/MG	Sistema Integrado de Administração Financeira [Integrated Financial Administration System]
SIARE	Sistema Integrado de Administração da Receita Estadual [Integrated State Revenue Administration System]
SICAF	Sistema de Informatização e Controle da Arrecadação e Fiscalização [Revenue Collection and Audit Computerization and Control System]
SPED	Sistema Público de Escrituração Digital [Digital Public Accounting System]
STN	Secretaria do Tesouro Nacional [National Treasury]
TCE/MG	Tribunal de Contas do Estado de Minas Gerais [Audit Office of the State of Minas Gerais]
VoIP	Voice over Internet Protocol

PROJECT SUMMARY

BRAZIL

INSTITUTIONAL STRENGTHENING PROJECT TO MODERNIZE FISCAL MANAGEMENT IN THE STATE OF MINAS GERAIS (PROFORT/SEF) (PROFISCO/MG – BR-L1236) PERFORMANCE-DRIVEN LOAN (PDL)

CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP) FOR THE PROGRAM TO SUPPORT THE MANAGEMENT AND INTEGRATION OF TAX ADMINISTRATIONS IN BRAZIL (PROFISCO – BR-X1005)

Financial Terms and Conditions			
Borrower: State of Minas Gerais (MG)		Amortization period:	20 years
Guarantor: Federative Republic of Brazil		Grace period:	5 years
Executing agency: State of Minas Gerais, acting through the State Finance Department (SEF/MG)		Disbursement period:	2 years
Source	Amount (US\$)	Inspection and supervision fee:	*
IDB – Ordinary Capital (OC)	40.0 million	Interest rate:	Based on LIBOR
Local	4.0 million	Credit fee:	*
Total	44.0 million	Currency:	United States dollars drawn from the Single Currency Facility of the OC
Project at a glance			
Objectives and description:			
Objective: The project's general objective is to improve the efficiency and transparency of fiscal management in the State of Minas Gerais, with a view to: (i) increasing the State's own revenue; (ii) making public expenditure more efficient and effective, and improving its oversight; and (iii) providing better services to citizens.			
Description: This individual performance-driven loan (PDL) forms part of the CCLIP to Support the Management and Integration of Tax Administrations in Brazil (PROFISCO) (BR-X1005), which was approved by the Bank's Board of Executive Directors through Resolution DE-132/08 on 5 November 2008. It is structured in four components with their respective subcomponents, as follows:			
1. Integrated strategic management: (i) organizational upgrading and integration of finance management; and (ii) national and international interagency cooperation.			
2. Tax administration and tax litigation: (i) more efficient and effective tax administration; and (ii) better management of the taxpayer registry and implementation of the digital public accounting system (SPED);			
3. Financial and asset management and internal oversight of fiscal management: (i) more efficient and effective financial management; and (ii) more efficient and effective management of materials and assets in the finance area.			
4. Management of strategic resources: (i) modernization and upgrading of information and communication technology services in the finance area; (ii) upgrading of human resource management in the finance area; and (iii) strengthening of knowledge management in the finance area.			

Special contractual clauses: As a condition precedent to the first disbursement of the loan proceeds, the borrower will submit evidence to the Bank's satisfaction that the PROFISCO CCLIP Program Operating Regulations, established by the Bank, have entered into force (see paragraph 3.4).

Exceptions to Bank policy: (i) To determine the equivalence in U.S. dollars of expenses incurred in reais, the exchange rate in force the day before the disbursement request is presented to the Bank will apply (see paragraph 2.4); and (ii) It is requested that the State Audit Office (TCE/MG) be authorized to perform project audits, even though it has not been accredited to audit other Bank-funded projects (see paragraph 3.6(c)).

Project qualifies as: SEQ [] PTI [] Sector [] Geographic [] Headcount []

* 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 provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. DESCRIPTION AND RESULTS MONITORING

- 1.1 This individual operation under the performance-driven loan (PDL) modality is part of the CCLIP to Support the Management and Integration of Tax Administrations in Brazil (PROFISCO - BR-X1005), which was approved by the Bank's Board of Executive Directors through Resolution DE-132/08 on 5 November 2008.

A. Background, challenges, and rationale

- 1.2 **Socioeconomic considerations.** The state of Minas Gerais, whose capital is Belo Horizonte) is located in the southeastern region of Brazil. It is divided into 853 municípios, and occupies a land area of 586,523 km² (6.9% of national territory); it has a population of 19 million (10% of the national total), 85% of whom live in urban areas and 15% in rural ones. In 2005, the state produced 9.0% (R\$192.639 billion) of the nation's gross domestic product (GDP) and 16% of regional GDP. These figures were broadly repeated in 2006, with the state contributing 9.1% (R\$214.814 billion) of national GDP. The main components of state GDP are service activities (46.77% in 2005 and 47.09% in 2006), followed by manufacturing (32.46% in 2005 and 31.85% in 2006), commerce (11.46% in 2005 and 12.69% in 2006), and agriculture (9.31% in 2005 and 8.37% in 2006).¹
- 1.3 The total value of goods and services produced in Minas Gerais in 2005 generated per capita income of R\$10,012, just below the national average of R\$11,658 and placing it 10th in the national ranking. This performance is reflected in the state's human development, its Human Development Index (HDI) having risen from 0.698 to 0.766 between 1991 and 2000, placing it close to the "high-development" band (0.8-1) and 11th nationally. Minas Gerais is within the national average in terms of income concentration; its Gini index (which measures inequality in the distribution of per capita household income) was 0.532 according to 2005 data, marginally lower than in 2004 (0.536).
- 1.4 **Fiscal considerations.** Some key indicators of the effectiveness of tax administration, obtained from the Finance Department of the State of Minas Gerais (SEF/MG), include the following: (i) in 2007, total tax income came to R\$3.5 billion in current prices—an increase on the 2006 figure, thanks mainly to an increase of R\$3.47 billion in the collection of own income, which accounted for 98.4% of total revenue growth; (ii) the Goods and Services Sales Tax (ICMS), the state's main source of tax revenue, generated an additional R\$2.3 billion in 2007, representing a nominal variation of 13.9% (the main ICMS, which excludes fines and outstanding payments, accounted for 65.4% of the increase in tax revenue during that fiscal year); (iii) the state increased its relative share in the country's total ICMS revenue, from 9.9% in 2006 to 10.3% in 2007; and it maintained its position as the second largest ICMS revenue-earner among the country's federative units; and (iv) other taxes in 2007 posted the following growth figures in relation to

