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BRAZIL

FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF PIAUÍ
(BR-L1498)

SECOND 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

CCLIP	Conditional Credit Line for Investment Projects
CGE/PI	Secretaria da Controladoria do Estado [Office of the State Comptroller General]
ICAS	Institutional Capacity Assessment System
ICB	International competitive bidding
ICMS	Imposto sobre Circulação de Mercadorias e Serviços [Tax on the Circulation of Goods and Services]
ICTs	Information and communication technologies
IEFi	Instituto de Estudos Fiscais [Institute for Fiscal Studies]
IMF	International Monetary Fund
IT	Information technology
LIBOR	London Interbank Offered Rate
LOA	Lei Orçamentária Annual [Annual Budget Law]
MD-GEFIS	Modelo para Avaliação da Maturidade e Desempenho da Gestão Fiscal [Model for Evaluating the Status and Performance of Fiscal Management]
NCB	National competitive bidding
NEEFI	Núcleo de Estudos Econômicos-Fiscais [Economic and Fiscal Studies Unit of SEFAZ-PI]]
NF-e	Nota fiscal eletrônica [electronic tax invoice]
PCU	Project coordination unit
PGE/PI	Procuradoria Geral do Estado [Office of the State Attorney General]
PI	State of Piauí
PROFISCO	Program to Support Management and Integration of Tax Administrations in Brazil
QCBS	Quality- and cost-based selection
SEADPREV	Secretaria de Estado da Administração e Previdência do Piauí [Piauí State Department of Administration and Social Security]
SEFAZ/PI	Secretaria de Fazenda do Estado do Piauí [Piauí State Finance Department]
SGLD	Sistema de Gestão de Liquidez Diária [Daily Liquidity Management System]
SIAFE	Sistema Integrado de Administração Financeira do Estado do Piauí [Piauí State Integrated Financial Administration System]
SIAT	Sistema Integrado de Administraçao Tributária [Integrated Tax Administration System]
SPED	Sistema Público de Escrituração Digital [Digital Public Accounting System]
SUPREC	Superintendente da Receita [Office of the Superindendent of Revenue (SEFAZ/PI)]
TCE/PI	Tribunal de Contas do Estado do Piauí [Piauí State Audit Office]

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Financial Terms and Conditions				
Borrower: State of Piauí			**Flexible Financing Facility**[a]	
			Amortization period:	25 years
Guarantor: Federative Republic of Brazil			**Disbursement period:**	5 years
Executing agency: State of Piauí, through its Finance Department (SEFAZ/PI)			**Grace period:**	5.5 years [b]
			Interest rate:	LIBOR-based
Source	**Amount (US$)**	**%**	**Credit fee:**	[c]
IDB (Ordinary Capital)	44,935,000	89.9	**Inspection and supervision fee:**	[c]
Local	5,065,000	10.1	**Original weighted average life:**	15.25 years
Total	50,000,000	100.0	**Currency:**	United States dollar

Project at a Glance

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

This project is the second individual loan operation under the PROFISCO II CCLIP (BR-X1039).

Special contractual clauses precedent to the first loan disbursement: (i) the borrower's adherence to the program Operating Regulations, previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) formation of the project coordination unit and designation of its members (paragraph 3.3).

Special contractual condition for execution: Prior to initiating the execution of activities to develop outputs for the Office of the State Attorney General (PGE/PI), the Office of the State Comptroller General (CGE/PI), the Department of Planning (SEPLAN), or the Department of Administration and Social Security (SEADPREV), SEFAZ/PI will sign a cooperation instrument with these agencies establishing their roles and responsibilities during execution of the respective activities (paragraph 3.4).

Exceptions to Bank policies: 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 in 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 the 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 relevant 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. PROJECT DESCRIPTION

A. Background, problem addressed, and rationale

1.1 This project is the second individual loan operation that the Government of Brazil has requested from the Bank under the PROFISCO II CCLIP (BR-X1039),[1] with a view to consolidating the progress achieved under the PROFISCO I CCLIP (BR-X1005) and ensuring continuity in the process of modernizing fiscal management in the states.

1.2 **Brazil's macrofiscal context.** Brazil faces substantial challenges to keeping its economy on a sustainable growth path. The country's GDP contracted by 3.8% in 2015 and 3.6% in 2016.[2] The economic recovery will be slow, with projected growth of just 0.2% in 2017 and 2% in 2018 (Fiscal Trends in Brazil's Consolidated Public Sector, 2013-2017).[3]

1.3 The decline in economic activity led to a significant drop in consolidated public sector revenues, representing losses of around two percentage points of GDP from 2013 to 2016. Despite plummeting revenues, public expenditure grew steadily over this period, up from 37.4% of GDP in 2013 to 41.6% in 2016. As a result, the primary balance deteriorated from an average surplus of 3.4% of GDP from 2002 to 2008 to one of 1.3% between 2009 and 2015. In 2016, the primary deficit reached 2.5% of GDP,[4] and the country is not expected to attain a structural primary surplus again before 2019.[5] The public debt grew by almost one third in just three years, from 60% of GDP in 2013 to 78.6% in 2016, and is expected to reach 84.3% in 2021.[6]

1.4 The recessionary backdrop has adversely affected fiscal performance in the states. Tax collections fell from 7.6% of GDP in 2008 to 6.9% in 2015. The Tax on the Circulation of Goods and Services (ICMS)—the main source of state tax revenue—dropped by 6% on average in real terms, from 6.7% of GDP in 2013 to 6.5% in 2015. Favorable results from the implementation of PROFISCO I (described in paragraph 1.20) helped to avoid an even more precipitous decline. Transfers from the federal government fell over the same period, from 2.9% of GDP to 2.5%.[7]

1.5 While state revenues weakened, current expenditure grew on the back of an expansion in employment costs, which rose from 10.2% of GDP in 2011 to 10.9% in 2015.[8] Investment fell by 16% on average in real terms between 2013 and 2016. The primary balance deteriorated from 2012 onwards, with deficits recorded in three of the last four years. In 2015, 15 of Brazil's 27 states had primary deficits.[9]

1.6 **Fiscal situation in Piauí.** The crisis in the country has affected fiscal balance in Piauí and presents risks to the state's fiscal sustainability. There was a sharp

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1 Letter from the Ministry of Finance.

2 Brazilian Institute for Geography and Statistics (IBGE), International Monetary Fund (IMF).

3 Central Bank of Brazil.

4 Independent Fiscal Institution.

5 IMF Fiscal Monitor.

6 Independent Fiscal Institution.

7 National Treasury Department (STN).

8 Rossi.

9 National Treasury Department (STN).

slowdown in the rate of growth in ICMS collections, which fell from a real annual rate of 8% in the 2006-2013 period to 0.8% in the 2014-2016 period (Fiscal Performance in Piauí, 2013-2016). As a result, collections fell from an average of 8.2% of state GDP in the 2006-2013 period to 7.7% in 2014-2016. The slowdown in collections was curtailed only by repeated across-the-board increases in ICMS rates each year from 2014 onwards.

1.7 State finances have also been exposed to drastic changes in fiscal transfers from the federal government. The volume of transfers fell by four percentage points of state GDP between 2002-2013 (14.7%) and 2014-2016 (10.6%), representing a substantial loss of revenue to a state that is highly dependent on this source of financing.[10]

1.8 Although state spending has grown at a slower rate over the last three years (average annual real growth of 1.6% versus 6.5% between 2006 and 2013), this adjustment has been at the expense of public investment. While real annual growth in investment spending averaged 24% from 2006 to 2013, this shifted to a scenario of a 4% annual real contraction from 2014 to 2016. At the same time, current spending as a proportion of the total increased from 81% to 86% over the period analyzed. Although Piauí fulfills all of the requirements established under the Fiscal Responsibility Act, employment costs stand at 54% of liquid current revenue, which is above the prudential limit of 46.5% and close to the maximum level of 60% (Fiscal Performance in Piauí, 2013-2016).[11]

1.9 The state's primary balance has deteriorated over the last four years, from an average surplus of 1.4% of GDP between 2016 and 2012 to successive annual deficits averaging -0.9% of state GDP in the 2013-2016 period. Debt is low, at approximately 45% of liquid current revenue in 2016—below the average of 70% recorded in the other states and lower also than the 200% of liquid current revenue stipulated in the Fiscal Responsibility Act.

1.10 **Rationale.** The country's macroeconomic difficulties and the State of Piauí's vulnerability highlight the urgency of implementing new interventions to modernize fiscal management in the state, with the objective of balancing the public accounts and consolidating fiscal sustainability. There is also a need for new, complementary approaches aimed at enhancing Piauí's fiscal performance. PROFISCO I-PI placed considerable emphasis on improving tax administration, and it promoted integration of the state revenue authority with other levels of government through implementation of the Sistema Público de Escrituração Digital [Digital Public Accounting System] (SPED). This project will further develop these modernization activities, while also providing support for (i) strengthening public expenditure administration; (ii) leveraging the SPED and digital technologies; and (iii) simplifying tax compliance to improve the business environment.

1.11 The effectiveness and efficiency of public institutions is limited by the hurdles faced by the public employees working in them, as well as by access to information

10 Accounting for 49% of total state revenues in 2016. Within the states belonging to Brazil's northeastern region, Piauí (together with Maranhão) is the most dependent on transfers, and it is the fifth most dependent at the national level.

