Board of Executive Directors
No-Objection Procedure
Expires on 5 December 2018

PR-4651
21 November 2018
Original: Spanish
Public
Simultaneous Disclosure

To: The Executive Directors

From: The Secretary

Subject: Brazil. Proposal for an individual loan for the "Fiscal Management Modernization Project for the State of São Paulo – PROFISCO II-SP"

Inquiries to: Cristina Mac Dowell (telephone Country Office in Brazil 5561-3317-4238) or Ana Lucia Paiva (telephone Country Office in Brazil 5561-3317-4256)

Remarks: This is the seventh individual operation financed with resources from the Conditional Credit Line for Investment Projects (CCLIP) for the "Fiscal Management Modernization Program in Brazil – PROFISCO II" (document PR-4546), approved pursuant Resolution DE-113/17.

The Executive Directors are requested to inform the Secretary, in writing, no later than **5 December 2018**, if they wish to interrupt this procedure. If no such communication is received by that date, the attached resolution will be considered adopted by the Board of Executive Directors, and a record to that effect will be made in the minutes of a forthcoming meeting.

Reference: GN-1838-3(6/18), DR-398-18(8/18), GN-2915(2/18), GN-2915-2(8/18), GN-2246-1(7/03), DE-58/03, GN-2246-4(12/06), DE-10/07, GN-2246-7(11/07), DE-164/07, GN-2246-9(9/16), DE-86/16, GN-2564-3(12/11), DE-225/11, PR-4546(11/17), DE-113/17, DE-114/17, PR-4559(12/17), DE-133/17, PR-4560(12/17), DE-132/17, PR-4561(12/17), DE-131/17, PR-4580(6/18), DE-28/18, PR-4593(8/18), DE-45/18

PUBLIC
SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

BRAZIL

FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF SÃO PAULO – PROFISCO II-SP

(BR-L1516)

SEVENTH 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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2. Monitoring and Evaluation Plan
3. Procurement Plan

OPTIONAL

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ABBREVIATIONS

BEC	Bolsa Eletrônica de Compras [Online procurement exchange]
CCLIP	Conditional credit line for investment projects
CF-e	Cupom Fiscal Eletrônico [Electronic tax coupon]
CT-e	Conhecimento de Transporte Eletrônico [Electronic transportation document]
DCA/SP	Departamento de Controle e Avaliação do Estado de São Paulo [São Paulo State Oversight and Evaluation Department]
ECD	Registro Contable Digital [digital book-keeping]
EFD	Escrituração fiscal digital [Digital tax accounting]
e-PAT	Processo Administrativo Tributário Eletrônico [Online tax administration process]
IBGE	Instituto Brasileño de Geografía y Estadísticas [Brazilian Institute of Geography and Statistics]
ICB	International competitive bidding
ICMS	Imposto sobre operações relativas à circulação de mercadorias e à prestação de serviços de transporte interestadual e intermunicipal e de comunicação [Goods and services sales tax]
IEF	Instituto de Estudos Fiscais [Fiscal Studies Institute]
IMF	International Monetary Fund
IPEA	Instituto de Pesquisa Econômica Aplicada [Institute of Applied Economic Research]
IRR	Internal rate of return
IT	Information technology
ITCMD	Imposto de Transmissão Causa Mortis e Doação [Inheritance and gifts tax]
LOA	Lei do Orçamento Anual [Annual Budget Law]
MD-GEFIS	Avaliação da Maturidade e Desempenho da Gestão Fiscal [Fiscal Management Maturity and Performance Assessment]
MEP	Monitoring and evaluation plan
NCB	National competitive bidding
NF-e	Nota fiscal eletrônica [electronic tax invoice]
ONE	Operador Nacional dos Estados [National States Operator]
PCU	Project coordination unit
PGE	Procuradoria Geral do Estado [Office of the State Attorney General]
PROFISCO	Fiscal Management Modernization Program in Brazil
QCBS	Quality- and cost-based selection
RH Folha	Recursos Humanos Folhas [Human resources payroll]
SAT	Sistema Autenticador e Transmissor de Cupons Fiscais Eletrônicos [Electronic tax coupon authentication and transmission system]
SEADE	Fundação Sistema Estadual de Análise de Dados [State Data Analysis Foundation]
SEFAZ/SP	Secretaria de Fazenda do Estado de São Paulo [São Paulo State Finance System Department]
SIAFEM	Sistema Integrado de Administração Financeira para Estados e Municípios [Integrated financial management system for the states and municípios]

SIGEO	Sistema de Informações Gerenciais da Execução Orçamentária [Budgetary execution managerial information system]
SPED	Sistema Público de Escrituração Digital [Digital public accounting system]
SPG/SP	Secretaria de Planejamento e Gestão do Estado de São Paulo [São Paulo State Planning and Management Department]
STN	Secretaria do Tesouro Nacional [National Treasury Department]
TCE/SP	Tribunal de Contas do Estado de São Paulo [São Paulo State Audit Office]
UCSP	Unidade de coordenação e supervisão do programa [Program coordination and supervision unit]

PROJECT SUMMARY

BRAZIL
FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF SÃO PAULO – PROFISCO II-SP
(BR-L1516)

SEVENTH INDIVIDUAL LOAN OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP) FISCAL MANAGEMENT MODERNIZATION PROGRAM IN BRAZIL – PROFISCO II
(BR-X1039)

Financial Terms and Conditions				
Borrower: State of São Paulo			**Flexible Financing Facility**[a]	
Guarantor: Federative Republic of Brazil			**Amortization period:**	25 years
Executing agency: State of São Paulo, through its Finance Department (SEFAZ/SP)			**Disbursement period:**	5 years
			Grace period:	5.5 years[b]
Source	**Amount (US$)**	**%**	**Interest rate:**	LIBOR-based
IDB (Ordinary Capital):	87,120,000	90	**Credit fee**	[c]
Local:	9,680,000	10	**Inspection and supervision fee:**	[c]
Total:	96,800,000	100	**Weighted average life:**	15.25 years[d]
			Currency of approval:	U.S. dollars

Project at a Glance
Project objective/description: The project objective is to contribute to the state's fiscal sustainability by: (i) modernizing fiscal management; (ii) improving tax administration; and (iii) improving public expenditure management. This is the seventh individual loan operation under the PROFISCO II CCLIP (BR-X1039) approved by the Board of Executive Directors through Resolution DE-113/17.
Special contractual conditions precedent to the first disbursement of the loan: (i) The borrower will adhere to the program Operating Regulations previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) the project coordination unit will have been established and its members appointed (paragraph 3.5). **Special contractual condition for execution:** Prior to the start of the execution of activities that will benefit the São Paulo State Planning and Management Department, SEFAZ/SP will sign a legal instrument with that department establishing the roles and responsibilities of the parties during project execution (paragraph 3.6).
Exceptions to Bank policies: None.

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

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

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

[c] The credit fee and 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 applicable policies.

[d] The original weighted average life of the loan may be shorter, depending on the date the loan contract is signed.

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

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

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

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

1.2 **Economic and fiscal situation in Brazil.** Brazil is facing significant challenges in keeping its economy on a sustainable growth path. Its GDP contracted by 3.8% in 2015 and by 3.5% in 2016, and grew by just 1.1% in 2017[1] (IBGE, 2018). Nonetheless, economic recovery is now under way, with expansions projected at 1.9% in 2018 and 2.1% for 2019[2] (IMF, 2018).

1.3 The slackening pace of economic activity caused consolidated public-sector revenue to fall sharply by about three percentage points, from 34.5% of GDP in 2013 to 31.6% in 2017. Public expenditure, however, climbed steadily during this period, going from 37.4% of GDP in 2013 to 41.6% in 2016. The primary balance has deteriorated in recent years from an average primary surplus of 3.4% of GDP in 2002-2008, to 1.3% between 2009 and 2015. The next two years (2016 and 2017) saw primary deficits of 2.5% and 1.9% of national GDP, respectively, and the country is not expected to attain a structural primary surplus again until 2023.[3] Public debt also grew by almost a third in just three years, from 60.2% of GDP in 2013 to 78.6% in 2016; and it is projected to reach 96% in 2023.[4]

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

1.5 As state revenues dwindled, current expenditure continued to grow, fueled by personnel costs that rose from 10.2% of GDP in 2011 to 10.9% in 2015.[6] In contrast, investment dropped by an average of 16% in real terms between 2013 and 2016. As a result, the primary balance began to deteriorate in 2012, and primary deficits were recorded in three of the last four years, with 10 of Brazil's 27 states posting primary deficits in 2016 (National Treasury Department–STN, 2017).

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1 Brazilian Institute of Geography and Statistics (IBGE), 2018.

