

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**BRAZIL**

**FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE  
STATE OF RIO GRANDE DO SUL  
PROFISCO II/RS**

(BR-L1534)

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

(BR-X1039)

**LOAN PROPOSAL**

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## ABBREVIATIONS

AWP	Annual work plan
CAPAG	Metodologia de Avaliação da Capacidade de Pagamento [Payment Capacity Assessment Methodology]
CCLIP	Conditional credit line for investment projects
CRF	Corporate Results Framework
EFD	Escrituração fiscal digital [digital tax accounting]
FPE	Fundo de Participação dos Estados [State Revenue Sharing Fund]
IBGE	Instituto Brasileiro de Geografia y Estadística [Brazilian Institute of Geography and Statistics]
ICB	International competitive bidding
ICMS	Imposto sobre a circulação de mercadorias e prestação de serviços [goods and services sales tax]
ICT	Information and communications technology
IPVA	Imposto sobre a propriedade de veículos automotores [motor vehicle ownership tax]
IRR	Internal rate of return
IT	Information technology
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
MTBF	Medium-term Budget Framework
NCB	National competitive bidding
NCI	Net current income
NF-e	Nota fiscal eletrônica [electronic tax invoice]
PCR	Project completion report
PCU	Project coordination unit
PGE/RS	Procuradoria Geral do Estado [Office of the Rio Grande do Sul State Attorney General]
PMR	Progress monitoring report
PNAFE	Programa Nacional de Apoio à Modernização da Administração Fiscal para os Estados Brasileiros [National Fiscal Administration Program for Brazilian States]
PNAFM	Programa Nacional de Apoio à Gestão Administrativa e Fiscal dos Municípios Brasileiros [National Program to Support the Administrative and Fiscal Management of Brazilian Municípios]
PROCERGS	Companhia de Processamento de Dados do Estado do Rio Grande do Sul [State of Rio Grande do Sul Data Processing Company]
PROFISCO	Programa de Apoio à Gestão e Integração dos Fiscos no Brasil [Program to Support the Management and Integration of Finance Administrations in Brazil]
RRF	Regime de Recuperação Fiscal [Fiscal Recovery System]

SBC	Special Bidding Committee
SEFAZ/RS	Secretaria de Estado da Fazenda [Rio Grande do Sul State Finance Department]
SIAF	Sistema Integrado de Administração Financeira [Integrated Financial Administration System]
SPED	Sistema Público de Escrituração Digital [Digital Public Accounting System]
STN	Secretaria do Tesouro Nacional [National Treasury Department]

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Financial Terms and Conditions				
<b>Borrower:</b>			<b>Flexible Financing Facility<sup>(a)</sup></b>	
State of Rio Grande do Sul (RS)			<b>Amortization period:</b>	25 years
<b>Guarantor:</b>			<b>Disbursement period:</b>	5 years
Federative Republic of Brazil			<b>Grace period:</b>	5.5 years <sup>(b)</sup>
<b>Executing Agency:</b>			<b>Interest rate:</b>	LIBOR-based
State of Rio Grande do Sul, acting through the State Finance Department (SEFAZ/RS)			<b>Credit fee:</b>	<sup>(c)</sup>
<b>Source</b>	<b>Amount (US\$)</b>	<b>%</b>	<b>Inspection and supervision fee:</b>	<sup>(c)</sup>
<b>IDB (Ordinary Capital):</b>	60.0 million	90%	<b>Weighted average life:</b>	15.25 years
<b>Local</b>	6.7 million	10%	<b>Currency of approval:</b>	U.S. dollar
<b>Total</b>	66.7 million	100%		
Project at a Glance				
<b>Project objective/description:</b> The project objective is to contribute to the state's fiscal sustainability through: (i) modernization of fiscal management; (ii) improvement of tax administration; and (iii) improvement of public expenditure management. This project is the eleventh individual loan operation under the PROFISCO II CCLIP (BR-X1039), approved by the Board of Executive Directors pursuant to Resolution DE-113/17.				
<b>Special contractual conditions precedent to the first disbursement of the loan proceeds:</b> (i) the borrower adheres to the program <a href="#">Operating Regulations</a> previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) the project coordination unit (PCU) has been established, and its members appointed (see paragraph 3.4).				
<b>Special contractual execution conditions:</b> Prior to the start of execution of activities with the Office of the Rio Grande do Sul State Attorney General (PGE/RS) as beneficiary, the executing agency will sign a cooperation agreement with that entity, specifying the roles and responsibilities of the parties during project implementation (see paragraph <b>Error! Reference source not found.</b> )				
<b>Exceptions to Bank policies:</b> None.				
Strategic Alignment				
<b>Challenges<sup>(d)</sup>:</b>	SI <input type="checkbox"/>	PI <input checked="" type="checkbox"/>	EI <input type="checkbox"/>	
<b>Crosscutting themes<sup>(e)</sup>:</b>	GD <input type="checkbox"/>	CC <input type="checkbox"/>	CI <input checked="" type="checkbox"/>	

<sup>(a)</sup> 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, interest rate, and commodity conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

<sup>(b)</sup> 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.