11 Through Decree 16,474 of March 2016, the government has imposed limits on current expenditure with the objective of balancing the fiscal accounts and creating fiscal space for increased investment.

technologies, the availability of financial resources, and the legal framework (Arenas de Mesa, 2016; Finan et al., 2017). In this sense, Piauí needs to address remaining weaknesses that curtail its fiscal performance. In terms of human resources,[12] the State Finance Department (SEFAZ/PI) has 1,268 permanent staff, but it lacks a human resources database and evaluation methods for managing these staff, as well as procedures for downsizing the administrative labor force; as a result, staff skills and experience cannot be quantified, and staff appointments do not meet the Department's needs. Moreover, SEFAZ employees have low levels of qualifications, with only 46% of staff possessing third-level qualifications. The supply of education and training that would allow SEFAZ employees to obtain higher qualification levels is limited. SEFAZ dedicates only 0.68% of its total budget to staff education and training programs. In terms of incentives, there is a lack of merit-based criteria for deciding appointments to senior positions. Lastly, SEFAZ does not have a staff code of ethics. From 2015 to 2016, only 36% of complaints filed resulted in sanctions, and these had to be based on the Public Employees' Statute and other legal mechanisms (Federal Law 8429/92 and Resolution 666/98 of the Piauí State Audit Office).

1.12 In terms of limitations in technological infrastructure,[13] SEFAZ/PI's equipment consists of approximately 1,200 workstations that are more than nine years old with low processing power (Windows 7 and i3 processor). The Integrated Tax Administration System (SIAT) is operated using desktop systems running Visual Basic, which is an old, out-of-date programming language that is not only costly and complex to maintain but also hinders integration with other systems (Court of Justice, Board of Trade, the Commercial Registry, and the Department of Transportation). Moreover, the current system does not allow the efficient use of wide area networks, which hinders the work routines of SEFAZ/PI users. Lastly, SEFAZ's servers are running at 80% of their maximum storage and processing capacity. Technological developments, shifting security threats, and the growing volume of data from the SPED and the NF-e (Nota Fiscal eletrônica [Electronic Tax Invoice]) mean that there is a need for updates.

1.13 Lastly, with regard to the legal framework,[14] tax legislation is scattered across at least four laws (the ICMS, the tax on motor vehicle ownership (IPVA), the inheritance and gift tax (ITCMD), and miscellaneous fees and taxes) that could be consolidated into a single document; this fact adds complexity to tax administration and complicates the work of auditors, accountants, and taxpayers. There are also four different tax declarations: Guia Nacional de Informação e Apuração do ICMS-Substituição Tributária [National ICMS Information and Verification Guide - Tax Substitution] (GIA-ST); Declaração de Informações Econômico-Fiscais [Economic and Fiscal Information Declaration] (DIEF); Declaração de Informação e Apuração do ICMS [ICMS Information and Verification Declaration] (DIAP); and Sistema Integrado de Informações sobre Operações Interestaduais com Mercadorias [Integrated Information System on Interstate Goods Transactions] (SINTEGRA). These duplications of information and could also be consolidated into a single declaration.

[12] SEFAZ (2017), Technical note on human resources.

[13] SEFAZ (2017), Technical note on technology management.

[14] SEFAZ (2017), Technical note on tax policy.

1.14 A more specific assessment of state fiscal management points to three issues:[15]

1.15 **Fiscal management.** SEFAZ's institutional performance is inadequate[16] due to the low level of development[17] of processes in the areas of governance; strategic management; management of staff, technology, and procurement; and civic responsibility regarding fiscal matters. This is a consequence of:

a. Difficulties in strategic planning and performance evaluation, due to: (i) a limited focus on results-based management; (ii) difficulty in identifying and managing risks in corporate processes; (iii) weaknesses in the instruments that support the project cycle; and (iv) difficulties in developing strategic guidelines and communicating these to staff;

b. Weak performance of human resource management processes,[18] due to: (i) a lack of standardization in most processes, which are generally performed manually; (ii) insufficient ongoing training for employees and knowledge management; and (iii) weaknesses in the instruments for sanctioning employees and promoting satisfactory behavior;

c. Limited effectiveness in the management of information and communication technologies (ICTs) to support decision-making by SEFAZ,[19] due to: (i) outdated software, hardware, and telecommunications infrastructure; (ii) outdated instruments to support strategic ICT management; and (iii) insufficient installed technological capacity to fully exploit the potential of the SPED and NF-e systems; and

d. Low effectiveness and quality of social communication,[20] due to: (i) insufficient integrated information and communication tools for serving citizens; and (ii) the low coverage of fiscal education programs.

1.16 **Tax administration.** Collections performance is limited compared to the potential,[21] while the complexity of tax compliance has an adverse impact on the business environment and harms the state's competitiveness.[22] This is a consequence of:

a. Weaknesses in the tools that support tax policy, given that (i) the legislation involves several legal instruments and is scattered and duplicative, making it difficult to apply and consult; (ii) tax benefits are high and awarded inefficiently,

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[15] MD-GEFIS, February 2017.

[16] In 2015, only 62% of targets were achieved (MD-GEFIS).

[17] Only one of the six dimensions of financial management (information technology management) is highly developed, while the others are still rudimentary (MD-GEFIS).

[18] Of the Department of Personnel Management's 51 macroprocesses, only three have any degree of automation (MD-GEFIS).

[19] Twenty-three percent of complaint calls involve problems in information systems (MD-GEFIS).

[20] In the case of the Sistema Eletrônico do Serviço de Informações ao Cidadão [Electronic Citizen Information System] (e-SIC) communication channel, only 10 of the 1,000 requests attended to were evaluated by citizens (MD-GEFIS).

[21] An average taxation gap in the ICMS of 34% of potential collections over the 2009-2012 period (MD-GEFIS).

[22] Piauí ranked 24th out of the country's 27 states plus the Federal District of Brasília in the 2016 Competitiveness Ranking, scoring 34.5 compared to an average of 50.3% for the other states.

as there are no adequate procedures for analyzing and monitoring them;[23] and (iii) it is difficult to estimate tax evasion;

b. Weaknesses in the planning, execution, and evaluation of inspection, fiscal intelligence, and audit actions,[24] due to: (i) weaknesses in generating information from different sources to support taxpayer selection and management; (ii) outdated technological infrastructure for the control of transported merchandise at inspection points; and (iii) the difficulty of generating information for data mining procedures for fiscal intelligence, due to inadequate modern tools and technologies;

c. Low effectiveness in SEFAZ/PI's administrative collections, as a result of: (i) weaknesses in generating the information needed to carry out billing and collection procedures; (ii) manual billing and collection of declared taxes and manual processing of ancillary obligations; (iii) low degree of standardization and insufficient information for refunding tax credits owed to taxpayers; and (iv) weaknesses in the large-scale cross-matching of data generated by the tax authorities with other sources of information (financial, banking, property, businesses, and other levels of government) to identify assets or claims that can ensure that debts are recovered;

d. Slow, inefficient[25] management of tax litigation,[26] due to: (i) a lack of integrated information for effectively and transparently managing billing processes relating to the debtor portfolio; and (ii) difficulty for taxpayers of obtaining information regarding their debts and of handling the associated processes due insufficient information provided by the SIAT;

e. Deficiencies in taxpayer services, due to: (i) the poor quality and limited standardization of service procedures, and (ii) a high proportion of in-person services, which leads to considerable delays;[27] and

f. Tardiness in registering taxpayers, modifying the information of companies, or removing them from the registry;[28] complexity and duplication of tax declarations; and difficulties in the process of importing goods.[29]

1.17 **Public expenditure management.** A number of weaknesses lead to marked discrepancies between the priorities established in planning instruments (Multiyear Execution Plan), the budget as planned at the beginning of the fiscal year, and the

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[23] Fiscal benefits were equivalent to 17% of potential revenue on average from 2009 to 2012 (MD-GEFIS).

[24] Evasion is estimated to have averaged 21% per year over the last four years, based on just 346 firms (large taxpayers) that were audited (MD-GEFIS).

[25] The percentage of accounts receivable that were recovered in 2015 was just 0.85% (MD-GEFIS).

[26] Piauí takes three years to execute these processes, whereas the average for Brazil is two years (Financial Policy Council (CONFAZ), 2014).

[27] The average duration of an in-person service visit in an agency in Teresina (the state capital) is 80 minutes. Of the 50 services that would ideally be offered online by the tax authorities, only 33 are currently available (MD-GEFIS).

[28] Any changes to the tax registry must be done in person at SEFAZ, and changes are processed manually by SEFAZ employees (MD-GEFIS).