2 International Monetary Fund (IMF), 2018. In its 18 May 2018 edition, the Focus market report, published by the Central Bank of Brazil, forecasts national GDP growth of 2.5% for 2018 and 3% for 2019.

3 IMF, 2017.

4 IMF, 2018.

5 National Treasury Department (STN), 2016.

6 Rossi, 2016.

1.6 **Fiscal situation in the state of São Paulo** (STN, 2017). The crisis in Brazil affected São Paulo's public accounts and is putting the state's fiscal sustainability at risk. As happened at the national level, real growth of the state's GDP fell from an average of 3.9% per year in 2010-2013 to -2.6% between 2014 and 2016 (IBGE, regional GDP 2002-2015), before staging a slight recovery with an expansion of 1.7% in 2017. Nonetheless, indicators for the first quarter of 2018 point to a slowdown in the economy relative to 2017 (State Data Analysis System Foundation (SEADE), 2018).

1.7 The economic crisis impacted state finances, causing the real growth rate of São Paulo's tax revenues to drop from an average of 2% per year in 2010-2013 to -2.9% between 2014 and 2017. In particular, ICMS revenue, which represents 64% of the state's current income and is strongly correlated with economic activity,[7] shrank sharply from an average of 6.7% of the state's GDP in 2010-2013 to 6.1% between 2014 and 2017. Although the state relies little on federal government transfers (an average of 10.1% between 2000 and 2016), their real growth rate has also fallen steeply in recent years, from 3% between 2010 and 2013 to -1.8% in 2013-2017.

1.8 In response to the drop in income and rise in current expenses,[8] which surged by 4.5% per year between 2010 and 2014, São Paulo adopted current expenditure containment measures, which succeeded in slowing their growth to an average of -1.9% in 2014-2017. These measures also impacted personnel expenses,[9] which dropped from 44% of net current income in 2014 to 43.4% in 2017—below the 60% ceiling set in the Fiscal Responsibility Law. Public investment, which has been used as an adjustment variable, slumped from 1% of state GDP in 2010 to 0.5% in 2017. São Paulo's investment capacity in recent years has been volatile and dependent on borrowing.

1.9 In 2012-2017, the primary balance was positive, but small in relation to state GDP, and it is continuing to decline (from 0.3% of GDP in 2012 to 0.01% in 2017). The consolidated debt represents 171% of net current income, still below the established limit of 200%.

1.10 **Rationale**. Brazil's slow economic recovery and the state's vulnerability highlight the need to implement new fiscal management modernization initiatives, with the aim of balancing the public accounts and consolidating fiscal sustainability. New complementary approaches are also required to bolster the state's fiscal performance. PROFISCO I-SP[10] placed a heavy emphasis on improving tax administration and promoting integration of the state treasury with other levels of government through the Digital Public Accounting System (SPED). This project will build on the modernization efforts under PROFISCO's first phase and will also promote: (i) the strengthening of public expenditure management; (ii) the use of SPED and digital technologies; (iii) simplification of tax compliance to improve the business environment; (iv) improvement of personnel management; and

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7 SEADE, 2018.

8 Decree 62.409/2017 and Decree 63.146/2018.

9 Decree 61.132/2015.

10 PROFISCO I-SP (loan 2331/OC-BR) final status report.

(v) greater predictability in the impacts of fiscal risks, mainly those relating to social security, public-sector companies, and public-private partnerships.

1.11 The effectiveness and efficiency of public institutions are limited by the restrictions faced by public employees, access to information technology, availability of financial resources, and the legal framework (Arenas de Mesa, 2016; Finan et al., 2017). Empirical evidence demonstrates the need for strong fiscal institutions to consolidate an environment that promotes fiscal sustainability (Poterba, 1999).

1.12 In this regard, the São Paulo State Finance Department (SEFAZ/SP) needs to address remaining weaknesses that hinder its fiscal performance. In terms of human resources, SEFAZ/SP has a payroll of 6,200 employees and 784 contract staff, with 48% of the total being close to retirement. Nonetheless, it does not have a management model, nor evaluation methodologies or procedures for determining the size of the workforce, which would make it possible to quantify and ascertain the profiles and composition of its staff. As a result, the allocation of civil servants does not meet current and future needs and does not make it possible to target training on the basis of competencies. In addition, no knowledge transfer or training program has been implemented, which would make it possible to upgrade the skills of staff, based on competencies, and provide a program to develop new leaders. Lastly, the state has multiple human resources management systems responsible for the storage and processing of staff data, including payroll. As these systems are poorly automated, a great deal of manual work is required.[11]

1.13 As regards technological infrastructure constraints, the SEFAZ/SP technology stock has recently been modernized with new computers, upgraded telecommunications, stronger security and further development of corporate portals. Nonetheless, digitalization of the large volume of tax documents (SPED, electronic tax invoice (NF-e) and the consumer electronic invoice) requires ever greater expansion of capacity.[12] The SEFAZ/SP technological platform is still insufficient to meet the need to protect and recover data and information and guarantee its integrity, while also satisfying new demands in terms of technologies and the processing of large volumes of data. There are also deficiencies, restrictions and obsolescence in the software used to monitor networks, servers, and systems, which cause delays in response times and lengthen service processing times. SEFAZ/SP currently has 4,510 terabytes of capacity in specialized high-performance equipment, but this will decrease significantly by 2019, as the equipment reaches the end of its life cycle.[13]

1.14 Lastly, in relation to the legal framework,[14] it has not yet been possible to catalogue, update, and consolidate many regulatory documents; and this makes tax administration more complex and harder for auditors, accountants, and taxpayers to consult. In addition, compliance with ICMS tax obligations requires taxpayers to fill out multiple tax returns, in which some of the information is duplicated, when this could be done through a single return.

[11] Strategic personnel management program.

[12] In 2017, storage capacity grew at a rate of 435 terabytes per month.

[13] SEFAZ/SP information technology platform installed.

[14] Procedures and ancillary obligations simplified.

1.15 There are other major challenges involved in strengthening São Paulo's fiscal sustainability, which were identified during the application of the Fiscal Management Maturity and Performance Assessment (MD-GEFIS) methodology, as well as in the institutional capacity assessment platform report and the Matrix of Problems, Solutions, and Results—the instrument used to define outputs and activities based on the problems and challenges identified, as detailed below:

1.16 **Fiscal management.** SEFAZ/SP's corporate processes related to personnel management, technology, procurement, and internal oversight are underdeveloped and poorly integrated,[15] which limits its institutional performance. The underlying causes of this problem are:

a. **Financial and legal control of public accounts with little value-added for the formulation of sector policies and monitoring of results,** because: (i) audits are not proactive and are not based on a risk analysis of work processes;[16] and (ii) access to the management systems of other state government bodies is limited, and the tools are inadequate for the preventive work of internal control.

b. **Inefficient use of the work force,** owing to: (i) the absence of a personnel management policy aligned with SEFAZ/SP strategic planning and management of the allocation, succession and training plan based on the required competencies; (ii) piecemeal quality of life actions that are unrelated to a diagnostic assessment;[17] (iii) high costs of running face-to-face courses, and low operating capacity and limited territorial scope to meet training needs;[18] and (iv) the need for improvements in property infrastructure.[19]

c. **Weak societal knowledge of tax obligations and public expenditure execution,[20]** owing to a lack of granularity and inadequate coverage of the Tax Education Program for Citizens.[21]

d. **Inefficient management of public procurement in the State of São Paulo,** because: (i) the Online Procurement Exchange (BEC) only uses a lowest-price of purchasing procedure (invitation, auction, and waiver of tender), thereby limiting its use;[22] (ii) there is no system of supplier management and development to improve the public procurement cycle by increasing the

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15 Two of the six dimensions of fiscal management display an initial maturity level, and another two are only intermediate (MD-GEFIS).

16 Audit actions were undertaken in just 172 of the 978 Execution Management Units that were active in 2017, all of which are of a financial and legal nature. Proactive audit and control model implemented.

17 In all, 71% of civil servants express dissatisfaction with their work environment. Strategic personnel management program.

18 Running a distance education course costs about 90% of an equivalent in-person course; and in SEFAZ/SP only 20% of the courses offered are available in distance mode. Strategic personnel management program.

19 The internal spaces of the Treasury Unit in the city of Campinas and the SEFAZ/SP building, which are owned by the State, are inadequate.

20 The public's lack of knowledge of the taxes charged by the government: Poor (38.8%); Very poor (28.9%), and of the areas in which the revenue collected is spent: 86%. Tax Education Program for Citizens implemented.