¹ Official figures for regional and state GDP after 2006 are not yet available.

2006: Automobile Ownership Tax (IPVA), 17.72%, and Inheritance and Gifts Tax (ITCMD), 40.79%.

- 1.5 The main indicators of the fiscal adjustment and restructuring program (PAF)² show that the state has fulfilled its commitments with the federal government throughout the 2003-2008 period (see Table 1.1).

• **Table 1.1: Evaluation of Fulfillment of Targets in the Fiscal Adjustment and Restructuring Program (PAF) - 2003/2008**

TARGETS	2003	2004	2005	2006	2007	2008 ¹
1. Financial debt/net real income (maximum)						
<i>Target established</i>	3.10	3.35	3.09	2.64	2.61	2.39
<i>Outcome achieved</i>	3.09	3.17	2.81	2.58	2.40	2.28
2. Primary balance (R\$ million)						
<i>Target established</i>	815	1,181	1,596	1,573	1,704	1,700
<i>Outcome achieved</i>	1,157	1,264	1,698	1,661	2,916	1,715
3. Payroll expenses/net current income (%)						
<i>Target established</i>	69.14	63.59	61.20	60.49	60.00	60.00
<i>Outcome achieved</i>	67.17	61.01	56.10	58.59	59.64	56.44
4. Own income (R\$ million)						
<i>Target established</i>	13,313	14,499	17,104	20,002	21,704	26,458
<i>Outcome achieved</i>	13,418	15,416	18,206	20,068	23,125	27,924

Source: National Treasury Department.

Note: (1) Preliminary figures, subject to confirmation of target fulfillment by the National Treasury Department.

- 1.6 **Macroeconomic setting** The global economic crisis is already affecting state economic growth, resulting in lower levels of own income, federal transfers, exports, and, consequently, investments. The economic slowdown provoked by the global financial crisis has been eased by Brazil's macroeconomic environment and proactive government measures to stimulate the economy. This operation also makes a significant contribution to improving collection and the quality of expenditure, thereby mitigating the effects of the crisis on state finances.
- 1.7 Data obtained in 2009 indicate a major repercussion of the crisis on the income of the state of Minas Gerais, comparing first quarter ICMS revenue for 2008 and the equivalent figure for 2009.

² The PAF, approved by Law 9,496/97 is an integral part of the debt recognition and renegotiation contract between the states and the federal government. It consists of a document whereby the state proposes actions to meet fiscal targets or commitments.

Table 1.2: ICMS revenue - Quarterly average 2008-2009³ (in billions of reais)

State	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1
Minas Gerais	1.939	1.846	1.989	1.964	1.680

- 1.8 **Management improvements and performance agreements.** Taking 2003 as the base year, the economic-financial situation of the state of Minas Gerais was extremely precarious, with a budget deficit of R\$2.4 billion.
- 1.9 With a view to solving the fiscal crisis and improving its administrative performance, the state government implemented the “Choque de Gestão” [management shock] program, with the goals of reforming the state, achieving a positive balance between revenue and expenditure ("zero deficit"), and monitoring actions to maximize the efficiency of government interventions.
- 1.10 The following initiatives have been undertaken in this context: (i) development of the Minas Gerais Integrated Development Plan (PMDI), which provides a strategic vision for the state of Minas Gerais through 2020; and the Multiyear Government Action Plan (PPAG) covering the four-year period 2004-2007 (the 2008-2011 PPAG is currently in force); (ii) introduction of the innovative "performance-driven state" concept into state government; (iii) inclusion of a set of priority actions in the PPAG through structural projects;⁴ and (iv) the signing and monitoring of “Performance Agreements”⁵ with all state departments.
- 1.11 **Results achieved.** Over the last few years, the Finance Department of the State of Minas Gerais (SEF/MG) implemented a wide-ranging institutional strengthening process, financed largely by the Bank, as part of the National Fiscal Administration Program for the Brazilian States (PNAFE). Fiscal management (in the tax and financial domains) made the following progress in the various areas during the past decade:⁶
- a. **Management for results.** The key innovations introduced by SEF/MG in this area include: (i) signing of the first-stage SEF/MG Performance Agreement, for 2007-2009, requiring a review of targets annually, and at any other time as necessary; (ii) signing of the second-stage Performance Agreement by the Department of Finance with each superintendent and direct advisors, in 26 administrative units; (iii) implementation of the system for monitoring and evaluation of Performance Agreements and the sector agenda, through the

³ Data obtained from monthly information on ICMS revenue, in R\$ billion, published on the website of the National Council on Financial Policy (CONFAZ).

⁴ Structural projects stem from the strategic orientation of the Government of Minas Gerais, and represent planned actions and improvements for the state in outcome areas considered priorities.

⁵ A Performance Agreement is an institutional performance assessment tool that guides the government in pursuing management for results.