[29] The average time taken to release imported goods is at least 10 days (MD-GEFIS).

budget as effectively executed.[30] This situation reflects an environment that makes it difficult to achieve better results in the areas of fiscal discipline and the efficiency and effectiveness of public spending. The reasons for this are:

a. Inertia and a lack of precision in budget formulation,[31] which also fails to reflect state priorities, due to: (i) a lack of coordination between strategic planning and budget formulation with a multiyear time horizon;[32] and (ii) information generated by the Piauí State Integrated Financial Administration System (SIAFE) is insufficient for integrating and effectively managing budget planning, formulation, and programming;

b. Weaknesses in financial management, due to: (i) a disconnect between financial programming and cash management;[33] (ii) the difficulty of consolidating information for performing cash management procedures; (iii) insufficient automation of contract management for the state procurement of goods and services; and (iv) the difficulty of managing financial applications of the Daily Liquidity Management System (SGLD) due to their weak integration with the SIAFE;

c. Low efficiency and a failure to take advantage of potential savings in public procurement,[34] as a result of: (i) a lack of definition in state procurement planning and policy; (ii) low level of standardization in the products and services procured by the different state departments; (iii) many state suppliers are uncertified; (iv) differences between the departments in the supporting documents used for procurement; (v) use of different prices by different departments for the same goods; and (vi) the information generated by the different departments has not been consolidated, hindering decision-making in procurement;

d. Inefficiencies in public investment management,[35] due to: (i) procedures for the different stages of the investment cycle—particularly that of preinvestment—that either do not exist, are outdated, and/or are not aligned with best practices; (ii) difficulty in prioritizing key state investments due to information and processing gaps in determining investment needs; (iii) the lack of a portfolio of strategic medium-term investment projects that have been subjected to rigorous evaluation; (iv) difficulties in preparing projects and

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[30] The average deviation between the planned budget and the executed budget was 13% between 2012 and 2016 (i.e. execution of US$2.8 billion was planned, but US$3.2 billion was effectively executed). The international standard—as established in the Public Expenditure and Financial Accountability (PEFA) methodology—is for a maximum of 5% (MD-GEFIS).

[31] There were 5,353 supplementary budget items in 2016 for US$1.6 billion (R$5.1 billion), equivalent to 56% of the budget as initially approved (MD-GEFIS).

[32] Of 1,696 outputs prioritized in the Multiyear Execution Plan for 2016-2019, only 64% received budget funding in 2017. The Multiyear Execution Plan is not updated during the period it is in force.

[33] The commitment often occurs at the same time as settlement and payment (MD-GEFIS).

[34] There are high and differentiated costs in public procurement, and procurement processes are slow. For example, some departments buy bottled water at a price that is 46% higher than the market price, and there are differences of as much as 51% in purchase prices for the same bottled water between the different state agencies. The average time taken to complete a bidding procedure is one year, compared to an appropriate time scale of 60 days, according to Tenders Law 10,520 of 2004 (MD-GEFIS).

[35] Delays in executing projects in the 2013-2017 period were around 400% of the time frames stipulated in the contracts (MD-GEFIS).

prefeasibility/feasibility studies owing to a lack of methodologies and guidelines; and (v) weak knowledge of public investment management among departmental staff due to a lack of specialized training in this area;

e. Accounting information does not provide a sufficient basis for decision-making,[36] as: (i) accounting is still not completely consistent with the Brazilian Accounting Standards Applied to the Public Sector (NBCASP); (ii) information regarding movable assets and real property is not included in the accounting system; (iii) time is wasted and mistakes occur in bank reconciliation, which is performed manually; and (iv) difficulties in the year-end closing of accounts because information is scattered across different systems (SIAFE, SIAT, Debt, and Assets); and

f. Weaknesses in managing state public debt, because: (i) there is no management control of loans taken on by the state; (ii) SEFAZ does not participate in loan negotiations, nor does it perform ex ante analyses of contract terms and conditions; (iii) the criteria for authorizing loans and carrying out transactions are not clearly defined or divulged; (iv) there is no medium-term debt management strategy to guide loan agreements; (v) debt recording and management is done on Excel spreadsheets with inadequate security; and (vi) there are no mechanisms for identifying and promoting mitigation of the impact of fiscal risks (e.g. contingent liabilities and pensions) that could affect the debt path.

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 under the National Fiscal Administration Program for the Brazilian States (PNAFE, operation 980/OC-BR) and the Fiscal Management Modernization Program for the State of Ceará (loan 2044/OC-BR). It also supported the São Paulo Program to Support the Management and Integration of Finance Administrations in Brazil, the Program to Support Fiscal Management Modernization and Transparency in the State of Bahia, and fiscal consolidation programs for the States of Amazonas, Alagoas, Bahia, Pernambuco, and Rio Grande do Sul. With respect to other levels of government, it supported the Fiscal Modernization Project for the Federal Revenue Authority and the National Program to Support the Administrative and Fiscal Management of Brazilian Municipalities (PNAFM I, II, and III).

1.19 Based on the midterm evaluation of the PROFISCO I CCLIP,[37] the ratio of ICMS collections to GDP grew at a faster rate in states with PROFISCO projects at an advanced stage of execution than in states where execution was at a low level. From 2009 to 2013, the difference in collections between the two groups averaged 6%. A final evaluation of PROFISCO I-PI (loan 2308/OC-BR) indicated satisfactory project performance. One hundred percent of project funds were disbursed in the 2010-2016 period. PROFISCO I-PI (loan 2308/OC-BR) has contributed to growth in tax revenues[38] (mainly through introduction of the Digital Public Accounting System

[36] There is no knowledge whatsoever of the real value of public assets, which hinders the more effective management of nontax revenues (MD-GEFIS).

[37] Operation BR-X1005.

[38] These grew by approximately US$200 million between 2009 and 2016.

(SPED),[39] particularly the electronic tax invoice (NF-e), and improvements in inspection activities based on audits and a data warehouse), as well as to improved control and transparency in public spending (with implementation of SIAFE),[40] and an improvement in taxpayer satisfaction (through an increase in the number of services available on the Web and creation of a virtual service agency.[41]

1.20 **Lessons from the Bank's operations in the country.** The main lessons from previous operations that have been considered for this project—including those under PROFISCO I-PI (loan 2308/OC-BR)—are:

a. The need to address the problem of fiscal management through comprehensive actions, and the lack of a tool for identifying innovative solutions based on best practices, to support the design of fiscal modernization operations. To address this lesson learned, the Model for Evaluating the Status and Performance of Fiscal Management (MD-GEFIS) was developed. This evaluation facilitates the identification of areas that need strengthening. Its results will be used as a baseline for project monitoring and evaluation.

b. In terms of achieving results, the product that contributed most to enhancing the efficiency of fiscal controls in the states was the SPED, including the NF-e, the Digital Fiscal Information System (EFD), and the Digital Accounting System (ECD).[42] This operation will invest heavily in further developing and exploiting the full potential of the SPED, expanding the use of the information that it generates to automate fiscal audits,[43] simplify tax obligations, and improve public procurement,[44] leveraging the new technologies of the digital economy to this end.

c. Execution of the operations required management tools to compensate for delays in implementation. To this end, the Bank developed a monitoring tool as part of the PROFISCO I CCLIP, known as the Plan for Excelerating Execution, which will be used to support this project in tandem with the Bank's formal instruments. This plan uses the project monitoring report to identify outputs that have been subject to delays in execution, together with the names of those responsible for them; it then prepares mitigation measures and monitors progress in these interim indicators until execution returns to normal.

1.21 **Bank experience in other countries in the region.** The Bank's recent experiences in the area of tax administration reform in Ecuador (loan 3325/OC-EC), El Salvador (loan 3852/OC-ES), Guatemala (loan 3786/OC-GU),

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[39] A digital system that facilitates the integrated electronic transmission of companies' accounting and fiscal books and documents across the three levels of government. The number of companies using the SPED rose from 14 in 2014 to 1,500 in 2016.

[40] SIAFE has evolved from a first- to a third-generation system (Grupo de Gestores das Finanças Estaduais, 2017).

[41] The rate of ESAFAZ user satisfaction rose from 62% in 2008 to 85% in 2016, while the number of virtual services rose from five in 2009 to 33 in 2016 (MD-GEFIS).

[42] McKinsey (2014): The NF-e and SPED have helped to reduce informality in Brazil's job market over the last ten years, from 55% to 40%.

[43] The use of the SPED together with artificial intelligence will increase the chances of identifying tax fraud (Araujo, 2013).

[44] Conselho Nacional de Secretários de Estado da Administração [National Council of State Administration Secretaries], 2016.

Honduras (loan 3541/BL-HO), Jamaica (loan 2658/OC-JA), and Peru (3214/OC-PE); in the modernization of financial management systems in Guatemala (loans 2050/OC-GU and 2766/OC-GU), and Guyana (loans 1550/SF-GY and 1551/SF-GY), Honduras (loan 2032/BL-HO); and in public investment management in Argentina (loan 3835/OC-AR), Bolivia (loan 3534/BL-BO), Chile (loan 1281/OC-CH), Ecuador (loan 2585/OC-EC), México (2550/OC-ME), Paraguay (loan 3628/OC-PR), Panama (loan 2568/OC-PN) and Peru (2703/OC-PE) have been taken into account in this operation, and some of the lessons learned are described below, together with the international evidence.

1.22 **International evidence.** The empirical evidence demonstrates the need to establish strong fiscal institutions to consolidate a supportive environment for fiscal sustainability.[45] Banerjee et al. (2017) find that execution costs for a public program are reduced when the government relies on an electronic platform for distributing benefits. Dhaliwal and Hanna (2014) find that automated programs for monitoring processes, associated with staff attendance/assistance, can improve efficiency in the use of public resources and improve the quality of public services. Arenas de Mesa (2016) summarizes evidence showing that management, together with fiscal transparency and responsibility, helps to strengthen fiscal institutions—one of the four dimensions of the public finances that contribute to fiscal sustainability.