21 Only 14% of São Paulo's muncípios are impacted by the Tax Education Program for Citizens.

22 Only one third of the total value of state procurements are processed through the BEC. BEC services extended

participation of suppliers registered in the State of São Paulo Unified Suppliers Register (CAUFESP);[23] and (iii) a lack of public procurement planning because there are no general guidelines and systems for procurement, contracting, and stock management (supply cycle).

e. **Insufficient storage and processing capacity to meet current and new demands for information technology and services,[24]** resulting from: (i) the lack of integrated management of information technology solutions; and (ii) insufficient storage infrastructure and data security to respond to technological developments and the increased use of digital systems.

f. **Lack of capacity to incorporate innovation into technological processes and solutions,[25]** owing to: (i) poor incentives for promoting internal innovation and/or seek cutting-edge solutions; and (ii) lack of a model and instruments for innovation management.

1.17 **In tax administration,** revenue performance is below potential,[26] owing to:

a. **High taxpayer compliance costs**, because of: (i) the large number of additional obligations[27] and lack of a global vision of the quantity of ancillary obligations;[28] and (ii) systems for receiving tax data that generate redundancy in the information provided by the taxpayer.

b. **Shortcomings in analysis of the consistency between taxpayers' online fiscal and registry data,** owing to the following: (i) the accreditation systems of the NF-e, the electronic transportation document (CT-e) and digital tax accounting (EFD) are mutually independent, old, and difficult to maintain, which makes them unreliable[29] and not always available; (ii) information from the SEFAZ/SP tax document authorizing environment is not automatically accessible to meet taxpayers' needs; and (iii) the lack of a system to ensure consistency in the information supplied by taxpayers in the national simplified tax regime.

c. **Large number of errors in the receipt of electronic tax coupon (CF-e) batches,[30]** because of: (i) a lack of orientation in the technical specification of requirements of the electronic tax coupon authentication and transmission

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23 Only 10% of registered suppliers participated in a bidding process in 2017. BEC services extended.

24 SEFAZ/SP information technology platform installed.

25 The proliferation of data and information have overloaded and hindered SEFAZ/SP's actions, demanding more data and information processing technology. Innovation management implemented.

26 An ICMS revenue shortfall was estimated at 28% of potential receipts in 2017 (São Paulo fiscal diagnostic assessment). Tax evasion in Brazil represents an estimated 7.6% of national GDP. SINPROFAZ, 2016.

27 São Paulo tax legislation passed between 2013 and 2017. Baseline: 23 Laws; 285 Decrees; 708 Official Notices (*Portarias*); 123 Communications; 142 Resolutions. Procedures and ancillary obligations simplified.

28 Survey conducted by SEFAZ/SP. Number of hours spent complying with ancillary obligations: 9.9 million hours/month, with an estimated annual cost, at current prices, of R$2.2 billion. Procedures and ancillary obligations simplified.

29 Occurrence of 19 identified types of failure in the systems of the electronic tax documents (DFe), in 2017. Electronic tax documents management model implemented.

30 Monthly number of batches with a processing error: 1,217,452 annual; and number of taxpayer complaints due to technical problems: 1,281 messages (21% of total messages received at all levels of service). Electronic tax document authentication and transmission system expanded.

system (SAT); (ii) a failure to observe the technical specification of SAT requirements; (iii) the absence of mechanisms to verify taxpayer errors; (iv) inadequate stress testing mechanisms; and (v) the absence of CF-e custody policies.

d. **Insufficient control over goods in transit,** owing to the absence of mechanisms for tracking cargoes in transit in the state.[31]

e. **Loss of efficiency in data processing for the production of tax intelligence data**, owing to: (i) unreliability of the information available, due to errors and lack of standardization of the data and the existence of a heterogeneous environment that lacks data modeling, integrated governance, security, auditing, and data quality tools; and (ii) technological obsolescence[32] and outdated work techniques being used.

f. **Low collection rate in the inheritance and gifts tax (ITCMD)**,[33] owing to: (i) the nonexistence of a reliable source for consulting real estate market values and the absence of a legal ruling allowing the use of a specific source;[34] and (ii) lack of automation of procedural routines and failure to apply the tax regulations in the business rules of the declaration system.

g. **Loss of revenue due to poor fiscal control exercised on fuel resale outlets**, owing to a lack of capacity to obtain and process data on the volume of fuel sold by the resellers, for the purpose of analyzing the corresponding tax obligations.[35]

h. **Inefficiency in the management of tax claims**,[36] because of: (i) the lack of a structured collection model and insufficient data, indicators, and reports; (ii) the data is fragmented in different databases according to type of collection, and there is poor integration between the different tax claim management systems; and (iii) low quality of taxpayer registers.

i. **Limited capacity of taxpayer services not provided face-to-face**,[37] due to the quality of the content available and call centers with fragmented operations and controls.

j. **Inefficient response to queries on the interpretation of tax legislation**, due to: (i) a deficient and obsolete Tax Consulting system;[38] and (ii) São Paulo's complex tax laws.

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31 Border tax posts were eliminated in 2004. National States Operator integration system implemented .

32 24 forensic software licenses expiring by end-2018.

33 A tax on bequests and gifts.

34 Revenue loss of approximately R$49 million in respect of private pension plan transfers. Impact study in revenue collection system implemented.

35 Estimated ICMS evasion of R$4 billion per year. Evasão Fiscal: A teoria do comportamento dos agentes públicos e privados.

36 Increase in final noncompliance with ICMS adjudicated claims, from 3.87% (2013) to 4.49% (2017).

37 The *Contáctenos* [Contact us] system is obsolete, and roughly 40% of the questions it receives have to be referred up to the third level of service.

38 Average time over the last 12 months for which tax queries wait in line: 55.96 days.

k. **Inefficient tax litigation**, because of: (i) manual routines being used owing to the lack of integration in systems that deal with the tax administration process;[39] (ii) dispersion of databases, making it difficult to prepare management reports; and (iii) lack of integration of SEFAZ/SP's online tax administration process with the system of the Attorney General's Office (PGE) for registration as adjudicated debt.

1.18 **Public expenditure management** suffers from shortcomings that prevent better results from being achieved in terms of tax discipline and efficiency, and the effectiveness of public spending. The causes are:

a. **Risk for the state's financial operations** because the integrated financial management system for the states and municípios (SIAFEM) has the following weaknesses:[40] (i) it is a first-generation system, developed in the 1990s on an outdated platform;[41] (ii) it is difficult to develop new functionalities;[42] and (iii) reports pertaining to the Fiscal Responsibility Law are prepared manually.

b. **Limited visibility of the impacts of fiscal risks**, due to the nonexistence of management tools that identify, measure, and estimate the probability of occurrence and incorporate the materialization of contingent liability risks.

c. **Inefficiency in the payroll payment process**, due to: (i) the multiplicity of civil servant register systems in use by the various state bodies, which makes it possible to adopt different criteria for the same situation;[43] (ii) manual processes with excessive paper flow causing errors and expenses with improper payroll payments; (iii) difficulty in centralizing information for the purpose of compliance with labor obligations (*e-Social*); (iv) lack of a reliable database to support strategic decisions; and (v) impossibility of adopting standard rules in payroll processes, which makes it possible to generate identical benefits paying different amounts.[44]

d. **Insufficient information on the costs of public services**, due to the limited coverage of the cost system, which has only been implemented in two state bodies.[45]

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39 Average time for processing litigation: over 27 months and increasing. Procedures and ancillary obligations simplified.

40 Financial management system implemented.

41 Report issued by the Financial Law and Regulation Research Group (GEFIN).

42 SIAFEM has only nine of the 25 possible submodules.

43 Only 48% of bodies/entities are included in the Unified State Payroll.

44 Unified Human Resources Management System implemented.

45 Prison Administration Department and Casa Foundation. Public services cost system expanded.

1.19 **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) (980/OC-BR) and the PROFISCO I CCLIP (loan BR-X1005). It also supported the Fiscal Modernization Project in the State of São Paulo, the Program to Support Fiscal Management Modernization and Transparency in the State of Bahia (loan 1727/OC-BR), and fiscal stability consolidation projects in the states of Amazonas, Alagoas, Bahia, Pernambuco, and Rio Grande do Sul.[46] At other levels of government, the Bank supported the Brazilian Federal Revenue Service Fiscal Modernization Program (Federal Revenue Secretariat–SRF, 1996) and the Fiscal Management Program for Brazilian Municipalities (PNAFM loans I/1194/OC-BR, II/2248/OC-BR and III/3391/OC-BR).

1.20 The midterm evaluation of the PROFISCO I CCLIP showed that ICMS tax revenue intake as a share of GDP rose by more in states with a PROFISCO project in which execution was further along than in those where the level of execution was low. Between 2009 and 2013, this difference in intake averaged 6%. It was found that the SPED, including the NF-e, digital tax accounting (EFD), and digital book-keeping (ECD), did the most to enhance the efficiency of fiscal controls in the states.[47]

1.21 Similarly, a final evaluation of PROFISCO I-SP rates the project's performance as satisfactory, with 100% of the four impact targets and 75% of the 12 outcome targets being attained.[48] The project's achievements include an increase in ICMS revenue intake from retail trade, which grew from US$1.76 billion in 2009 to US$2.962 billion in 2016, resulting from implementation of the NF-e, digital book-keeping (ECD), and CT-e, and the use of tax documents in audits. In addition, a cost system was developed, which made it possible to determine the costs of the Prison Administration and Education Departments; and the public procurement system was upgraded.