⁶ The institutional-fiscal macrodiagnostic assessment, which can be found in the additional technical references, provides a more detailed description of the setting and progress achieved by the state's fiscal management.

strategic management unit, to monitor performance from the signing of the agreement; (iv) implementation of the financial prize reward system for all staff (except Secretary and Deputy Secretary), to be distributed in proportion to the performance of the 26 units; and (v) audit of the first-stage Performance Agreement, overseen by a commission set up for this purpose, consisting of a representative from the State Planning and Management Department (SEPLAG/MG), a representative from SEF/MG, and SEF/MG staff.

- b. ***Strategic management.*** In this context, the main actions undertaken were as follows: (i) formation of the Strategic Management Committee to mobilize SEF/MG leaders and monitor results systematically; (ii) strengthening of the strategic planning process by holding quarterly meetings to evaluate the implementation of projects and actions; (iii) development of structural projects to improve SEF/MG infrastructure and operating conditions; (iv) implementation of the sector agenda,⁷ to mitigate risks associated with the organization's targets; (v) implementation of the Balanced Score Card (BSC) methodology, to form a basis for the planning process; and (vi) awareness-raising for risk management at the highest level of administration.
- c. ***Tax administration.*** To achieve the revenue-growth targets, the main actions undertaken in SEF/MG were as follows: (i) implementation of the Digital Audit Unit (NAD) to support data collection, including image generation and the Digital Audit Laboratory (LAUD) for data management (digital tests); (ii) implementation of the Analysis and Investigation Unit (NAP), with specialized training on fiscal intelligence techniques; (iii) implementation of the Criminal Monitoring Unit (NSC), as an interface with the Office of the Public Prosecutor, for the notification of criminal acts, and a property inventory; (iv) expansion of on-line services and introduction of an annual survey of user satisfaction (taxpayers and accountants); (v) automation of supporting records, to improve the service provided electronically, allowing for comparison of information, consultations, and oversight filters; (vi) modernization of administrative litigation by creating the fast-track procedure, computerizing and classifying processes, standardizing sentencing; (vii) migration of the Revenue Collection and Audit Computerization and Control System (SICAF) to a low-level platform and relational database; and (viii) implementation of the Integrated State Revenue Administration System (SIARE), within the PNAFE project, with access via the web and a taxpayer focus.
- d. ***Financial administration.*** The following actions were undertaken to improve financial management: (i) decentralization of account balances through the Integrated Financial Administration System (SIAFI IMG); (ii) up-to-date payment of suppliers; (iii) anticipation of the closing date for annual account

⁷ Each department's sector agenda aims to act on the main administrative and operational bottlenecks that could affect achievement of the sector strategy.

filing, through the SIAFI/MG; and (iv) systematized monitoring of assets and property control system.

- 1.12 **Institutional considerations.** Fiscal management in the state of Minas Gerais is the responsibility of SEF/MG, which aims to ensure state revenue inflows through the design and implementation of economic/taxation policy; finance administration; and the management, orientation, and coordination of the activities of revenue collection, inspection, and oversight of tax and other state revenue.
- 1.13 SEF/MG has a permanent staff of 4,089, distributed among four specific categories of tax administration, as follows: Tax Auditor of the state Tax Administration (1,770 high-level staff); revenue agent (GEFAZ) (1,250 high-level staff); revenue technician (855 middle-rank staff); and revenue analyst. The SEF/MG workforce also includes 40 commissioned posts subject to free appointment.
- 1.14 Other areas of the state government's strategic management are implemented through the following structure: (i) SEPLAG/MG, which coordinates the formulation, execution, and evaluation of state public policies; (ii) the General State Attorney (AGE), which defends the rights and interests of the state, through legal advisory services and legal and out-of-court representation of public entities; and (iii) the state's Auditor General, which performs auditing and administrative correction functions in Executive Branch agencies.
- 1.15 **Future challenges.** Despite the strong results achieved thus far, SEF/MG also faces challenges in the following areas:⁸
- a. ***Integrated management.*** Decision-making processes in the SEF/MG environment are fragile, owing to: (i) lack of systemization of the process for evaluating fiscal risks and short-, medium-, and long-term impacts; and (ii) little sharing of information and management practices with other fiscal administrations.
 - b. ***Tax administration.*** There is potential for revenue loss, owing to shortcomings in: (i) the monitoring of taxpayers covered by the *Super Simples* simplified tax regime;⁹ (ii) real-time oversight of revenue collection and cash control; (iii) monitoring of administrative collection; (iv) fiscal control of merchandise transit and the operational infrastructure of inspection units; (v) commitment of operating capacity from the digital auditing area; (vi) functionalities of the Synchronized National Taxpayer Registry (CadSin) system; (vii) infrastructure and systems for implementing electronic tax invoicing (NF-e), electronic shipment documentation (CT-e), the Digital Tax Accounting System (EFD), and the Digital Bookkeeping System (ECD); and

⁸ The matrix of problems, solutions, and results, in the additional technical references, provides a detailed description of the main problems identified in state fiscal governance and their respective causes.

⁹ A special unified regime for the collection of taxes and contributions from microenterprises and small businesses, instituted by Complementary Law 123 of 14 December 2006.

(viii) tools for large-scale processing of data and information received by the Digital Public Accounting System (SPED).