1.23 On the tax side, recent evaluations show that the collections performance depends to a significant extent on the institutional strengthening of tax administrations in terms of their organizational structure, processes, and supporting instruments: (i) improving access to available information,[46] and the quality of the latter; (ii) performing inspection activities based on the intensive use of information;[47] (iii) simplifying procedures to facilitate tax compliance;[48] and (iv) determining strategies for ensuring that human resources are both optimized and motivated.[49] Several tax administrations in Latin America have strengthened these elements—particularly Brazil and Uruguay.[50]

1.24 In addition, in terms of the efficiency and effectiveness of spending, a variety of studies point to the need to establish an expenditure management system that takes a multiyear approach to budget formulation, such as the medium-term budget framework.[51] Most member countries of the Organization for Economic Cooperation and Development have implemented this tool, along with several countries in Latin

[45] Poterba, James M., and Jürgen von Hagen. *Fiscal Institutions and Fiscal Performance*. University of Chicago Press, 1999. Alesina, Alberto, et al. *Budget institutions and fiscal performance in Latin America*. Journal of Development Economics 59.2 (1999).

[46] Evasion rates are eight times higher when the tax administration lacks automated tools for verifying taxpayers' sources of income (Slemrod et al., 2015; Pomeranz, 2015; Kleven et.al., 2011).

[47] Almunia and López Rodríguez, 2016.

[48] This can lead to increases of up to four percentage points in payment rates (Hallsworth et al., 2014).

[49] Incentive arrangements for collections staff generate rates of return of between 35% to 51% (Khan et al., 2016).

[50] Project Completion Report (loan 1783/OC-UR). The Tax Management Support Program increased the tax burden by two percentage points between 2006 and 2012.

[51] World Bank (2013: 8; 1998: 32).

America.[52] Those countries with a medium-term budget framework tend to be more effective in achieving their fiscal targets.[53]

1.25 The economic and social impact of investment spending depends on its efficiency.[54] An estimated 30% of potential public investment benefits are lost due to inefficiencies in management processes.[55] In Latin America, the countries with the most developed national public investment systems have the highest rates of efficiency.[56]

1.26 **Bank's strategy with the country.** The project is aligned with the IDB Country Strategy with Brazil 2016-2018 (document GN-2850), as it promotes an improvement in the business climate and in the efficiency of public resource management.

1.27 **Strategic alignment.** The project is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008), and is strategically aligned with the development challenge of productivity and innovation in that it reduces collection costs.[57] It is also aligned with the crosscutting theme of institutional capacity and the rule of law, as it aims to strengthen tax systems[58] and public resource planning and management systems.[59] The program supports the Corporate Results Framework 2016-2019 (document GN-2727-4), through the following indicators: (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. It is also aligned with the Sector Strategy for Institutions for Growth and Social Welfare (document GN-2587-2), and it is consistent with the Sector Framework Documents for Fiscal Policy and Management Sector (document GN-2831-3) and Decentralization and Subnational Governments (document GN-2813-3), in the following dimensions: (i) improving the efficiency and quality of expenditure and service delivery; (ii) increasing tax collections; and (iii) fostering greater transparency and accountability.

B. Objectives, components, and cost

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

1.29 By boosting performance in the public finances, increasing tax collections, enhancing public spending efficiency, and improving the fiscal sustainability of the State of Piauí, citizens will benefit from the improved delivery of quality services. This operation will finance the following components:

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52 World Bank (2013: 1); IDB (2009).

53 IMF (2013); World Bank (2013).

54 Calderón and Servén (2004); Gupta et al. (2014); IMF (2014).

55 IMF (2015).

56 Armendariz and Contreras (2016).

57 Outcome indicator 2 of the results matrix.

58 Impact indicator 2 of the results matrix.

59 Outcome indicator 3 of the results matrix.

1.30 **Component I. Fiscal management and transparency (US$22.86 million).** This component seeks to improve SEFAZ/PI's institutional performance by further developing its corporate processes. It will finance:

a. **Improvements in results-based fiscal management.** This includes: (i) new automated procedures to support results-based management; (ii) a methodology for risk management to support planning; (iii) creation of a project management office and a process management office as part of the public investment system; and (iv) updating of SEFAZ's strategic and communication plans;

b. **Strengthening of human resource management.** This includes: (i) new automated procedures for skills-based human resource management; (ii) ongoing training program; (iii) new knowledge management model; and (iv) introduction of instruments to uphold staff conduct, including procedural manuals and a code of ethics;

c. **Strengthening ICT governance.** This includes: (i) updating the ICT management model; (ii) reprogramming the SIAT to adapt it to a new technology platform; (iii) updating the ICT Master Plan; and (iv) updating SEFAZ/PI's hardware and software technology platform; and

d. **Improved social communication tools**, through: (i) the redesign of communication procedures; (ii) integration of the service system, managing the information from the different communication channels;[60] and (iii) a broadened fiscal education program.

1.31 **Component II. Tax administration and litigation (US$16.95 million).** This component seeks to enhance efficiency of tax collection and simplify tax compliance. It will finance:

a. **Improvements to the management model for the instruments that support tax policy.** This includes: (i) drafting of a single tax code and implementation of a system to support queries; (ii) updating of the management procedures for awarding fiscal benefits; and (iii) methodology for estimating evasion.

b. **Strengthening inspection activities and fiscal intelligence.** This includes: (i) a methodology for selecting taxpayers for audit; (ii) an automated management system for audits; (iii) the modernization of fiscal and technology infrastructure for controlling goods in transit; and (iv) tools for data mining (big data) and analysis (software, database, etc.).

c. **Improved management of tax proceedings.** This includes: (i) the review and adjustment of management procedures for the first and second stages of the collection process; (ii) integration of the "e-processo" tool with the Court of Justice; and (iii) development of the web portal with search functions for processes, case law, agreements, and minutes.

d. **Improvements in comprehensive taxpayer services.** This includes: (i) the review, adjustment, and standardization of service procedures; and (ii) the

[60] This also allows SEFAZ/PI to communicate with the private sector.

implementation of a management information system based on an expansion in virtual services.

e. **Implementation of administrative processes for collection and recovery**, through: (i) a new collection and recovery methodology; (ii) automated system for managing credits; (iii) updating and automation of nontax revenue; and (iv) automated system for the collection and recovery of declared taxes based on information from the SPED and the DT-e (Domicílio Tributário Eletrônico [Electronic Tax Domicile]), integrating this with the SIAT; and

f. **Strengthening of the business environment.** This includes (i) a new management system for the taxpayer registry, integrating the National Network for Simplification of the Registration and Legalization of Companies and Businesses (RedeSim) and SIAT into the Commercial Registry system; (ii) further developing SPED functionalities with respect to the parameters of the ICMS and the IPI (tax on manufactured goods); (iii) integrating the SIAT into the Single External Trade Portal in order to centralize and automate tax payments; and (iv) simplification of the import system and procedures used by individual taxpayers.

1.32 **Component III. Financial management and public expenditure (US$8.67 million).** This component seeks to support fiscal discipline and increase the efficiency and effectiveness in public spending. It will finance:

a. **Implementation of a medium-term budget framework that integrates planning, fiscal programming, and budget formulation actions.** This includes: (ii) an implementation strategy (general design, sequencing, technical instruments, and changes to organization and rules); (ii) a medium-term fiscal framework that bases macrofiscal programming on fiscal projections and sector limits; (iii) budget programming with a medium-term, multiyear time horizon; and (iv) adjusting the SIAFE to the requirements of the medium-term budget framework, and integrating it with other systems (debt, investment, goods procurement, and contracts);

b. **Improved state treasury management.** This includes: (i) review and adjustment of treasury procedures, integrating these with public procurement procedures; (ii) automated contract management system; (iii) cash management methodology with development of an automated system in the SIAFE; and (iv) integration of SGLD with the SIAFE;

c. **Strengthening of state procurement.** This includes: (i) a new procurement policy; (ii) review and adjustment of procurement procedures; (iii) new consolidated product catalog for state procurement; (iv) consolidated registry of certified suppliers; (v) standardization of terms of reference, technical specifications, bidding processes, and contracts; (vi) automated procurement management system integrated into the SIAFE; and (vii) methodology and system for the use of reference prices based on information in electronic tax documents;

d. **Implementation of the public investment management model.** This includes: (i) new procedures and tools for the programming and investment prioritization phase, with a system of indicators for estimating investment gaps and needs; (ii) project preparation tools and methodologies; and (iii) a

management system for the physical and financial monitoring of investment projects;

e. **Strengthening of the budgeting, financial, and asset management elements of the accounting system.** This includes: (i) reviewing accounting procedures and adjusting them to the Brazilian Accounting Standards Applied to the Public Sector (NBCASP); (ii) a management system for movable assets and real property, integrating the data into the asset accounts; (iii) automating bank reconciliation; and (iv) integrating the SIAFE with other state systems;[61] and

f. **Improvements in public debt management.** This includes: (i) updating the rules and procedures for contracting financial liabilities, and a new internal structure for the debt; (ii) develop a medium-term strategy for debt management; (iii) automated debt management system incorporated into the SIAFE; and (iv) a fiscal risk management methodology with tools for identifying, classifying, quantifying, and mitigating the main fiscal risks.