1.22 **Lessons learned.** The main lessons learned from the PROFISCO I CCLIP include:

a. The need to tackle fiscal management issues through comprehensive actions, together with an instrument to identify these innovative solutions, taking account of best practices, which can support the design of fiscal modernization operations. The Fiscal Management Maturity and Performance Assessment (MD-GEFIS) was developed for this purpose, making it possible to identify the areas that need strengthening activities. The results of its application will be used as a baseline for project monitoring and evaluation.

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46 Policy-based loans: 2081/OC-BR; 2841/OC-BR; 2850/OC-BR; 3039/OC-BR; 3061/OC-BR; 3138/OC-BR; and 3139/OC-BR.

47 McKinsey & Company, 2014: NF-e and SPED increased the risk of identification for evaders and contributed to a reduction in employment informality in Brazil over the last 10 years (from 55% to 40%).

48 The first outcome—reduction in average in-person service time—was not achieved owing to a strike by SEFAZ/SP employees. The ninth and tenth outcomes, concerning sophistication of the management of information technology services and projects, were not evaluated because information was not available.

b. The PROFISCO I project completion report highlights the following: (i) the importance of continuing to invest in technological innovation, so this operation will continue to develop SPED and seek to exploit its potential, expanding use of the data that it generates to automate the tax audit, simplify tax obligations, and enhance public procurement, among other issues, leveraging the new digital technologies; (ii) the need for strategies to avoid the obsolescence of technological solutions, for which the project envisages actions to update and implement an information technology master plan for medium-term planning and maintenance of the software and hardware infrastructure; (iii) the importance of advance planning to implement complex products, so in this project an agreement has been reached with the executing agency for technical specifications and terms of reference, mainly of technological innovation products, to be prepared before the startup mission with support from specialized consulting services; (iv) the importance of more effective knowledge transfer in relation to software developed by external consultants, for which the executing agency favors including a clause in the development contracts giving SEFAZ/SP access to source code; and (v) the difficulty of evaluating projects with very many and heterogeneous indicators, so individual PROFISCO II projects will have a single outcome indicator for each component, common to all operations

c. In particular, PROFISCO I-SP obtained a 24-month extension, and it was recognized that the negative factors involved mainly the following: (i) difficulty preparing terms of reference and technical specifications; (ii) the bidding committee and oversight bodies did not have sufficient knowledge of Bank procurement policies and regulations; and (iii) complexity in the technical acceptance of the outputs as a result of the approval flows. Accordingly, the project has included actions to: (i) contract specialized consulting services to support the preparation of terms of reference and bidding documents; (ii) provide training for all actors involved in the procurement process; and (iii) redesign internal information flows between the Project Coordination Unit (PCU) and other SEFAZ/SP technical areas for output delivery.

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

1.24 In terms of taxation, tax-collection performance is highly dependent on institutional strengthening in the tax administration and its organizational structure, processes, and supporting tools: (i) improving the accessibility and quality of the information available;[49] (ii) implementing information-intensive inspection models;[50] (iii) simplifying procedures to facilitate tax compliance;[51] and (iv) defining strategies to ensure the suitability and motivation of staff.[52] Several Latin American tax administrations have strengthened these elements, particularly Brazil and Uruguay.[53] In terms of financial management strengthening, the available evidence shows that automating without improving processes does not produce the expected results.[54]

1.25 **The Bank's country strategy.** The project is aligned with the country strategy with Brazil 2016-2018 (document GN-2850) in relation to improving the business climate and making management of public resources more efficient. The operation is included in the Update of Annex III of the 2018 Operational Program Report (document GN-2915-2).

1.26 **Strategic alignment.** The project is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008). It is also strategically aligned with the development challenge of productivity and innovation, through reducing tax collection costs,[55] and with the crosscutting area of institutional capacity and rule of law, through the strengthening of tax systems[56] and public resource management and planning systems.[57] The project contributes to the Corporate Results Framework 2016-2019 (document GN-2727-6) via the indicators for: (i) percent of GDP collected in taxes; and (ii) government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery, through strengthening of the e-Fisco state revenue system; (iii) accountability institutions strengthened; and (iv) subnational governments benefited by decentralization, fiscal management, and institutional capacity. Lastly, the project is aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) and consistent with the following Sector Frameworks: Decentralization and Subnational Governments (document GN-2813-8) and Fiscal Policy and Management (document GN-2831-3), in the dimensions of: (i) improving the efficiency and quality of expenditure and service delivery; (ii) improving own revenue collection; and (iii) working with greater transparency and accountability.

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

50 Almunia and López Rodriguez (2016).

51 Hallsworth et al. (2014).

52 Khan et al. (2016).

53 Project completion report of loan 1783/OC-UR. Barreix and Zambrano (2018).

54 Project completion reports for loans 1550/SF-GY and 1551/SF-GY.

55 Outcome indicator 2 of the Results Matrix.

56 Impact indicator 2 and Component II output indicators of the Results Matrix.

57 Outcome indicator 3 and Component III output indicators of the Results Matrix.

B. Objectives, components, and cost

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

1.28 **Beneficiaries.** By enhancing the performance of public finances, increasing tax revenue intake, and increasing the efficiency of public spending, greater fiscal sustainability of the state will benefit its citizens, firms, and individual taxpayers, and public and nongovernmental entities, through better service delivery, better facilities and lower costs in tax compliance, and greater availability of information and data for public management and transparency in public accounts. The project will finance the following components:

1.29 **Component I. Fiscal management and transparency (US$49,203,415).** This component seeks to improve management instruments and modernize the technological infrastructure, while also enhancing the transparency of SEFAZ/SP's relationship with society and improving its institutional performance. The component will finance the following activities:

a. **Proactive audit and control model,** through: (i) redesign of proactive monitoring and control processes based on risk analysis; (ii) systematic data collection and analysis for monitoring and control of the state government; and (iii) implementation of electronic audit trails.

b. **SEFAZ/SP strategic personnel management model**, through: (i) a competencies-based personnel development model; (ii) quality-of-life development activities and plan; (iii) expansion of the distance education program; and (iv) physical remodeling of the treasury unit.[58]

c. **Modules of the Tax Education Program for Citizens,** through: (i) development of digital media to disseminate the program; (ii) events to disseminate and raise awareness on tax issues; and (iii) a survey of public perception of taxes and the allocation of public expenditures.

d. **BEC modules**, through: (i) new services and bidding modules, with ongoing maintenance and upgrades; (ii) a state supplier management module; and (iii) a state government supply cycle management module.

e. **Information technology governance model**, through: (i) training for technicians in the corporate architecture; (ii) implementation of a corporate architecture model; and (iii) expansion of the hardware and software technological infrastructure.

f. **Innovation management model**, through: (i) an innovation management methodology; and (ii) innovation promotion instruments.

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[58] The proposed physical remodeling of the treasury unit in the city of Campinas and the SEFAZ/SP building in São Paulo is on a small scale and merely involves renovating existing facilities.

1.30 **Component II. Tax administration and litigation (US$22,493,714).** This component seeks to make tax collection more efficient, grow revenues, and simplify tax compliance. It will finance implementation of the following:

a. **Methodology for simplifying ancillary obligations,** through: (i) an ancillary tax obligation simplification plan; and (ii) a module to integrate tax obligation databases.

b. **Electronic tax document management systems,** through: (i) integrated systems for the accreditation of electronic tax documents (NF-e, CT-e and EFD); (ii) a panel to monitor the online services provided to taxpayers; and (iii) post-validation system for taxpayers in the national simplified tax regime.

c. **Electronic tax coupon authentication and transmission system (SAT),** through: (i) technical specification modules of SAT requirements and analysis paths; (ii) query of CF-e processing errors; (iii) implementation of the system availability panel for the taxpayer; (iv) functionality testing environment; and (v) definitive CF-e storage system.

d. **National States Operator (ONE**) **integration system**, through: (i) development of technology environments to receive ONE data; and (ii) a web service to integrate with operators that collect data from number plate and vehicle tag readings.

e. **SEFAZ/SP tax intelligence model**, through: (i) structured data analysis model; and (ii) new technological tools providing forensic expertise.

f. **ITCMD collection system**, through: (i) methodology and implementation of a survey of the market value of urban and rural properties; and (ii) ITCMD declaration system, cross-checking against the data declared by the taxpayers.

g. **Fiscal control system over fuel sales**, through a system of authentication and transmission of fiscal data records, including the following modules: (i) structuring of the tax document certification system by SEFAZ/SP; (ii) structuring of equipment management back-up; (iii) structuring of data reception back-up; and (iv) data cross-referencing and generation of alerts.

h. **Collection model for state taxes,** through: (i) specific collection rules according to taxpayer profile; (ii) collection call center; and (iii) collection management system with automatic notification of tax debits.

i. **Single call center system to provide online service to citizens**, including: (i) a web-based self-service module integrated with phone and in-person self-service modules; and (ii) knowledge management system for taxpayer services information, particularly at the first service level.

j. **System for querying the interpretation of tax legislation**, with at least the following functionalities: (i) legislative search system; (ii) electronic statement of query status; (iii) revocation and modification of query; and (iv) distribution of queries to the sector responsible.

k. **Tax litigation system**, through: (i) a module to integrate the online tax administration process (e-PAT) with the tax account system; (ii) database module with e-PAT data for managerial use; (iii) module to integrate e-PAT with PGE systems; and (iv) e-PAT module aligned and extended to standards and procedures.