- c. ***Financial and asset management.*** There is potential for fewer resources saved as a result of shortcomings in: (i) control of the public debt and its recording in the accounts; (ii) the methodology for analyzing and defining the most efficient and effective modality for procuring goods and contracting services within SEF/MG; and (iii) the means used for communication between decentralized finance units.
- d. ***Management of strategic resources.*** There is potential for productivity loss in the different SEF/MG units owing to deficiencies in: (i) planning and infrastructure of SEF/MG hardware, software, and networks; (ii) availability and performance of SEF/MG information and communication technology systems and services; (iii) conservation of the SEF/MG documentary archive; (iv) network security in terms of controlling access and monitoring use in the SEF/MG domain; (v) the size of the SEF/MG workforce in technical areas; (vi) training for revenue staff; and (vii) the generation and shared use of knowledge in the fiscal area.

B. Objectives and components

- 1.16 The project's general objective is to make fiscal management in the state of Minas Gerais more efficient and effective, with a view to: (i) increasing the state's own revenue; (ii) making public expenditure more efficient and effective, and improving its oversight; and (iii) providing better services to citizens.
- 1.17 The project is structured in four components with their respective subcomponents:
- 1.18 **Component I – Integrated strategic management.** This component seeks to improve methods and tools for supporting integrated management in SEF/MG and generating information for decision-making. It will include the following subcomponents and respective outputs:
 - a. ***Organizational improvement and integration of finance management.*** The resources allocated to this subcomponent will finance implementation of the integrated risk management methodology in the finance area.
 - b. ***National and international interagency cooperation.*** The subcomponent will finance activities aimed at increasing the shared use and exchange of knowledge with other institutions, with a view to implementing or making shared use of new finance management methodologies.
- 1.19 **Component II – Tax Administration and Tax Litigation.** This component seeks to improve the performance of tax administration and increase tax collection, through the following subcomponents and respective outputs:
 - a. ***Improvement of the efficiency and effectiveness of tax administration.*** The resources allocated to this subcomponent will finance: (i) implementation and monitoring of the *Super Simples* simplified tax regime and adaptation of the

SIARE and SICAF corporate systems. (ii) improvement of the revenue collection process and administrative tax collection; (iii) improvement of the inspection of goods in transit; (iv) expansion of the operating capacity of the NAD in SEF/MG; (v) implementation of the analytical intelligence solution data mining tools); (vi) promotion and institutionalization of fiscal education practice; and (vii) improvement and adaptation of administrative tax workflows, with automated ex post review functions.

- b. ***Better management of the taxpayer registry and implementation of the Digital Public Accounting System (SPED).*** The resources allocated to this subcomponent will finance: (i) more effective implementation of CadSin; (ii) implementation of the NF-e and CT-e modules in the SPED; (iii) implementation of SPED-EFD; (iv) implementation of SPED-ECD; and (v) implementation of the system for comparing data and information from SPED modules: NF-e, CT-e, EFD and ECD.

1.20 **Component III – Financial and asset management, and internal control of fiscal management.** This component seeks to improve the performance of financial administration and strengthen the control of financial management and public borrowing. It includes the following subcomponents and respective outputs:

- a. ***More efficient and effective financial management.*** The resources allocated to this subcomponent will be used to improve controls on funded debt¹⁰ by implementing a new system for controlling loan operations, incorporated into the Integrated Financial Administration System (SIAFI/MG), including new functions.
- b. ***More efficient and effective materials and asset administration in the revenue area.*** The resources allocated to this subcomponent will finance: (i) the design and implementation of the methodology for managing supplements in finance units; and (ii) better communication and control of goods in transit by implementing Voice over Internet Protocol (VoIP) technology, via satellite and “backbone” in decentralized finance units.

1.21 **Component IV – Management of strategic resources.** This component seeks to improve and fine-tune the methods, instruments, and systems of operational and administrative support for finance management, thereby helping to enhance institutional performance and interaction with society. It will include the following subcomponents and respective outputs.

- a. ***Modernization and improvement of information and communication technology services in the finance area.*** The subcomponent’s resources will finance the following: (i) implementation of the model for information technology governance and best practices in finance management; (ii) expansion and updating of the hardware, software, and network platform,

¹⁰ Funded debt, also known as consolidated debt, is debt contracted by the State Treasury by issuing bonds, or contracted with financial institutions to fulfill callable commitments for periods of over 12 months.

by procuring equipment and software licenses, and upgrading network infrastructure for finance units; (iii) review and implementation of the performance and availability management process in the finance network; (iv) implementation of Electronic Document Management as part of the SEF/MG documentary archive, which consists of proper document storage and making information available for consultation; (v) design and implementation of processes for managing network access, log management, and identity management; and (vi) review of the performance of SIARE, SICAF, and the Integrated Targets and Activities Management System (SIGMA).

- b. ***Better human resource management in the finance area.*** The resources allocated to this subcomponent will finance: (i) the implementation of a methodology for resizing the SEF/MG workforce; and (ii) implementation and increased use of distance education to provide for vocational training for finance civil servants.
- c. ***Strengthening of knowledge management in the finance area.*** The resources allocated to this subcomponent will finance: (i) the implementation of a competencies-based staff management model for SEF/MG; and (ii) design of a knowledge management model for SEF/MG.

C. Cost and financing

- 1.22 **Overall budget** The total project cost is estimated as US\$44 million equivalent, of which US\$40 million will be funded from the Single Currency Facility of the Bank's Ordinary Capital, and US\$4 million will be provided as local counterpart funding by the State of Minas Gerais. Project financing is structured as follows:

Table 1.3: Structure of Project Financing (US\$000)

Investment Categories	IDB	Local	TOTAL	Dist.%
A. Management and verification of outcomes	0	56	56	0.1%
B. Components	40,000	3,944	43,944	99.9%
I. Integrated strategic management	288	0	288	0.7%
II. Tax administration and tax litigation	24,103	0	25,103	57.0%
III. Financial and asset management, and internal control of fiscal management	1,724	0	1,724	4.0%
IV. Management of strategic resources	12,885	3,944	16,829	38.2%
PROJECT TOTAL	40,000	4,000	44,000	100%

- 1.23 **Disbursement programming.** The loan proceeds will be disbursed over a two-year period counted from the date on which the loan contract enters into force, in the percentages indicated below. The Bank will disburse 20% of the loan amount in advance, without verification of results, as requested by the borrower and authorized by policy GN-2278-3 of 14 April 2006, once the conditions precedent to

the first disbursement have been met. The expenses associated with this advance will be charged against the other disbursement tranches.