1.33 The project will finance all components, consultancies (individual and consulting firms) in the amount of US$15.7 million; non-consulting services for US$1.2 million; goods for US$26.7 million; training for US$1.7 million; and technology upgrading and remodeling of office spaces for US$3.7 million.

C. Key results indicators

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

1.35 **Economic evaluation.** An economic analysis was performed of the project's economic and financial benefits. Project interventions are expected to result in a real increase in tax collections due to the implementation of measures to modernize tax inspection activities and tax simplification. Using a discount rate of 12%, and based on all of the costs and benefits for five outputs, project investments are expected to generate a net present value of US$24 million by year-end 2027, with an internal rate of return of 50.5%. The results are robust to a sensitivity analysis that considers three additional scenarios: a possible exchange rate devaluation, a reduction in benefits, or a combination of these.

II. Financing Structure and Main Risks

A. Financing instruments

2.1 **Fulfillment of the eligibility conditions for participating in the PROFISCO II CCLIP (operation BR-X1039).** This project is the second individual loan operation under the PROFISCO II CCLIP (BR-X1039). The project meets the eligibility criteria set out in the policy for the CCLIP instrument (document GN-2246-9) and its

61 To attain "Generation Plus" level, six new functions be need to developed and incorporated into the SIAFE (revenue, debt, contracts, goods procurement, assets, and personnel).

guidelines (document GN-2246-11) for individual loan operations, given that: (i) it concerns the fiscal sector and is compatible with all of the components under the PROFISCO II CCLIP; (ii) it is included in the 2017 lending program with Brazil;[62] (iii) SEFAZ/PI (the executing agency for the first individual operation, 2308/OC-BR, the operational phase of which ended in June 2017) will execute the operation on behalf of the state; (iv) the findings of the institutional assessment demonstrate that there has been no deterioration in SEFAZ/PI's capacities, and the same tools used to execute and monitor the last project may be used for this new operation, while the staff of the project coordination unit will also be the same. The Fiscal and Municipal Management Division prepared the final evaluation report for operation 2308/OC-BR with a structure and content similar to a project completion report, based on the new procedures. This evaluation shows that (i) project objectives were achieved in a satisfactory manner; (ii) 100% of the resources were disbursed; and (iii) the executing unit complied with the Bank's contractual requirements and disbursement policies, and its accounts were audited, meeting the required quality standards.

2.2 This operation is designed as an investment loan for specific projects. The total estimated cost of US$50 million will be financed through a loan for up to US$44.93 million funded from the Bank's Ordinary Capital and a local counterpart contribution of US$5.06 million. The distribution of funds by source of financing and category is provided in the table below:

Table 1. Total budget (US$)

Categories	Bank	Local counterpart	Total	%
1. Direct costs	**43,428,000**	**5,065,000**	**48,493,000**	**96.99**
1.1 Component I – Fiscal management and transparency	20,025,184	2,838,500	**22,863,684**	**45.73**
1.2 Component II - Tax administration and litigation	14,855,499	2,096,500	**16,951,999**	**33.90**
1.3 Component III - Financial management and public expenditure	8,547,317	130,000	**8,677,317**	**17.35**
2. Project administration	**507,000**		**507,000**	**1.01**
2.1 Monitoring and evaluation	257,000		257,000	0.51
2.2 Audit	250,000		250,000	0.50
3. Contingencies	**1,000,000**		**1,000,000**	**2.00**
Total	**44,935,000**	**5,065,000**	**50,000,000**	**100.00**
%	**90**	**10**	**100**	

62 An aide-mémoire was signed on 13 November 2017 to update the 2017 lending program with Brazil.

2.3 **Disbursement schedule.** Disbursements will be made over a period of five years, as follows:

Table 2. Disbursement schedule (US$ million)

Sources	Year 1	Year 2	Year 3	Year 4	Year 5	Total
IDB	5.01	12.13	7.57	11.98	8.24	44.93
Local	0.441	1.34	1.41	1.01	0.864	5.06
TOTAL	**5.46**	**13.46**	**8.98**	**12.99**	**9.10**	**50.00**
%	**11.00**	**27.00**	**18.00**	**26.00**	**18.00**	**100.00**

B. Environmental and social risks

2.4 This project has been classified as a category "C" operation, in accordance with the Environment and Safeguards Compliance Policy (Operational Policy OP-703) and the results of the Safeguard Policy Filters. The project will support the strengthening of tax and financial processes through systems development and institutional strengthening; no socioenvironmental risks are therefore anticipated.

C. Fiduciary risks

2.5 The assessment performed using the Institutional Capacity Assessment System (ICAS) led to the identification of three risks that could delay project execution: (i) a high-level risk owing to a lack of clarity in internal workflows for processes (e.g. roles, responsibilities, and time frames). This risk will be mitigated by hiring a consultant to work alongside the parties involved in procurement to prepare the project timeline and recommend actions to optimize administrative procedures; and (ii) a high-level risk owing to the involvement of several departments of the Procuradoria Geral do Estado [Office of the State Attorney General] (PGE/PI) in analyzing procurement processes. This risk will be mitigated by establishing a formal agreement between SEFAZ/PI and the PGE to prioritize the review of PROFISCO II processes. The lack of sufficient knowledge for preparing terms of reference for the planned procurement processes has resulted in a medium-level risk. This risk will be mitigated by hiring a consultant to support preparation of the terms of reference, and funds have been allocated within the project to this end.

D. Other risks

2.6 A risk management workshop was held using the Bank's methodology, and it was determined that the operation is subject to medium-level risks. These are:

a. **Fiscal sustainability.** There is a medium-level risk that the expected project outcomes will not be attained if a deterioration in the country's economic situation interferes in the state's performance, with an adverse impact on the outcome of increasing tax collection. To mitigate this risk, the state adopted preventive measures to ensure fiscal balance by containing expenditure (Decree 16,47409 of March 2016).

b. **Development.** There is a medium-level risk that outputs (such as the medium-term budget framework, investment, and procurement) will not be implemented or that their execution will be delayed due to the need for other departments to participate in their design and implementation. This risk will be mitigated by formally establishing cooperation agreements and creating working groups

with the participation of the different departments involved, establishing the benefits and responsibilities of each.

c. **Public management and governance.** There is a medium level of risk that (i) interruptions will occur or outputs will be discontinued due to new priorities based on possible changes in the direction of state policy after the 2018 elections, leading to execution delays. This risk will be mitigated by an action plan aimed at accelerating the main procurement contracts under the project in 2018; and (ii) project actions are not implemented or are delayed due to possible resistance among SEFAZ/PI staff to the changes promoted by the project. This risk will be mitigated by the following outputs included in the project: (i) change management; and (ii) communication plan.

d. **Monitoring and accountability.** There is a medium level of risk that delays will occur in execution due to weaknesses in planning and difficulties in monitoring the project. This risk will be mitigated by providing training in project management and by the use of automated tools for planning, executing, and monitoring projects.

III. Implementation and Management Plan

A. Summary of execution arrangements

3.1 The borrower will be the State of Piauí, which will execute the project through the Secretaria de Fazenda do Estado do Piauí [Piauí State Finance Department] (SEFAZ/PI). The Federative Republic of Brazil will guarantee the financial obligations associated with the loan. A project coordination unit (PCU) will be created to execute the project, made up of a coordinator and specialists in procurement, finance, monitoring, and planning (with experience in project management). The PCU will coordinate activities relating to project planning, monitoring, evaluation, and audit. SEFAZ/PI is expected to cooperate with the Office of the State Attorney General (PGE/PI), the Office of the State Comptroller General (CGE/PI), the Department of Planning (SEPLAN), and SEADPREV in executing activities that will benefit these bodies. Leads will be appointed in these institutions for the relevant outputs, and these will coordinate their actions with the PCU and ensure technical development and implementation.

3.2 The main functions of the PCU will be: (i) planning the execution of activities; (ii) preparing, implementing, and updating the project operational tools: the program execution plan, annual work plan, procurement plan, and monitoring and evaluation plan; (iii) supervising execution and submitting progress reports; (iv) preparing terms of reference and conducting bidding and procurement processes for goods and services; (v) submitting disbursement requests and documentation of expenditure to the Bank; (vi) preparing financial statements; and (vii) submitting the project evaluation. The borrower will adhere to the program Operating Regulations approved by the Bank for the PROFISCO II CCLIP, which describe: (i) the eligibility criteria for the projects and products that may be financed; (ii) project execution functions, procedures, and rules; and (iii) operational and contractual relationships between the parties involved in the project.

3.3 **Special contractual conditions precedent to the first disbursement of the loan: (i) the borrower's adherence to the program Operating Regulations previously approved by the Bank for all individual operations under the PROFISCO II CCLIP.** This condition is warranted due to the operational, fiduciary, and institutional responsibility considerations that will need to be regulated for the effective launch and execution of the project. The program Operating Regulations will be a flexible document subject to periodic revision, and it may be modified subject to the Bank's express approval; **and (ii) formation of the PCU and designation of its members.** This condition is warranted as the establishment of the PCU is essential for mitigating the risk of delays in execution, and it will facilitate operational and fiduciary processes under the project to be performed by dedicated staff with the necessary experience.