1.31 **Component III. Financial administration and public expenditure (US$21,249,990).** This component aims to enhance fiscal discipline and make public expenditure more efficient and effective. It will finance implementation of the following:

a. **Financial administration system**, including the following modules: (i) budget and financial consolidation; (ii) accounts payable and receivable, treasury, and accounting; (iii) financial; (iv) contract management; (v) procurement management; (vi) asset management; and (vii) managerial.

b. **Medium-term projections and fiscal risks model implemented**, through: (i) a methodology for analyzing and quantifying pension risks; (ii) a methodology for analyzing and quantifying risks relating to public enterprises; (iii) identification of fiscal risks in public-private partnership contracts; and (iv) a base model for the identification and measurement of public-private partnership risks.

c. **Integrated state human resources and payroll management**,[59] including: (i) a module for integrating payroll databases; (ii) a module for making human resource processes paperless and automating them; (iii) a functional management module for human resource processes; and (iv) implementation of an *RH Folha* (payroll) project unit.

d. **Public service cost system in four state departments or agencies,**[60] through implementation of: (i) the materials management system; and (ii) the public service cost system.

1.32 For all components, the project will finance consulting services (individual consultants and firms) for US$10.0 million; nonconsulting services for US$35.8 million; goods for US$41.5 million; training for US$4.2 million; and civil works for US$1.9 million, the latter consisting of the remodeling of existing physical spaces of SEFAZ/SP units.

C. Key results indicators

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

1.34 **Economic analysis.** An economic analysis of the project was made comparing the economic and financial costs and benefits, considering the following results: (i) an increase in tax revenue intake following the adoption of a new ITCMD model; (ii) resource savings from the adoption of the new state payroll

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[59] Development of computer system.

[60] Education Department and three other departments with the materials management system yet to be chosen. As this is a state corporate system that does not require joint procurement, it is treated like the financial management system, so cooperation agreements do not have to be signed.

management system and from the expansion of BEC services, which will make it possible to increase the amounts negotiated; and (iii) a reduction in costs for taxpayers by eliminating an ancillary obligation and shortening service times, through the replacement of face-to-face interactions with other channels. By end-2028 (in 10 years' time), the project's investments will have a net present value of US$94.9 million and an internal rate of return (IRR) of 64.15%. These results are robust to a sensitivity analysis that considered three different scenarios: a 30% devaluation of the Brazilian real (IRR of 41.78%), a 30% reduction in all benefits (IRR of 31.12%), and a scenario that combines both devaluation and reduction in benefits (IRR of 17.06%).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 The present operation was designed as an investment loan for specific projects under the PROFISCO II CCLIP (BR-X1039). It has an estimated total cost of US$96.8 million, which will be financed through an investment loan of up to US$87.1 million (90% of the project cost) from the Bank's Ordinary Capital and a local counterpart contribution of US$9.6 million (10% of the total project cost). The breakdown of resources by funding source and category is given in the following table.

Table 1. Total budget (US$)

Categories	Bank	Local	Total	%
A. Direct costs	**84,261,818**	**8,685,301**	**92,947,119**	**96.0**
Component I - Fiscal management and transparency	44,471,618	4,731,797	49,203,415	50.8
Component II - Tax administration and litigation	20,580,651	1,913,063	22,493,714	23.2
Component III - Financial administration and public expenditure	19,209,549	2,040,441	21,249,990	22.0
B. Project management	536,958	411,924	948,882	1.0
Monitoring and evaluation	260,808	411,924	672,732	0.7
Auditing	276,150	-	276,150	0.3
C. Contingencies	2,321,224	582,775	2,903,999	3.0
Total	**87,120,000**	**9,680,000**	**96,800,000**	**100.00**
%	**90**	**10**	**100**	

2.2 **Disbursement schedule.** Disbursements will be made over a five-year period as shown in Table 2.

Table 2. Disbursement schedule (US$)

Source	Year 1	Year 2	Year 3	Year 4	Year 5	Total
IDB	5,946,878	17,311,033	24,868,925	23,238,414	15,754,750	87,120,000
Local	576,663	2,423,954	1,993,708	3,109,345	1,576,330	9,680,000
Total	**6,523,541**	**19,734,987**	**26,862,633**	**26,347,759**	**17,331,080**	**96,800,000**
%	6.7	20.4	27.8	27.2	17.9	**100.0**

2.3 **Compliance with the PROFISCO II CCLIP eligibility conditions (BR-X1039).** This is the seventh individual loan operation under the PROFISCO II CCLIP (BR-X1039), approved by the Board of Executive Directors through Resolution DE-113/17. The project meets the eligibility criteria envisaged in the policy on CCLIPs (document GN-2246-9) and its guidelines (document GN-2246-11) for individual loan operations, given that: (i) it pertains to the fiscal sector and is compatible with all components of the PROFISCO II CCLIP; (ii) it is included in the Update of Annex III of the 2018 Operational Program Report (document GN-2915-2); (iii) the State will implement the operation through SEFAZ/SP, which was the executing agency for the first individual operation under the PROFISCO I CCLIP (loan 2331/OC-BR); (iv) the institutional analysis found that SEFAZ/SP's capabilities have not deteriorated, and the same project execution and monitoring tools may be used for this new operation as for the previous project. The project coordination unit (PCU) staff will also be the same. According to the final report of loan 2331/OC-BR: (i) the objectives of the project were achieved satisfactorily; (ii) the project execution unit complied with the contractual requirements and Bank disbursement policies, and its accounts were audited and found to meet the required quality standards.

B. Environmental and social risks

2.4 In accordance with the Bank's Environment and Safeguards Compliance Policy (operational policy OP-703), Directive B.3, this is classified as a Category "C" operation. The project only involves the remodeling of internal spaces, for which no socioenvironmental risks are foreseen. Nonetheless, in order to undertake the works in question, the bidding documents will require the implementation of an environmental and social management plan, covering occupational health and safety issues; and a communication plan.

C. Fiduciary risks

2.5 A medium-level fiduciary risk was identified, related to possible delays in the procurement and contracting processes, due to the quality of the terms of reference and prioritization of PROFISCO processes by the various areas (SEFAZ/SP procurement unit, legal advisory service, Attorney's Office). This risk will be mitigated by: (i) strengthening the Procurement, Internal Oversight and Legal Consultancy Unit; (ii) planning and immediate start of the search of minutes and of online auction processes to record goods, equipment, and software procurements, at least those planned for the first year; and (iii) training in Bank policies for the entire execution team.

D. Other project risks and key issues

2.6 A risk management workshop was held using the Bank's methodology, which found that the operation carries medium risk. The risks are:

a. **Fiscal sustainability (medium risk):** that the country departs from a sustainable growth path, which could affect the state's economic and fiscal performance. São Paulo has adopted measures to mitigate this risk: (i) cost containment actions (Decree 61.131/2015); (ii) expenditure restrictions and ceilings in SEFAZ/SP, 2018 (Memorandum 13/2018-GS); and (iii) expenditure guidelines and restrictions on state executive power, 2018 (Decree 63.146/2018) and 2017 (Decree 62.409/2017).

b. **Development (medium and high risks).** The following was classified as a medium risk: (i) delays in output development, attributable to the state body involved in project execution. This risk will be mitigated through coordination between the Office of the Governor and SEFAZ/SP and SPG/SP, to align joint actions and sign a cooperation agreement between SEFAZ/SP and SPG/SP, and designation of a focal point in the PCU. The following was classified as a high risk: (ii) delays in the implementation of project processes and systems owing to the capacity of the information technology area in SEFAZ/SP and the SPG/SP to respond in time to prepare technical requirements. This risk will be mitigated through: (i) redefinition of the information technology governance model and coordination with the technical areas involved in the design, and a technical opinion on the SEFAZ/SP and SPG/SP technological solutions; (ii) the creation of a focal point in SEFAZ/SP for the internal coordination of the demand for systems development and continuous monitoring of actions; and (iii) information technology contracts with schedules aligned so as to control the outputs more effectively.