Table 1.4: Disbursement programming (US\$ million)

Events	Amount of advance	Performance-based disbursements				Total IDB financing
		1st disbursement	2nd disbursement	3rd disbursement	4th disbursement	
Disbursements	8.0	12.0	8.0	8.0	4.0	40.0
%	20%	30%	20%	20%	10%	100%
Advance discount	-	1.0	3.0	2.0	2.0	-
Expenses subject to verification	-	13.0	11.0	10.0	6.0	40.0

D. Results Matrix and Framework of Indicators

- 1.24 The results matrix and framework of indicators (Annex II) show how the loan proceeds will be disbursed in four tranches, subject to the fulfillment of targets set for each disbursement.
- 1.25 **Evaluation of outcomes.** Project evaluation will be based on targets, the baseline, and the respective output and outcome indicators contained in the indicators matrix. This evaluation will be performed by the independent consulting firm mentioned in paragraph 2.2 of this document, as the targets and outcome and output indicators envisaged for each disbursement are attained. The outcomes achieved will be presented in accordance with a standard model adopted by the borrower (Structural project evaluation report), prior to each disbursement request.
- 1.26 For each disbursement, fulfillment of three of the four targets set for each disbursement in the results matrix and framework of indicators will be a necessary and sufficient condition for acceptance of full compliance.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing and contractual conditions

- 2.1 **Loan modality.** In accordance with the options offered under the PROFISCO CCLIP, the project will be implemented pursuant to the performance-driven loan (PDL) modality.
- 2.2 **Disbursement mechanisms.** The loan proceeds will be disbursed on the basis of the following: (i) fulfillment of at least three of the four targets set for each tranche, as indicated in the results matrix and framework of indicators; (ii) certification by the independent auditing firm, in the manner set out in this paragraph, of expenses actually incurred, according to the list presented by the borrower and extracted from its SIAFI MG; and (iii) Bank approval of the technical report prepared by the independent consulting firm specializing in performance appraisal, to be hired for this purpose by the borrower with the Bank's prior no objection to the terms of reference. Before each disbursement, this firm will verify fulfillment of the

indicators in the results matrix and the eligibility of the expenditures incurred, based on the Plan of Action and Eligible Expenses contained in Appendix I to the Program Operating Regulations for the PROFISCO CCLIP ([see technical reference](#)).

- 2.3 Should the expenditure actually incurred be less than the amount estimated for the respective tranche, the nonreimbursed difference will be carried forward to the next disbursement.
- 2.4 **Exchange rate.** As an exception to Bank policy, to determine the equivalence in U.S. dollars of expenses incurred in reais, the exchange rate in force the day before the disbursement request is presented to the Bank will apply.
- 2.5 **Eligibility of expenses.** The expenses eligible for all disbursements are those directly relating to the intermediate outputs or final outcomes set out in the project's results matrix, with verification of the amount and relevance by an independent firm. The Bank may recognize expenses incurred by the borrower in the amount of up to US\$12 million, chargeable to the loan proceeds, to achieve the partial targets in the project's results matrix, incurred up to the date of approval of this operation by the Bank's Board of Executive Directors but after 12 December 2008.

B. Environmental and social risks

- 2.6 On environmental issues, the project was classified as a "C" operation under the criteria of the "Sustainable Finance Toolkit", which is consistent with the Project Team's evaluation, since this is an operation for institutional modernization of a finance department ([see technical reference](#)).

C. Fiduciary risk

- 2.7 A specialized team from the Bank's Country Office in Brazil analyzed the fiduciary risk involved in this operation, and classified it as medium-low, for which reason no additional recommendations were made.

D. Main risks

- 2.8 **Poor integration of fiscal management nationally.** This risk would be mitigated by the State of Minas Gerais participating in activities promoted by the Financial Management Commission (COGEF), especially created by the National Council on Financial Policy (CONFAZ), to encourage the exchange of experiences and shared use of technical solutions in the context of PROFISCO.
- 2.9 **Financial analysis.** In view of the size of this operation, the project team opted to conduct a comparative analysis of the incremental financial costs and benefits arising from implementation of a number of project outputs, including the following: (i) the own revenue growth arising from the implementation of five outputs (monitoring of *Super Simples*; adaptation of SIARE and SICAF; improvement of revenue collection and administrative collection processes, including IPVA; inspection of goods in transit; increased operational capacity of the NAD and of the analytical intelligence solution; and (ii) a reduction in operating

costs arising from the implementation of two outputs (improvement of communication and control of goods in transit by implementing VoIP technology via satellite and “backbone” in decentralized finance units; and implementation of the distance education model, with an increase in this method of teaching as a way to provide vocational training to finance department staff. The analysis also used the following references: (i) a 10-year horizon; (ii) a discount rate of 12.5% per year; and (iii) a growth rate of 2.5% per year.¹¹

- 2.10 According to Table I of the project's Financial Analysis ([see technical reference](#)), a net cumulative financial benefit of US\$57.6 million in present value terms is expected by the second year of disbursement of the loan proceeds (2010); so the project is fully financially justified.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Execution mechanism