3.4 **Special contractual condition for execution:** Prior to initiating the execution of activities to develop outputs for the PGE, CGE, SEPLAN, or SEADPREV, SEFAZ/PI will sign a cooperation instrument with these agencies establishing their roles and responsibilities during execution of the respective activities. This condition is warranted due to the need to ensure that the entities benefiting from the activities will cooperate as necessary with SEFAZ/PI (which is responsible for executing the activities), and because the PGE is independent from SEFAZ/PI and is a project beneficiary.

3.5 **Procurement.** Procurement under the project will be carried out in accordance with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-9), the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-9), and the provisions of the procurement plan. No advance procurement or retroactive financing is anticipated.

3.6 **Direct contracting.**[63] In accordance with paragraph 3.10(d) of the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN 2350-9), single-source selection can be used when only one firm is qualified or has experience of exceptional worth for the assignment. The use of single-source selection is therefore planned for the following: (i) government training academies, data processing enterprises, and research centers (eligible under the provisions of paragraph 1.11(c) of the above-cited policies), which have extensive experience and the appropriate infrastructure to train civil servants and offer technical assistance, primarily in the use of new ICTs[64] (ii) the Inter-American Center of Tax Administrations (CIAT), an international agency, owing to its specialization in technical assistance with a view to modernizing the tax administrations of the region; and (iii) the company Logus Sistemas de Gestão Pública, which was hired through a competitive process to develop the SIAFE with funding under PROFISCO I. In developing new SIAFE modules, direct contracting of Logus will reduce the technical risks of integration, execution times, and costs.

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[63] See Annex III, Chapter IV.

[64] These are: (a) the School of Financial Administration (ESAF); (b) the National School of Public Administration of the Ministry of Planning, Budget, and Management (ENAP/MP); (c) government schools of Brazil's states; (d) data processing enterprises of Brazil's states; (e) the Institute for Applied Economic Research (IPEA); and (f) the Institute for Fiscal Studies (IEF).

3.7 **Audited financial statements.** The borrower will submit the project's audited financial statements to the Bank on an annual basis, within 120 days of the end of each fiscal year. SEFAZ/PI will be responsible for contracting the auditing firm, and its terms of reference will be approved by the PCU subject to the prior no objection of the Bank. The project will also be audited by the Piauí State Audit Office, once it meets Bank eligibility criteria.

B. Summary of results monitoring arrangements

3.8 **Monitoring.** This will be based on the (i) program execution plan and annual work plan; (ii) procurement plan; (iii) results matrix; (iv) monitoring and evaluation plan; and (v) progress monitoring report. The PCU will prepare semiannual progress reports for the Bank's approval, covering compliance financial progress and outcome and output targets. The Bank will conduct inspection visits and ex post reviews as part of project monitoring activities.

3.9 **Evaluation.** The project will be evaluated against the annual targets and indicators for the outcomes and outputs included in the results matrix. The monitoring and evaluation plan includes midterm and final evaluations conducted by an independent agency. Should the Bank deem it necessary, the borrower will prepare a midterm evaluation report for submission to the Bank within 90 days of the date on which 50% of the proceeds have been disbursed, or after 36 months of execution, whichever occurs first. Within 90 days of the final disbursement date, it will also submit a final evaluation to the Bank to be used as an input for the project completion report.

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; and ii) enhance efficiency in the management of public resources.
Country Program Results Matrix		The intervention is not included in the 2017 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	**8.8**	
3.1 Program Diagnosis	3.0	
3.2 Proposed Interventions or Solutions	2.8	
3.3 Results Matrix Quality	3.0	
4. Ex ante Economic Analysis	**8.5**	
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	4.0	
4.2 Identified and Quantified Benefits	1.5	
4.3 Identified and Quantified Costs	1.5	
4.4 Reasonable Assumptions	0.0	
4.5 Sensitivity Analysis	1.5	
5. Monitoring and Evaluation	**9.1**	
5.1 Monitoring Mechanisms	2.5	
5.2 Evaluation Plan	6.6	
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	Yes	
Mitigation measures have indicators for tracking their implementation	Yes	
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. Procurement: Information System.
Non-Fiduciary	Yes	Strategic Planning National System, Statistics National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Gender Equality		
Labor		
Environment		
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 Piauí, to design the project and to monitor future performance against the baseline.
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan	Yes	There will be an impact evaluation for the entire CCLIP and for the individual project of Piauí. The evaluation will contribute to closing knowledge gaps by providing empirical evidence of the effectiveness of the PROFISCO projects on raising tax revenues at the state level in Brazil, and particularly on the effect that digital technologies and futher automation of electronical fiscal documents can have on the level of tax collection.

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

The main goal of the operation is to contribute to the fiscal sustainability of the State of Piauí. To achieve this end, the project profile 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 the second child of a series of operations under the Conditional Credit Line for Investment Projects (CCLIP) parent BX-L1502.

The project profile diagnoses a primary balance of -0.79 percent of the State PIB in 2016 (Secretariat of Finance, 2016). The diagnosis quantifies gaps in physical and human capital allocated to fiscal management. It also describes the relevant legal framework. The diagnosis includes a review of over 145 processes in the three main areas and eighteen subareas. The diagnosis relies on information provided by the Maturity and Performance of Fiscal Management (MD-GEFIS) tool.

The economic analysis provides a quantification of three types of benefits. First, it quantifies the additional revenue expected to result from the investment. Under a social perspective, additional tax revenue is usually assumed neutral. Second, it quantifies savings through technological tools which allow for efficiency gains to the state. Third, it quantifies savings to firms which reduce costs in fulfilling tax obligations. Thus, quantified benefits are a mix of added revenue to the State and social benefits. The costs include investment and maintenance. The analysis estimates a net present value for the operation of US$25 million.

The results matrix includes 16 product indicators, 3 results indicators, and 3 impact indicators. Most indicators rely on reports and verification by the Secretariat of Finance. The ex post evaluation consists of estimating the effects of the program on tax revenue. It aims to assess the impact through administrative data and a synthetic-controls methodology.

RESULTS MATRIX

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

EXPECTED IMPACT

Indicator	Unit of measurement	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
<u>IMPACT 1:</u> Decrease in the ratio of the state's primary fiscal deficit to GDP											
Primary balance/GDP	% (R$)	-0.79	2016	-1.71	-0.63	-0.44	-0.11	-0.10	-0.10	SEFAZ Economic and Fiscal Studies Unit (NEEFI)-Superintendency for Expenditure report	**Calculation method:** Primary balance as a percentage of GDP **Baseline:** -0.79 Primary balance (2016) = -R$356 million GDP (2014) = R$44.585 million
<u>IMPACT 2:</u> Increase in the ratio of the state's tax revenue intake to GDP											
Tax revenue intake/GDP-PI	%	10	2016	10	10	10.2	10.5	10.8	11.0	SUPREC-SEFAZ Revenue Division report	**Calculation method:** Tax revenue intake at end of project as a percentage of GDP for the corresponding year **Baseline:** Tax collection (2016) = R$4.094 million GDP (2016) = R$40.909 million
<u>IMPACT 3:</u> Decrease in the ratio of the state's net current debt to GDP											
Net current debt/GDP-PI	%	0.08	2016	0.05	0.09	0.08	0.05	0.05	0.05	SEFAZ/NEEFI-Superintendency for Expenditure report	**Calculation method:** Net current debt as a percentage of GDP **Baseline:** 45% Net current debt (2016) = R$3.424 million GDP (2014) = R$44.585 million

EXPECTED OUTCOMES

Indicator	Unit of measurement	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
OUTCOME 1: Increase in the number of strategic planning goals met to total planned goals											
Number of goals met/total planned goals	%	62	2016	62	70	75	80	90	90	MD-GEFIS report	**Calculation method:** Number of goals met/total planned goals Baseline: 62% Goals met (2015) = 42% Total goals (2015) = 68%
OUTCOME 2: Decrease in the ratio of tax collection cost to total revenue intake											
SEFAZ operating budget/total revenue intake	%	6.7	2016	6.7	6.2	5.5	5	4.5	4.5	SUPREC-SEFAZ report	**Calculation method:** SEFAZ budget as a percentage of total revenue intake **Baseline:** 6.7% SEFAZ operating budget (2016) = R$269,087,197 Total revenue intake (2016) = R$4,011,109,630
OUTCOME 3: Narrowing of the gap between budget as initially planned and as executed											
Executed budget/ planned budget	%	12.3	2016	12.3	12.3	10	8	6	5	Annual Budget Law (LOA) and State Finance Report	**Calculation method:** 1 – (executed budget / planned budget). **Baseline (2016): 12.3%** Planned budget (LOA) = R$9.234 billion Final budget = R$10.540 billion (planned budget + supplementary items – cancellations)

OUTPUTS[1]

Indicator	Unit of measurement	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of verification	Comments
Component I: Fiscal management and transparency											
1.1 Results-based management model[2] implemented	Model	0	2016	0	0	1	0	0	1	Report generated by the IT system (software)[3] used to support the model's management, Planning and Projects Advisory Office (ASPRO-SEFAZ)	Monitoring and evaluation plan
1.2 Human resources trained	Staff trained	0	2016	50	100	100	100	150	500	Documents issued by Personnel Management Department certifying that training was completed (GEPES-SEFAZ)	Monitoring and evaluation plan
1.3 Technology platform installed	Platform	0	2016	0	0	0	0	1	1	Independent consultant's report issued by the Information Technology and Security Unit (UNITEC-SEFAZ)	Monitoring and evaluation plan
1.4 Integrated IT system for managing communication with citizens implemented	Software	0	2016	0	0	1	0	0	1	System report, Office of the Comptroller General	Monitoring and evaluation plan
Component II: Tax administration and litigation											
2.1 Management model for the instruments that support tax policy implemented	Model	0	2016	0	0	1	0	0	1	Independent consultant's report issued by the Department of Economic and Fiscal Information (GIEFI-SEFAZ)	Monitoring and evaluation plan

[1] Outputs are annual.