2.7 **Financial analysis.** The analysis of São Paulo's financial situation confirms its payment capacity to service the debt to be contracted, which represents 0.016% of the state's GDP in 2015 and 0.02% of its net current income in 2016.[61] Moreover, the state is classified in category B[62] by the National Treasury and has fulfilled the requirements of the Fiscal Responsibility Law and the conditions of the São Paulo Fiscal Adjustment Program.

2.8 **Project sustainability**. In addition to the steps the government is already taking (paragraph 2.6), the project includes measures that are conducive to fiscal sustainability in the medium and long term, such as cutting expenditure and reducing tax evasion, which will generate higher income. To ensure that the capacities developed by the project are sustainable once execution is completed, PROFISCO II-SP includes actions to reduce personnel expenses and make savings in procurement costs and service delivery. It will also increase income by improving tax inspection actions and recovery of tax claims, with the following related outputs: management of the state payroll and improvement of the procurement system; simplification of tax obligations; a new tax collection model; the use of new inspection and tax intelligence technologies; among other things (see economic analysis). In the case of investments in information and communication technology, SEFAZ/SP will mainly use its own staff supported by consulting services for in-house development. The project will also finance the information and communication technology corporate architecture model, which specifies responsibilities and resources for maintaining and updating the technology base.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The borrower is the State of São Paulo, which will execute the operation through SEFAZ/SP, its Finance Department. The Federative Republic of Brazil will

61 Technical Note – Financial Situation of the State of São Paulo.

62 The fiscal situation is robust, and credit risk is low (Official Notice (*Portaria*) 306/2012).

guarantee the borrower's financial obligations, pursuant to the policy on Guarantees Required from the Borrower (document GP-104-2). SEFAZ/SP will set up a PCU, staffed by a general coordinator, a technical coordinator, a financial coordinator, a monitoring and planning coordinator, and an administrative and procurement coordinator. The PCU will coordinate activities related to the project's monitoring, evaluation, and audit to ensure execution of the project and the achievement of its objectives.

3.2 The PCU's main functions will involve: (i) planning activity execution; (ii) implementing and updating the project's operational tools: the multiyear execution plan, annual work plan, and procurement plan; (iii) supervising execution and submitting status reports; (iv) providing support for processes for the preparation of terms of reference, goods procurement, and the selection and contracting of services; (v) submitting supporting documentation and disbursement requests to the Bank; (vi) preparing the financial statements; and (vii) submitting the project evaluation.

3.3 The borrower will adhere to the program Operating Regulations approved by the Bank for the PROFISCO II CCLIP, which specify: (i) criteria for project eligibility and outputs eligible for financing; (ii) functions, procedures, and standards for project execution; and (iii) operational and contractual relationships between the parties involved in the project.

3.4 **Coordination mechanism.** The SPG/SP or any other agency that takes over responsibility for *RH Folha* will sign a legal instrument establishing the relationship with SEFAZ/SP for executing the "integrated state human resources and payroll management system" output under Component III. The legal instrument will establish the obligation to appoint a specialist, with sufficient autonomy, to coordinate with the PCU and carry out technical development and implementation of the output. Coordination of this activity will be formalized through a legal instrument (paragraph 3.6).

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

3.6 **Special contractual condition of execution**. Prior to the start of the execution of activities that will benefit the SPG/SP, SEFAZ/SP will sign a legal instrument with that department establishing the roles and responsibilities of the parties during project execution. The activities in question relate to integrated management of state human resources and payroll. This condition is justified to underpin the mechanism of coordination between the different bodies, since it is an entity independent of SEFAZ/SP, and to mitigate the risk of delays in outputs during project execution (paragraph 2.6b).

3.7 **Procurement.** Project procurement and contracting processes will abide by the Policies for the Procurement of Goods and Works Financed by the Inter-American Development Bank (document GN-2349-9) and the Policies for the Selection and Contracting of Consultants Financed by the Inter-American Development Bank (document GN-2350-9) and the provisions of the procurement plan.

3.8 **Single-source selection.**[63] Single-source selection is planned for: (i) government schools and entities: entities responsible for building the knowledge, skills, and competencies of staff at Finance Departments in Brazil, for training and information technology (IT) development services. As a continuation of the investments made under the loan contract, aligned with the SEFAZ Training Plan, single-source selection is planned, pursuant to paragraphs 1.11(c) and 3.10 of document GN-2350-9, of the following state and federal government schools: (a) School of Tax Administration (ESAF); (b) National School of Public Administration of the Ministry of Planning, Budget, and Management (ENAP); (c) government schools for training civil servants; (d) data processing companies responsible for IT development in the states; and (e) federal and state universities that provide technical assistance in new IT solutions, notably the University of São Paulo, through its Support Foundation (FUSP), which is the main provider of support for the SAT's technical development, to increase its functionality and efficiency. There will also be single-source selection of the State of São Paulo Data Processing Company (PRODESP), which is in charge of IT development for the state and has been involved in developing SEFAZ's IT systems; (ii) specialized international agencies: pursuant to paragraphs 3.10 and 3.15 of document GN-2350-9, the Inter-American Center of Tax Administration (CIAT) would be contracted directly, given its specialization in providing technical assistance for updating and modernizing tax administrations; and (iii) research and study institutes: in accordance with paragraph 3.10(d) of document GN-2350-9, the Institute of Applied Economic Research (IPEA) and the Fiscal Studies Institute (IEF) will be contracted. The IPEA is Brazil's foremost research center, recognized internationally for its scientific studies and data production. The IEF, which is associated with Spain's Ministry of Finance and Public Administration, promotes training activities for civil servants to hone their specific job skills.

3.9 **Audited financial reports.** The borrower will submit audited financial statements to the Bank annually, no later than 120 days after each fiscal year-end. The external audit will be performed by an external auditing firm acceptable to the Bank. SEFAZ/SP will contract the audit for the entire project, for which the terms of reference will require the Bank's no objection.

B. Summary of arrangements for monitoring results

3.10 **Monitoring** will be based on: (i) the multiyear execution plan and annual work plan; (ii) the procurement plan; (iii) the Results Matrix; (iv) the monitoring and evaluation plan; and (v) the Progress Monitoring Report. The PCU will prepare semiannual reports on progress toward attaining the outcome, output, and financial

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[63] For further details see Annex III, Chapter IV.

targets for Bank approval; and the latter will conduct inspection visits and ex post reviews as part of project monitoring.

3.11 **Evaluation.** The project will be evaluated against the annual impact and outcome targets and indicators specified in the project Results Matrix, by comparing situations before and after the project. The monitoring and evaluation plan envisages an independent midterm evaluation, 90 days after the end of the third year of project execution or the date on which 50% of the loan proceeds have been disbursed, whichever occurs first; and a final evaluation, 90 days after the date of the last disbursement of the loan proceeds. The evaluation reports will serve as input for the PROFISCO II CCLIP project completion report. The monitoring and evaluation plan also includes an impact assessment using the controlled experiment methodology to identify and quantify the increase in tax revenue intake attributable to the voluntary regularization of tax obligations.

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	i) improving the business climate, by increasing the number and quality of services offered to businesses and taxpayers, and by simplifying the processes to open new businesses and to pay taxes; and ii) improving the efficiency of public resources management, by creating and strengthining public investment systems and implementing medium-term expenditure frameworks.
Country Program Results Matrix	GN-2915-2	The intervention is included in the 2018 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	10.0	
3.1 Program Diagnosis	3.0	
3.2 Proposed Interventions or Solutions	4.0	
3.3 Results Matrix Quality	3.0	
4. Ex ante Economic Analysis	9.0	
4.1 Program has an ERR/NPV, or key outcomes identified for CEA	3.0	
4.2 Identified and Quantified Benefits and Costs	3.0	
4.3 Reasonable Assumptions	1.0	
4.4 Sensitivity Analysis	2.0	
4.5 Consistency with results matrix	0.0	
5. Monitoring and Evaluation	10.0	
5.1 Monitoring Mechanisms	2.5	
5.2 Evaluation Plan	7.5	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	Medium	
Identified risks have been rated for magnitude and likelihood	Yes	
Mitigation measures have been identified for major risks	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, Internal Audit. Procurement: Information System, Price Comparison.
Non-Fiduciary	Yes	Strategic Planning National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	The IDB team developed and applied a methodology (MD-GEFIS) to assess the state of public finances and fiscal management processes in the State of Espirito Santo, to design the project and to monitor future performance against the baseline.