- 3.1 The borrower in this operation will be the State of Minas Gerais, with the Federative Republic of Brazil as guarantor of the financial obligations arising from the loan. The project's executing agency will be the State of Minas Gerais, acting through SEF/MG, in which a project coordination unit (PCU) will be set up, reporting directly to the Secretary of Finance and staffed by permanent personnel from the State of Minas Gerais.
- 3.2 The unit that will coordinate the project will be comprised of state officials and will have at least a general coordinator, who will have a monitoring and evaluation assistant, a technical coordinator, and an administrative-financial coordinator reporting to him.
- 3.3 The unit in charge of project coordination will have the following functions, among others: (i) submit disbursement requests to the Bank, duly supported by the relevant documentation; (ii) maintain the project's financial accounting system appropriately and in accordance with the Bank's rules on the subject; (iii) file reports on project execution, monitoring, and evaluation, under the terms of the specific appendices of the PROFISCO Operating Regulations for this individual operation (PAG, Appendix I to the PROFISCO Operating Regulations, and Execution Monitoring Matrix, Appendix II to the PROFISCO Operating Regulations); and (iv) keep the respective invoices, contracts, and payment orders and submit them to the Bank, the project auditors, and the consulting firm that verifies fulfillment of the results matrix targets.
- 3.4 **Program Operating Regulations.** The project will be governed by the PROFISCO CCLIP Operating Regulations previously approved by the Bank, which include eligibility criteria for the borrower, the project, and expenses. **As a special condition precedent to the first disbursement of the loan proceeds, the**

¹¹ Projected GDP growth rate of the state of Minas Gerais.

borrower will present evidence to the Bank that the PROFISCO CCLIP Operating Regulations have entered into force.

- 3.5 **Procurement and contracting.** Under the project, goods will be procured and minor works and services contracted as needed to achieve the targets set in the results matrix. According to the Bank's policies for PDLs (document GN-2278-3), the aforementioned procurement and contracting processes must be undertaken pursuant to the federal legislation of the borrowing country, provided principles of competition, economy, transparency, equality, publicity, and due legal process are all respected. The origin of goods, works, and services that the borrower acquires or retains for the project will not be limited to member countries of the Bank. The fees of the consulting firm hired to verify attainment of the targets in the results matrix and the list of eligible expenses will be paid in full from local counterpart resources, and the Bank will only review the terms of reference for the corresponding contract ex ante.

B. Arrangements for monitoring, evaluating, and auditing project execution

- 3.6 The project's monitoring and evaluation system, which is described in the technical annexes to this document, will be based on the model for structural projects adopted by the Government of Minas Gerais.
- a. **Semiannual progress reports.** The borrower will present semiannual progress reports as planned and on schedule as established in the general conditions of the loan contract. For purposes of presenting progress reports, the borrower will have monitoring reports for the structural projects in their various technical areas. The borrower's internal structure responsible for the reports is indicated in the project's technical references ([see Annex I to the PROFISCO Program Operating Regulations](#)). The semiannual progress reports will include the following information: (i) a summary of the results achieved, by component and subcomponent (partial and full); (ii) the project risks, when appropriate; (iii) a consolidated overview of the difficulties encountered and lessons learned; and (iv) conclusions and recommendations.
 - b. **Outcome verification reports.** These reports will be presented by the independent consulting firm, as provided for in paragraphs 1.25 and 2.2 of this document. Their purpose is to present to the Bank the outcomes achieved in terms of fulfilling the targets set for each disbursement in the results matrix and verification of the list of eligible expenses.
 - c. **Audit reports.** The project's audited financial statements will be prepared annually, in accordance with the general conditions of the loan contract, by an independent firm of auditors accepted by the Bank and retained pursuant to policies AF-200 and AF-400, or by the State Audit Office of Minas Gerais (TCE/MG) if so authorized by the Bank. **As a special exception to Bank policy, it is requested that the TCE/MG be authorized to perform the project audits even though it has not been accredited by the Bank to audit other Bank-funded projects.** In addition to the project's audited financial

statements, the annual audit will include ex post review of the documentation supporting the loan tranche disbursements, to make sure that project funds are being used to finance the eligible expenses needed to achieve the results set out in the results matrix.

Annex I

This annex is confidential.

INSTITUTIONAL STRENGTHENING PROJECT TO MODERNIZE FISCAL MANAGEMENT IN THE STATE OF MINAS GERAIS (PROFORT/MG)
(BR-L1236)

RESULTS MATRIX

Output/outcome	Indicator	Mathematical expression	Baseline	Targets ¹			
				1st disbursement	2nd disbursement	3rd disbursement	4th disbursement
GENERAL PROJECT OBJECTIVE (PURPOSE) ²							
1. Control of Public Debt	State financial debt in relation to net real income (NRI) (%)	Financial debt/NRI (maximum value)	2.38				Fulfillment of indicator under the terms of the final result of the PAF evaluation, issued by the STN/MG.
2. Positive primary balance	State primary balance	Primary balance (million) (minimum value)	1,715				Fulfillment of indicator under the terms of the final result of the PAF evaluation, issued by the STN/MG.
3. Increase in own revenue	% increase in collection	Increase in own collection (million) (minimum value)	27,924				Fulfillment of indicator under the terms of the final result of the PAF evaluation, issued by the STN/MG.

¹ Attainment of three of the four targets set for each disbursement will be a necessary and sufficient condition for acceptance of total fulfillment.