[2] Includes: (i) the procedures and business rules that determine its operation; (ii) the supporting application/IT system (software) for its implementation; (iii) training in executing the procedures and operating the software; and (iv) there is often a need to expand processing capacity through additional servers, computers for users, and storage devices due to increased data volume, and to improve communication for remote users.

[3] The application/IT system is the software that provides a set of rules for implementing the conceptual business model.

Indicator	Unit of measurement	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of verification	Comments
2.2 Inspection and mass fiscal intelligence model implemented	Model	0	2016	0	0	0	1	0	1	Taxpayer selection report generated by the SIAT, Inspections Unit (UNIFIS and UNITRAN)	Monitoring and evaluation plan
2.3 IT system to support the management of tax litigation implemented	Software	0	2016	0	0	0	1	0	1	Report on cases submitted electronically for enforced collection generated by the system, Administrative Tribunal for Tax Appeals (TARF) and the Office of the State Attorney General (PGE).	Monitoring and evaluation plan
2.4 Comprehensive taxpayer services via expanded web applications	Applications	33	2016	0	0	5	5	7	17	Reports on services offered electronically, generated directly by the SEFAZ portal, Service Unit (UNICAT-SEFAZ)	Monitoring and evaluation plan
2.5 IT system for administrative collections and recovery implemented	Software	0	2016	0	0	1	0	0	1	Report generated by the software, Department of Collections Control (GECAD-SEFAZ)	Monitoring and evaluation plan
2.6 IT system for tax obligations implemented	Software	0	2016	0	2	0	1	1	4	Report generated by the software, Tax Unit (UNATRI-SEFAZ)	Monitoring and evaluation plan
Component III: Financial management and public expenditure											
3.1 Medium-term budget framework model implemented	Model	0	2016	0	0	0	1	0	1	Report generated by the supporting software, Strategic Planning Superintendency (SUPLE- SEPLAN)	Monitoring and evaluation plan
3.2 IT system for treasury management implemented	Software	0	2016	0	0	1	0	0	1	Cash flow planning report generated by the State Integrated Financial Administration System (SIAFE), Treasury Superintendency (SUTESP-SEFAZ)	Monitoring and evaluation plan

Indicator	Unit of measurement	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of verification	Comments
3.3 State procurement management model implemented	Model	0	2016	0	0	0	1	0	1	Procurement planning and execution report, generated by the SIAFE, Department of Administration and Social Security	Monitoring and evaluation plan
3.4 Public investment model implemented	Model	0	2016	0	0	0	1	0	1	Independent consultant's report submitted by the Strategic Planning Superintendency in the State Department of Planning (SUPLE-SEPLAN)	Monitoring and evaluation plan
3.5 IT system for accounting strengthened	Software	0	2016	0	0	0	0	1	1	Banking reconciliation report generated directly by the SIAFE, Accounting Control Unit (UNICON)	Monitoring and evaluation plan
3.6 IT system for public debt management integrated into the SIAFE	Software	0	2016	0	0	1	0	0	1	Debt monitoring report (contracts and amortizations) generated by the SIAFE, Unit for Management of the State Public Debt and General Expenditures (UNIGED)	Monitoring and evaluation plan

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Brazil
Project number:	BR-L1498
Name:	Fiscal Management Modernization Project for the State of Piauí Second Individual Operation under the PROFISCO II CCLIP
Executing agency:	The State of Piauí, through the Department of Finance (SEFAZ/PI)
Fiduciary team:	Karina Diaz and Santiago Schneider (VPC/FMP)

I. EXECUTIVE SUMMARY

1.1 The institutional evaluation for project fiduciary management was prepared based on (i) the country's fiduciary context; (ii) the findings of the evaluation of the main fiduciary risks; (iii) prior experience under the first PROFISCO operation; and (iv) the results of the ICAS assessment.

1.2 Brazil's national fiduciary systems are robust, facilitating solid management of administrative, financial, control, and procurement processes, consistent with principles of transparency, economy, and efficiency. The development level of the executing agency's systems relating to its planning, organization, execution, and control capacities is considered medium.

1.3 SEFAZ/PI has the legal capacity and experience needed to execute project activities. In recent years, it has implemented projects together with the World Bank and the IDB, including the National Fiscal Administration Program for the Brazilian States (PNAFE) and the Program to Support Management and Integration of Tax Administrations in Brazil (PROFISCO I). It used its own structures for these, with a project coordination unit (PCU) in which one of the three SEFAZ superintendents serves as coordinator.

II. FIDUCIARY BACKGROUND OF THE EXECUTING AGENCY

2.1 SEFAZ comprises three superintendencies (Finance, Taxation, and Management). Additionally, the Corregedoria [Inspector General's Office] and the Technical Assistance Authority are attached to SEFAZ. The project will benefit a number of departments belonging to the aforementioned superintendencies. The Department of Administration and Social Security (SEADPREV), the Department of Planning (SEPLAN), the Office of the State Attorney General (PGE/PI), and the Office of the State Comptroller General (CGE/PI) are also expected to benefit from the project's activities.

2.2 In terms of staffing, the ICAS assessment did not reveal any significant weaknesses in SEFAZ's structure, confirming that there are sufficient, technically

qualified staff to execute the project. In relation to execution, SEFAZ has the PCU team that worked on PROFISCO I.

2.3 With respect to procurement, SEFAZ follows good practices and is fully compliant with the legal and regulatory framework governing public administration in Brazil. Most of the opportunities for improvement that have been identified will be financed as outputs under PROFISCO II, i.e. management model for state procurement, procurement policy, catalog of products and services, standardization of documentation, and reference prices based on fiscal documents. Nonetheless, the following needs have been identified: (i) support in preparing terms of reference, evaluation criteria, budgets, and other preparatory documents for bidding processes; and (ii) documenting and optimizing procurement process flows, definition of roles, responsibilities, resources, and response times. Given the role of the PGE/PI in reviewing procurement processes, it also needs to be included in the aforementioned flow.

2.4 Audit of the executing agency is both internal and external. Internal audit is the responsibility of the CGE/PI, while external audit is performed by the Piauí State Audit Office (TCE/PI). The TCE/PI is not currently eligible to perform external audits of Bank-financed projects.

2.5 Performance under PROFISCO I in Piauí was satisfactory, with 100% of funds disbursed and 16 out of 17 results targets achieved. Nonetheless, the loan period had to be extended by 24 months. One of the main lessons learned concerned the need for monitoring tools to complement Bank instruments. PROFISCO II will have these tools from the beginning.

III. FIDUCIARY RISK EVALUATION AND MITIGATION MEASURES

3.1 The ICAS assessment performed led to the identification of three risks that could delay project execution: (i) a high-level risk owing to a lack of clarity in internal workflows for processes (e.g. roles, responsibilities, and time frames). This risk will be mitigated by hiring a consultant to work alongside the parties involved in procurement to prepare the project timeline and recommend actions to optimize administrative procedures; and (ii) a high-level risk owing to the involvement of several departments of the Office of the State Attorney General] (PGE/PI) in analyzing procurement processes. This risk will be mitigated by establishing a formal agreement between SEFAZ/PI and the PGE to prioritize the review of PROFISCO II processes. The lack of sufficient knowledge for preparing terms of reference for the planned procurement processes has resulted in a medium-level risk. This risk will be mitigated by hiring a consultant to support preparation of the terms of reference, and funds have been allocated within the project to this end.

IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

4.1 The fiduciary agreements and requirements for procurement set out the rules governing the execution of all procurement processes planned under the project.

A. Procurement Execution

4.2 **Procurement of works, goods, and nonconsulting services.** Program-related contracts for works, goods, and non-consulting services subject to international competitive bidding (ICB) will be carried out using the standard bidding documents issued by the Bank. Contracts subject to national competitive bidding (NCB) will be carried out using national bidding documents agreed with the Bank. The review of technical specifications for contracts during preparation of the selection processes is the responsibility of the project sector specialist.

4.3 **Selection and contracting of consultants.** Contracts for consulting services under the project will be executed using the standard call for proposals issued by the Bank. The sector specialist is responsible for reviewing the terms of reference for consulting contracts.

4.4 **Use of country procurement systems.** The country procurement (sub) system approved by the Bank—Pregão Electrónico [reverse electronic auction]—will be used for the procurement of off-the-shelf goods with an estimated cost of up to US$5 million. Any system or subsystem that is subsequently approved will be applicable to the operation. The procurement plan for the operation and its updates will indicate the contracts that will be executed using approved country systems.