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

Evaluability Assessment Note:

The main goal of the operation is to contribute to the fiscal sustainability of the State of Sao Paulo. To achieve this end, the proposal defines three specific areas on which the project will intervene. The first area is fiscal management and transparency. The second area is tax administration and litigation. The third area is financial administration of public expenditure. Each of these areas define a component. The document includes a description of the process gaps that lead to weaknesses in each of these three areas. The project is the child of a series of operations under the Conditional Credit Line for Investment Projects (CCLIP) parent BX-L1502.

The project proposal diagnoses a primary balance as a share of the State PIB of 0.1 percent in 2016, and a Current Net Debt as a share of the State PIB of 14.3 Percent (SEFAZ, 2016). The diagnosis is based on the MD-GEFIS tool which analyzes processes in the three main areas which define the components. The Ministry of Finance provides a diagnosis for a total of 21 sub areas. Each diagnosis identified the main restrictions for the Ministry to increase tax revenue, decrease running costs or improve efficiency in expenditures, and improve service delivery to citizens. Overall, the diagnosis identifies gaps in institutional arrangements (such as weak coordination and outdated legal documents), deficits in personnel management and training, and gaps in capital investments (resulting in outdated technological infrastructure, limited availability of information, and lack of mechanisms to communicate with citizens). The quantification of these needs is disaggregated for 18 processes.

The economic analysis provides a quantification of savings to the State through technological tools which allow for efficiency gains. The quantification of benefits is associated to savings by citizens to file taxes. Benefits are also associated to savings via identification of providers able to supply goods and services at competitive costs. The costs include investment in technology and maintenance. The analysis concludes with a net present value of US$40.4 million.

Monitoring relies on reports by the Finance Secretariat of the State. The ex post evaluation plan includes an impact evaluation to identify the effects of a system for taxpayer voluntary regularization on taxation capacity. The evaluation relies on a randomized control trial.

There is one risk out of five classified as high. The main risk identified for the program to succeed are delays in execution. The mitigation measures include designating a specialist on information technology and the formalization of consultancy contracts.

RESULTS MATRIX

Project objective:	To contribute to the state's fiscal sustainability by: (i) modernizing fiscal management; (ii) improving tax administration; and (iii) improving public expenditure management.

EXPECTED IMPACTS

Indicators	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of Verification	Comments
IMPACT 1: Decrease in the ratio of primary fiscal deficit to state GDP											
Primary balance/São Paulo state GDP[1]	%	0.08	2016	0.08	0.10	0.11	0.13	0.15	0.15	Treasury report- São Paulo State Finance Department (SEFAZ/SP)	See Monitoring and Evaluation Plan (MEP)
IMPACT 2: Increase in the ratio of tax revenue intake to state GDP											
Tax revenue intake/ São Paulo state GDP	%	7.28	2016	7.28	7.29	7.30	7.31	7.32	7.32	Tax administration report SEFAZ/SP	See MEP
IMPACT 3: Decrease in the ratio of net current debt to state GDP											
Net current debt (NCD)/ São Paulo state GDP	%	14.28	2016	14.28	14.26	14.24	14.22	14.20	14.20	Treasury report- SEFAZ/SP	See MEP

[1] Gross domestic product – GDP.

EXPECTED OUTCOMES[2]

Indicators	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Target year	Means of Verification	Comments
OUTCOME 1: Increase in the ratio of strategic planning targets met to total planned targets												
Number of targets met/Total planned targets	%	76.33	2017	81.13	83.53	85.93	88.33	90.73	90.73	2023	Management contract evaluation report – SEFAZ/SP	See MEP
OUTCOME 2: Decrease in the ratio of administrative cost of tax collection to total revenue intake												
SEFAZ operating budget/Total tax revenue intake	%	1.15	2017	1.10	1.10	1.08	1.07	1.05	1.05	2023	Summary state balance sheet	See MEP
OUTCOME 3: Narrowing of the gap between the budget as planned and executed												
Budget as planned/Budget as executed	%	6.3	2017	5.9	5.7	5.5	5.3	5.1	5.1	2023	Summary state balance sheet and Annual Budget Law (LOA)	See MEP

2 Expected outcomes are cumulative.

OUTPUTS[3,4]

Outputs	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Component 1: Fiscal management and transparency											
Proactive audit and oversight model[5] implemented	Model	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP
SEFAZ/SP strategic personnel management model implemented	Model	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP
Tax Education Program for Citizens implemented	Module	0	2018	1	1	3	1	2	8	SEFAZ/SP management report	See MEP
Online procurement exchange modules implemented	Module	0	2018	0	0	1	1	1	3	SEFAZ/SP management report	See MEP
Information technology governance model implemented	Model	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP
Innovation management model implemented	Model	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP

3 Outputs are annual.

4 Outputs in the form of systems, models, or software will only be considered fulfilled when they are operational and being used by civil servants.

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

Outputs	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
<u>Component 2</u>: Tax administration and litigation											
Ancillary obligation simplification methodology implemented	Software	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP
Electronic tax document management system implemented	Module	0	2018	1	1	1	1	1	5	SEFAZ/SP management report	See MEP
Electronic tax coupon authentication and transmission system (SAT) implemented	Module	0	2018	0	0	1	1	1	3	SEFAZ/SP management report	See MEP
National States Operator (ONE) integration system implemented	Module	0	2018	0	1	1	0	0	2	SEFAZ/SP management report	See MEP
SEFAZ/SP tax intelligence model implemented	Model	0	2018	0	0	0	1	0	1	SEFAZ/SP management report	See MEP
Inheritance and gifts tax (ITCMD) collection system implemented	System	0	2018	0	0	0	1	0	1	SEFAZ/SP management report	See MEP
Fuel sales tax control system implemented	Module	0	2018	0	1	1	1	1	4	SEFAZ/SP management report	See MEP
Collection model for state taxes implemented	Model	0	2018	0	0	0	0	1	1	SEFAZ/SP management report	See MEP
SEFAZ single call center system for online citizen service implemented	Module	0	2018	0	0	1	1	0	2	SEFAZ/SP management report	See MEP
Tax law interpretation query system implemented	Module	0	2018	0	1	1	2	0	4	SEFAZ/SP management report	See MEP
Tax litigation system implemented	Module	0	2018	0	1	1	1	1	4	SEFAZ/SP management report	See MEP

Outputs	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Component 3: Financial administration and public expenditure											
Financial administration system implemented	Module	0	2018	0	1	2	2	2	7	SEFAZ/SP management report	See MEP
Projections and medium fiscal risks model implemented	Model	0	2018	0	0	1	0	0	1	SEFAZ/SP management report	See MEP
Integrated state human resources and payroll management implemented	Module	0	2018	0	1	1	1	1	4	SEFAZ/SP management report	See MEP
Public service cost system implemented in four state departments or agencies	Module	0	2018	0	1	1	0	0	2	SEFAZ/SP management report	See MEP

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Federative Republic of Brazil
Project number:	BR-L1516
Name:	Fiscal Management Modernization Project for the State of São Paulo - PROFISCO II-SP
Executing agency:	State of São Paulo through its Finance Department (SEFAZ/SP)
Fiduciary team:	Fábia de Assis Bueno and Marilia Santos (VPC/FMP)

I. EXECUTIVE SUMMARY

1.1 The institutional evaluation for the project's fiduciary management was based on: (i) the country's current fiduciary context; (ii) the results of the evaluation of the main fiduciary risks; (iii) the report of the Fiscal Management Maturity and Performance Assessment (MD-GEFIS); (iv) an institutional analysis; (v) previous experience in PROFISCO I; and (vi) working meetings held with the project team and the São Paulo State Finance Department (SEFAZ/SP).

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

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

II. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

2.1 SEFAZ/SP's organizational structure consists of the Office of the Finance Secretary, the State Capital Protection Council (CODEC), the State Taxpayer Advocacy Council (CODECON), the Financial Administration Coordination Unit (CAF), the Tax Administration Coordination Unit (CAT), the Online Procurement Coordination Unit (CCE), the Personnel Management Coordination Unit (CGP), and the Shared Services and Technology Coordination Unit (CSTC).

2.2 Project activities will be executed by SEFAZ/SP, through its Program Coordination and Supervision Unit (UCSP), which is responsible for institutional and technical coordination and forms part of the Office of the Finance Secretary.

2.3 The project will benefit the executing agency and the São Paulo State Planning and Management Department (SPG/SP).

2.4 Procurement and contracting processes will be centralized and managed by the UCSP.

2.5 The internal control of the executing agency is maintained by the São Paulo State Oversight and Evaluation Department (DCA/SP), which reports to the Office of the Finance Secretary and is responsible for the internal oversight of all state entities. External control is exercised by the São Paulo State Audit Office (TCE/SP), which performs audits on all state entities. The latter has not yet signed a protocol with the Bank to audit our operations.