² The state projects included in the PROFISCO CCLIP received special authorization from the National Treasury (STN) of the Ministry of Finance, pursuant to Article 7, paragraph 3 of Senate Resolution 43 of 9 April 2002, and thus remained outside borrowing limits. It was agreed that, throughout the execution of PROFISCO projects, the states will fulfill the fiscal targets agreed upon with the federal government in the context of the Fiscal Restructuring and Adjustment Program (PAF), which respects the thresholds set by the Fiscal Responsibility Law. The amounts will be reviewed in annual PAF negotiations with the STN/MG, when the biannual targets can be reviewed.

Output/outcome	Indicator	Mathematical expression	Baseline	Targets ¹			
				1st disbursement	2nd disbursement	3rd disbursement	4th disbursement
COMPONENT II: TAX ADMINISTRATION AND TAX LITIGATION							
1. Improvement of the collection and administrative collection process	Number of tax payment modalities after implementation of the system	Number of tax payment modalities after implementation of the system (-) Number of tax payment modalities at 31 December 2008.	(2008) tax payment modalities implemented: bank cash desk; self-service terminal, Internet, and Bankfone			One new tax payment modality (checking account debit) implemented for taxpayer use.	
2. Improvement of transit inspection	Number of DFTs installed with project implementation	Number of DFTs installed in the year of the disbursement request (-) Number of DFTs existing at 31 December 2008.	(2008) 6 DFTs installed		2 new DFTs installed and in operation		
3. Improvement of operational capacity of the Digital Audit Unit (NAD)	% of forensic analysis undertaken by LAUD/ERAD following implementation of the project.	Number of forensic analyses undertaken by LAUD/ERAD following implementation of the project (-) Number of forensic analyses undertaken by LAUD/ERAD at 31 December 2008.	(2008) 10 forensic analyses per year, undertaken supported by LAUD/ERAD				17 forensic analyses undertaken/ supported by LAUD / ERAD in SEF/MG during the last 12 months.
4. Promotion and institutionalization of the practice of fiscal education in the SEF.	Number of fiscal education events held.	Number of fiscal education events held	(2008): 2,629 events held according to the performance agreement	2,700 fiscal education events held			

Output/outcome	Indicator	Mathematical expression	Baseline	Targets ¹			
				1st disbursement	2nd disbursement	3rd disbursement	4th disbursement
5. Increase in ICMS and IPVA collection	% increase in collection	[ICMS and IPVA collection in the first quarter of each year/ICMS and IPVA collection in the previous year)-1]*100	(2009) first-quarter collection: ICMS= R\$4,951,429,000 and IPVA= R\$1,499,091,000.		5% increase in collection during the first-quarter of the year of the disbursement request, totaling ICMS= R\$5,199,000,000 and IPVA= R\$1,574,045,000		6.5% increase in collection during the first-quarter of the year of the disbursement request: ICMS= R\$5,536,935,000 and IPVA= R\$1,676,358,000
6. Expansion of implementation of the Synchronized National Taxpayer Registry (CadSin).	Number of automated services following expansion of implementation of the CadSin system.	Number of automated services after expansion of implementation of the CadSin system - Number of automated Cadsin services at 31 December 2008.	(2008) 1 automated Cadsin function implemented: Inscription:	1 additional systemized and standardized registration service implemented (deactivation, suspension, or reactivation).			
7. Implementation of SPED - Electronic Invoicing (NF-e) and Electronic Shipment Documentation (CT-e).	1st disbursement: Number of NF-e received since the date specified by CONFAZ. 3rd disbursement: Number of uses of the Federal Revenue Contingency System (third-party resources) without previous programming.	1st disbursement: NF-e received since the date specified by CONFAZ 3rd disbursement: Number of uses of the Federal Revenue Contingency System (third-party resources) without previous programming.	1st disbursement: (September/2007) No NF-e received 3rd disbursement: (April 2008): Non-use of contingency as a result of non-implementation of the NF-e system.	30 million NF-e received since the date specified by CONFAZ.		Uses of the Federal Revenue Contingency System (third-party resources) without previous programming below 12 in last 12 months	

Output/outcome	Indicator	Mathematical expression	Baseline	Targets ¹			
				1st disbursement	2nd disbursement	3rd disbursement	4th disbursement
8. Implementation of SPED - Digital Tax Accounting (EFD)	Index of the availability of EFD reception service, since the date specified by CONFAZ.	Monthly availability index = $(720 - (\text{Number of hours of interruption in electronic services related to the SEF/MG institutional website not reported with at least 24 hours' notice}) / 720)$	(April/2008): Service not yet available.			80% availability of the service (infrastructure and system) to receive EFDs from all taxpayers covered by CONFAZ.	
COMPONENT III: FINANCIAL AND ASSET MANAGEMENT AND INTERNAL CONTROL OF FISCAL MANAGEMENT							
1. Better control of funded debt by implementing a new Credit Operations Control System, integrated into SIAFI/MG, incorporating new functions.	% of active funded debt contracts controlled through the system formally integrated into SIAFI in real-time.	(Number of active funded debt contracts / Total number of active funded debt contracts) * 100	(2008): Control in mono-user system, in Clipper language, and with management reports on Excel spreadsheets.				50% of active funded debt contracts with formal control in real-time, with a SIAFI/MG interface allowing for automatic launch in accounts and the issuance of management reports.
2. Improvement of the communication and control of goods transit by implementing VoIP technology via satellite and/or via "backbone" in finance units.	Number of finance units with VoIP technology via satellite and/or "backbone" implemented.	Number of finance units with VoIP technology via satellite and/or "backbone" implemented.	(2008) No SEF/MG unit with VoIP technology via satellite and/or "backbone" implemented.			30 SEF/MG Treasury units with VoIP technology via satellite and/or "backbone" implemented.	
Component IV: STRATEGIC RESOURCE MANAGEMENT							
1. Design and implementation of network access management, log management, and identity management processes.	Finance network security index	Finance network security index	(2007) The most recent analysis of risks calculated the index at 59.86%.		10% increase in the finance network security index.		
2. Increased monthly availability of electronic	Monthly availability	Monthly availability index = $(720 - (\text{Number of hours of interruption in electronic services related to the SEF/MG institutional website not reported with at least 24 hours' notice}) / 720)$	(2008): Absence of systemized				Monthly availability of 95%