4.5 **Advance procurement/retroactive financing.** No advance procurement or retroactive financing is anticipated.

B. Direct contracting

4.6 **Government schools and agencies.** Regarding the organization of Brazil's finance departments, there are a number of agencies responsible for the coordinated building of knowledge, capabilities, and skills of the employees of these agencies. At the federal level, these are: (i) the Escola de Administração Fazendária [School of Tax Administration]; and (ii) the Escola Nacional de Administração Pública [National School of Public Administration] in the Ministry of Planning, Budget, and Management. At the state level, they are (i) government schools for training public employees; and (ii) data processing enterprises, which are responsible for developing IT systems for the states. In accordance with paragraphs 1.11(c) and 3.10 of the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-9), and with a view to ensuring sustainability of the outputs developed and financed under the project, direct contracting of the federal and state agencies responsible for training public employees is anticipated. With respect to the data processing enterprises, these will be contracted to provide IT development services provided that the Bank determines they have sufficient capacity for this purpose and that their costs are compatible with the market.

4.7 **Specialized international agencies.** Consistent with paragraphs 3.10 to 3.15 of document GN-2350-9, direct contracting of the Inter-American Center of Tax Administrations (CIAT), an international organization, is also anticipated, based on its specialization in technical assistance for the updating and modernization of tax administrations.

4.8 **Research centers.** Consistent with paragraph 3.10(d) of document GN-2350-9, direct contracting of the Institute for Applied Economic Research (IPEA) and the Institute for Fiscal Studies (IEFi) is anticipated. In the case of IPEA, this is based on its status as Brazil's most prominent research center, internationally recognized for

its data production and scientific studies. In the case of the IEFi (an agency attached to Spain's Ministry of Finance and Public Administration), as part of its mission of carrying out studies, research, and providing advisory services, it promotes training activities that will help civil servants in the Finance Department benefiting from the project's activities to perfect skills related to their functions.

4.9 **Integrated Financial Administration System (SIAFE).** Single-source selection will be used for a contract estimated at US$1,795,000 with the company Logus Sistemas de Gestão Pública. Logus was hired through a competitive process (quality- and cost-based selection – QCBS) to develop the SIAFE with funding under PROFISCO I. To improve connectivity and integrate state financial and fiscal management, with improved arrangements for payments, procurement, and human resources, among other things, there is a need to develop new modules that were not planned under the initial intervention. Hiring a new company for this purpose would run the risk of losing both integration with the main SIAFE system and the synergies that have been developed in implementing it (learning curve and knowledge of SEFAZ/PI stakeholders). The consequent increase in the development timeline would affect costs and the risk of developing the new modules using different platforms that would then need to be made technologically compatible. Accordingly, an open process would constitute a less efficient alternative, and direct contracting is appropriate based on the guidance set out in paragraph 3.10 (d) of document GN-2350-9.

Table 1. Thresholds for ICB and shortlists with international participants

Method	ICB (works)	ICB (goods and nonconsulting services)	International shortlist (consulting services)
Threshold amount	US$25 million	US$5 million	US$1 million

Table 2. Major procurement processes (US$ million)

Activity	Procurement method	Estimated date of bid/invitation	Estimated amount
Consulting services			
Redesign, automation, and implementation of the procurement system	QCBS	1st half, 2020	2.1
Integration of the SIAFE with other corporate systems	Direct contracting	1st half, 2021	0.5
SIAFE – Personnel Management Module	QCBS	2nd half, 2019	1.5
SIAFE – Debt Management Module	QCBS	1st half, 2019	0.8
Tax Administration System (Web)	QCBS	2nd half, 2018	5.0
Goods			
Inspection equipment	Reverse electronic auction	2020	4.4
Big data	Reverse electronic auction	2020	2.1
Artificial intelligence system	Reverse electronic auction	2019	2.3
IT equipment	Reverse electronic auction	2019	8.6

C. Procurement supervision

4.10 Procurement supervision will be conducted on an ex post basis, except in cases in which ex ante supervision is warranted. Where procurement is executed through the country system, supervision will also be performed by that system.

4.11 The supervision method will be determined for each selection process. Ex post reviews will be conducted every 12 months in accordance with the project supervision plan. 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. Ex post review thresholds

Works	Goods	Consulting Services
NCB and shopping	NCB and shopping	Less than US$1 million

D. Records and files

4.12 Documentation of the process is the responsibility of the PCU, which will maintain the necessary documentation for the purposes of supervision and audit.

V. Financial Management

5.1 **Programming and budget.** SEFAZ/PI, in coordination with SEPLAN/PI, is responsible for planning the execution of activities as envisaged in the multiyear execution plan and the annual work plan. State entities use the following tools: the multiyear execution plan, the Budgetary Directives Law, and the Lei Orçamentária Anual [Annual Budget Law] (LOA). The project budget will be included in the LOA.

5.2 The PCU will ensure that the project budgetary resources—both the Bank's contribution and local counterpart—are budgeted each year as planned and secured for execution consistent with project programming. The budget resources will be recorded in the SIAFE as an external source of funds in the year of execution. The LOA will include the funds necessary for execution in the cases of both the external loan and local counterpart funds.

5.3 **Accounting and information systems.** Government agencies in the State of Piauí use the SIAFE, which was financed with PROFISCO I funds and validated by the Bank. The system has 16 modules and is one of the most advanced (third-generation) in Brazil; it is in the final stages of implementation. The system meets the Bank's requirements in terms of controls, reports, and financial statements, and it will be used for executing PROFISCO II.

5.4 **Disbursements and cash flow.** The project will use the state's treasury system. Expenditures will be subject to the budgetary and financial execution process and will be duly reported in the SIAFE.

5.5 As in the case of PROFISCO I, IDB funds will be administered through an account that will permit the loan proceeds to be identified independently and facilitate bank reconciliation of those funds, including disbursements and payments. The account will be opened in a commercial bank to be determined by the Finance Department.

5.6 Disbursements will be made in U.S. dollars in the form of advances of funds. The exchange rate to be used for the IDB funds will be the rate in effect on the date the funds enter the country.

5.7 Advances of funds will be based on projections of future requirements for a maximum of 120 days and will be made when accounts have been rendered for at least 80% of the previous disbursements.

5.8 Expenditures considered ineligible by the Bank will be repaid from the local contribution or from other sources, as determined by the Bank depending on the nature of the ineligibility.

5.9 **Internal control and audit.** The CGE/PI is the entity responsible for internal audit of the State of Piauí. SEFAZ/PI has an internal audit team that coordinates its activities with the CGE. The team reviews all of SEFAZ/PI's procurement processes, particularly formalization of the process.

5.10 Currently, neither the CGE/PI nor the TCE/PI have integrated information systems. The PGE/PI will receive funding for institutional strengthening under the PROFISCO II tax administration component.

5.11 **External control and reports.** Project financial statements and expenditure eligibility will be subject to annual audit by a Level 1 firm eligible for Bank-financed projects. The TCE/PI is not currently eligible to perform external audits of Bank-financed projects. If the TCE/PI attains eligibility, it will be able to audit the project's financial statements.

5.12 In accordance with the provisions of the Financial Management Guidelines for IDB-Financed Projects, the auditor will submit a report regarding the accuracy of the financial statements and the eligibility of expenditures under the project. The project's audited financial statements will be submitted to the IDB at the latest within 120 days of the end of each SEFAZ financial period, in accordance with the procedures and terms of reference previously agreed with the Bank.

5.13 **Financial supervision.** The activities included in the supervision plan may be amended during project execution in response to changes in risk levels or if the Bank determines the need for additional control measures.

Table 4. Financial supervision activities

		Responsible party	
Nature and scope	**Frequency**	**Bank**	**Executing agency**
Ex post disbursement and procurement review	Annual	Fiduciary team	PCU - External Auditor
Annual audit	Annual	Fiduciary team	PCU - External Auditor
Review of disbursement requests	Periodic	Fiduciary team	
Supervision visit	Annual	Sector specialist and fiduciary team	

VI. Execution Mechanism

6.1 A PCU will be established to execute the project, made up of a coordinator and specialists in procurement, finance, monitoring, and planning (with experience in project management). The main functions of the PCU will be as follows: (i) planning the execution of activities; (ii) preparing, implementing, and updating the project cycle tools: the multiyear execution plan, the annual work plan, the procurement plan, and the monitoring and evaluation plan; (iii) supervising execution and submitting progress reports; (iv) preparing terms of reference and conducting bidding and procurement processes for goods and services; (v) submitting disbursement requests and documentation of expenditure to the Bank; (vi) preparing financial statements; and (vii) submitting the project evaluation. The program Operating Regulations will be prepared, setting out: (i) project execution functions, procedures, and rules; and (ii) the operational and contractual relationships between the parties involved in the project.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/17

Brazil. Loan ____/OC-BR to the State of Piauí. Fiscal Management Modernization Project for the State of Piauí. Second 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 Piauí, 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 Piauí, which constitutes the second individual operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 - Fiscal Management Modernization Program in Brazil – PROFISCO II, approved on __ ____________ 2017 by Resolution DE-__/17. Such financing will be in the amount of up to US$44,935,000, 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 __ ____________ 2017)

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