III. Institutional Capacity Assessment, Fiduciary Risk Evaluation, and Mitigation Actions

3.1 The evaluation and validation of institutional capacity with SEFAZ/SP staff concluded that the executing agency has a medium level of institutional capacity, with extensive experience of implementing projects in its sector and operations with the Bank, using its own project implementation team.

3.2 A medium fiduciary risk was identified in relation to possible delays in procurement processes, owing to the quality of the terms of reference and prioritization of PROFISCO processes by the different areas (SEFAZ Procurement Unit, General Counsel's Office, Attorney General's Office). This risk will be mitigated through: (i) strengthening of the procurement unit, internal oversight, and legal consulting unit; (ii) planning and immediate start on a search of minutes and online auction processes for recording goods, equipment, and software purchases, at least those planned for the first year; and (iii) training in Bank policies for the entire execution team.

IV. Agreements and Requirements for Procurement Execution

4.1 The fiduciary agreements on procurement specify the provisions applicable to all procurement processes envisaged in the project.

A. Procurement execution

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

4.3 **Selection and contracting of consultants**. Consulting contracts will use the standard request for proposals issued by the Bank. The sector specialist will be responsible for reviewing the terms of reference for contracting consulting services. These will be selected and contracted pursuant to the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-9).

4.4 **Use of country procurement system**. The country procurement (sub)system approved by the Bank (*Pregão Eletrônico*) will be used for the procurement of off-the-shelf goods for up to US$5 million. Any system or subsystem subsequently approved will be applicable to the operation. The procurement plan and its updates will specify that procurement will be executed using approved country systems.

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

B. Single-source selection

4.6 **Schools and government entities.** Given the way finance departments in Brazil are structured, outside entities coordinate the development of knowledge and skills, namely: (i) the School of Finance Administration (ESAF); (ii) the National School of Public Administration (ENAP); (iii) government schools for training public officials; (iv) data processing companies, responsible for the states' IT development; and (v) federal and state universities that provide technical assistance in new IT solutions. Pursuant to paragraphs 1.11(c) and 3.10 of document GN-2350-9, and to make the outputs developed and financed by the project sustainable, the federal and state entities that provide training to civil servants and assistance in IT development will be contracted by single-source selection.

4.7 The following will also be contracted through single-source selection: (i) the State Data Processing Company (PRODESP), to develop finance modules, functionalities, and systems for up to US$15,820,625; and (ii) the University of São Paulo Support Foundation (FUSP), the main entity supporting technical development of the electronic tax coupon authentication and transmission system (SAT), to make improvements to the SAT equipment that will be installed in fuel pumps, and to provide software and hardware solutions to enhance the functionality and efficiency of SAT equipment, for up to US$2,439,323.

4.8 **Specialized international agencies**. Pursuant to paragraphs 3.10 and 3.15 of document GN-2350-9, the Inter-American Center of Tax Administrations (CIAT), an international agency, will be contracted given its specialization in technical assistance for modernizing tax administrations.

4.9 **Research and study institutes**. Pursuant to paragraph 3.10(d) of document GN-2350-9, the Institute of Applied Economic Research (IPEA) and the Fiscal Studies Institute (IEF) will be contracted. The IPEA is the foremost research center in Brazil and is internationally recognized for the production of scientific data and studies. The IEF, an entity associated with Spain's Ministry of Finance and Public Administration, offers training activities that will help civil servants improve their skills to fulfill their functions.

Table 1. Thresholds for ICB and international shortlist

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

Table 2. Main procurement items

Procurement item	Selection method	Estimated date	Estimated amount (US$ million)
Goods and nonconsulting services			
Purchase of computer hardware	Country system	Q2/2019	3.80
Expansion of data storage capacity	Country system	Q2/2020	3.37
Expansion of data transmission capacity	Country system	Q2/2020	4.75
Acquisition of miscellaneous software	Country system	Q1/2020	4.21
Development of functionality in the SIAFEM	Country system	Q1/2019	3.36
Development of the *RH Folha* personnel management and payroll system	Country system	Q1/2020	4.68
Services to make processes paperless	Country system	Q4/2020	4.29
Consulting firms			
Implementation of best human resource management practices	Quality- and cost-based selection (QCBS)	Q1/2019	1.22
Input methodology	QCBS	Q2/2019	2.76
SAT requirements	Country system	Q4/2019	2.43

* The procurement plan can be accessed here.

C. Procurement supervision

4.10 Procurement will be subject to ex post supervision, except in cases where ex ante supervision is justified or of single-source selection. When the country system is used for procurement, the country system will also be used for monitoring.

4.11 The supervision method will be identified for each selection process. Ex post reviews will be conducted every 12 months in accordance with the project supervision plan. The ex post review reports will include at least one physical inspection visit, selected from among the processes subject to ex post review.

Table 3. Threshold for ex post review

Works	Goods	Consulting services
NCB and shopping	NCB and online auction *(Pregão)*	Less than US$1 million

D. Records and files

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

V. Financial Management

5.1 **Programming and budget.** SEFAZ/SP, acting through the UCSP, will coordinate the planning process for the execution of project activities, as foreseen in the multiyear execution plan and annual work plan. State entities use the following planning instruments: the multiyear plan, the Budget Guidelines Law (LDO), which provides budgetary guidance, and the Annual Budget Law (LOA). The project budget will form part of the LOA.

5.2 The UCSP will ensure that the budgetary resources for the project (Bank and local) are duly budgeted annually and earmarked for execution in accordance with project programming. Budgetary resources must be recorded in the year of execution within the Integrated Budgetary Management System (SIGO) as an external source. The LOA must include the funds needed for execution both for the external loan and for the local counterpart funding.

5.3 **Accounting and information systems.** Public entities in the state of São Paulo work with the integrated financial management system for the states and municípios (SIAFEM) and budgetary execution managerial information system (SIGEO), which were also used in PROFISCO I. SIAFEM handles all financial and accounting execution for state operations, while SIGEO produces management reports. These systems are not integrated with other corporate systems. SIGEO will also be used for issuing disbursements, reports, and audited financial reports of the project in PROFISCO II.

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

5.5 As in PROFISCO I, the Bank's resources will be managed through an exclusive account that makes it possible to identify the loan proceeds and perform bank reconciliations on them, covering both income and payments.

5.6 Disbursements will be made in U.S. dollars in the form of advances of funds. Advances will be based on a projection of financial resources for up to 180 days. For future advances, it will be necessary to account for at least 80% of cumulative funds previously advanced.

5.7 Expenditures considered ineligible by the Bank will be repaid from the local contribution or other resources, as the Bank sees fit, depending on the nature of the ineligibility.

5.8 The exchange rate agreed upon with the executing agency for recording expenditures paid out of advances of loan funds will be the internalization rate. To determine the equivalence of expenses incurred in the local counterpart, or the reimbursement of expenses charged against the loan, the agreed exchange rate will be that prevailing on the date on which the expense is actually paid.

5.9 **Internal control and internal audit**. Internal oversight of the state is exercised by DCA/SP, the central body of the executive branch's internal control system. Decree 60.812/14 defines its structure and gives it internal oversight and government audit functions, which it discharges mainly through public hearings, public transparency, and social oversight. It will oversee project activities.

5.10 **External control and reports**. External oversight is exercised by TCE/SP. The external audit of PROFISCO II will be performed by a firm of Bank-eligible external auditors.

5.11 Annual audited financial reports will be filed no later than 120 days after the close of each fiscal year, pursuant to terms of reference agreed on with the Bank.

5.12 **Financial supervision plan**. This plan may be amended during execution depending on how the risk levels develop or the need for additional oversight.

Table 4. Supervision plan

Nature and scope	Frequency	Party responsible	
		Bank	Executing agency
Ex post review of disbursements and procurement	Annual	Fiduciary team	UCSP - External auditor
Annual audit	Annual	Fiduciary team	UCSP - External auditor
Review of disbursement requests	Periodic	Fiduciary team	
Supervision visit	Annual	Fiduciary specialist	

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/18

Brazil. Loan ____/OC-BR to the State of São Paulo. Fiscal Management Modernization Project for the State of São Paulo – PROFISCO II - SP. Seventh 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 São Paulo, 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 São Paulo – PROFISCO II - SP, which constitutes the seventh individual operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 - Fiscal Management Modernization Program in Brazil – PROFISCO II, approved by Resolution DE-113/17, on December 8th, 2017. Such financing will be in the amount of up to US$87,120,000, 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 __ ____________ 2018)

LEG/SGO/CSC/EZSHARE-620307903-34219
Pipeline: BR-L1516