Output/outcome	Indicator	Mathematical expression	Baseline	Targets ¹			
				1st disbursement	2nd disbursement	3rd disbursement	4th disbursement
services obtainable on the SEF/MG institutional website	index	of interruption in electronic services related to the SEF/MG institutional website not reported with at least 24 hours notice)/720.	processes for indicating availability. Absence of systemized processes to indicate performance.				of electronic services related to the SEF/MG institutional website, excluding technical stoppages for maintenance, reported with at least 24 hours' advance notice.
3. Implementation and increasing use of the distance education model, as a finance staff vocational training methodology.	Number of participants in distance education vocational training events.	Number of participants in distance education vocational training events.	(2008) 230 participants in distance education events using rented platform.	200 participants in distance education events during the last 8 months.	300 participants in distance education events during the last 12 months.		

TABLE OF INDICATORS AND MEANS OF VERIFICATION

Indicator	Mathematical expression	Verification
Final outcomes		
State financial debt in relation to net real income (NRI) (%)	Financial debt/NRI (maximum value)	Paper sent to the state by STN/MG giving the result of the evaluation of the current Fiscal Adjustment Program.
State primary balance	Primary balance (million) (minimum value)	
% increase in collection	Increase in own collection (million) (minimum value)	
Component II: TAX ADMINISTRATION AND TAX LITIGATION		
1. Number of tax payment modalities after implementation of the system	Number of tax payment modalities after implementation of the system (-) Number of tax payment modalities at 31 December 2008.	SEF/MG website.
2. Number of DFTs installed and in operation prior to the date of signature of the contract.	Number of DFTs installed in the year of the request for disbursement Number of DFTs existing at 31 December 2008.	Physical installation
3. % of forensic analyses undertaken by LAUD/ERAD after implementation of the project	Number of forensic analyses undertaken by LAUD/ERAD after implementation of the project (-) Number of forensic analyses undertaken by LAUD/ERAD at 31 December 2008.	LAUD/ERAD technical report
4. Number of fiscal education events held	Number of fiscal education events held	Quarterly report on fiscal education events
5. % increase in collection	[(First-quarter ICMS and IPVA collection in each year/ICMS and IPVA collection for the first quarter of 2009) -1]*100	Monthly Collection Report (RMA) published by the State Tax Administration Subdepartment
6. Number of automated services after improvement of the Cadsin system	Number of automated services after improvement of the Cadsin system (-) Number of automated Cadsin services at 31 December 2008.	Report on product implementation system
7. <i>1st disbursement</i> Number of NF-e received since the date specified by CONFAZ and <i>third disbursement</i> Number of uses of the Federal Revenue Contingency System (third-party resources) without previous programming.	<i>1st disbursement</i> NF-e received since the date specified by CONFAZ <i>3rd disbursement</i> Number of uses of the Federal Revenue Contingency System without previous programming.	<i>1st disbursement</i> Product implementation system report <i>3rd disbursement</i> Report indicating the number of system uses.
8. Index of the availability of EFD reception service, since the date specified by CONFAZ	Monthly availability index = (720 - (Number of hours of interruption in electronic services related to the SEF/MG institutional website not reported with at least 24 hours' notice)/720	Report on second-stage Performance Agreement. The source information for the report will be generated by free software (Nagios) and, subsequently, by a performance monitoring tool to be acquired.

Indicator	Mathematical expression	Verification
COMPONENT III: FINANCIAL AND ASSET MANAGEMENT, AND CONTROL OF FISCAL MANAGEMENT.		
1. % of active funded debt contracts controlled through the system formally integrated into SIAFI and in real time	(Number of active funded debt contracts controlled/total number of active funded debt contracts)*100	Management reports issued by the new system in operation.
2. Number of finance units with VoIP technology via satellite and/or “backbone” implemented.	Number of finance units with VoIP technology via satellite and/or “backbone” implemented.	Technical Acceptance Report
COMPONENT IV: STRATEGIC RESOURCE MANAGEMENT		
1. Finance network security index	Finance network security index	Risk analysis report generated by the "Risk manager" software.
2. Monthly availability index	Monthly availability index = $(720 - (\text{Number of hours referring to stoppages in electronic services related to the SEF/MG institutional website not reported with at least 24 hours notice})/720)$	Report on second-stage Results Agreement. The source information for the report will be generated by free software (Nagios) and, subsequently, by a performance monitoring tool to be acquired.
3. Number of participants in distance education vocational training events	Number of participants in distance education vocational training events	Staff Development Activity Request (SADP) management spreadsheet.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/09

Brazil. Loan ___/OC-BR to the State of Minas Gerais
Institutional Strengthening Project to Modernize Fiscal
Management in the State of Minas Gerais
(PROFORT/SEF) (PROFISCO/MG)

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 Minas Gerais, as Borrower, and with the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of the Institutional Strengthening Project to Modernize Fiscal Management in the State of Minas Gerais (PROFORT/MG) (PROFISCO/MG), which constitutes an individual operation under the Conditional Credit Line (CCLIP) for the Program to Support the Management and Integration of Finance Administrations in Brazil (PROFISCO) approved on November 5, 2008 by Resolution DE-132/08. Such financing will be in the amount of up to US\$40,000,000, from the resources of the Single Currency Facility 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.