<sup>(c)</sup> 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.

<sup>(d)</sup> SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

<sup>(e)</sup> 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 project is the eleventh individual loan operation under the PROFISCO II conditional credit line for investment projects (CCLIP) (BR-X1039), approved by the Board of Executive Directors pursuant to Resolution DE-113/17, to consolidate the progress made by the PROFISCO I CCLIP (BR-X1005) and continue to pursue the states' fiscal management modernization.
- 1.2 The PROFISCO II CCLIP (BR-X1039) was approved in 2017 for US\$900 million with the aim of improving fiscal sustainability through: (i) modernization of fiscal management; (ii) improvement of tax administration; and (iii) improvement of public expenditure management. Agencies in Brazil's 26 states, the Federal District, and the Federative Republic of Brazil receiving a favorable recommendation to develop an individual operation from the Planning Ministry's External Financing Commission will be eligible borrowers.
- 1.3 The PROFISCO II CCLIP (BR-X1039) aims to increase tax revenue, improve the country's business environment and competitiveness, and was designed primarily to support: (i) complementing the Digital Public Accounting System (SPED) by automating tax auditing and tax obligations, making it possible to eliminate at least 12 monthly tax returns per taxpayer; (ii) improvements in public purchasing, by using reference prices, reducing costs and processing times; and (iii) strengthening of processes, methodologies, and technologies already begun under PROFISCO I CCLIP.
- 1.4 **Economic and fiscal conditions in Brazil.** Brazil's GDP contracted by 6.9% in real terms between 2014 and 2016. Growth only resumed recently in 2017, at 1.0%, and stayed at approximately the same level in 2018. The economy is expected to grow nearly 0.9% in 2019, and 2% in 2020.<sup>1</sup>
- 1.5 The decline in economic activity caused consolidated public sector revenue to fall sharply by around three percentage points, from 34.5% of national GDP in 2013, to 31.3% in 2018). In contrast, inertial forces kept public expenditure rising steadily during this period, from 37.4% of national GDP in 2013, to 38.1% in 2018.<sup>2</sup> As a result, the federal government posted a succession of primary deficits (2.5%, 1.8%, and 1.7% of national GDP in 2016, 2017, and 2018, respectively), and public investment retreated sharply by 24.2% between 2014 and 2017). The public debt grew from 60% of national GDP in 2013, to 78.6% in 2018, and may surpass 90% in 2023.<sup>3</sup>
- 1.6 To mitigate the crisis, the federal government is promoting economic measures to promote fiscal sustainability. Congress approved the pension system reform,<sup>4</sup> and bills addressing the fiscal balance responsibility program of subnational governments and economic freedom were sent to Congress, to cut red tape and improve the business climate. The National Congress is debating other tax reform

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<sup>1</sup> [Brazilian Institute of Geography and Statistics \(IBGE\)](#) and [Central Bank of Brazil, 2019](#).

<sup>2</sup> [Tesouro Transparente](#).

<sup>3</sup> [International Monetary Fund \(IMF\), 2019](#).

<sup>4</sup> The reform raises the minimum retirement age for men and women, as well as the contribution period for the retirement plan.

proposals, including the creation of a nationwide value-added tax. Lastly, the federal government is speeding up the infrastructure privatization and concessions program.

- 1.7 **Fiscal conditions in Rio Grande do Sul.**<sup>5</sup> Rio Grande do Sul has Brazil's fourth largest economy, representing 6.5% of GDP in 2016.<sup>6</sup> Owing to the economic crisis that affected the country, the average annual GDP growth rate in Rio Grande do Sul went from 5.5% from 2003 to 2013, to 1.2% in 2014, -3.54% in 2015, and 0.65% in 2016. The setback in economic activity had a greater impact on the fragile condition of the state's public accounts, which have historically highly leveraged their current resources in service to the debt<sup>7</sup> and payroll expenses, including pension payments.<sup>8</sup> Financial liabilities also exceed available funds, and their capacity to generate funds is insufficient to cover financial obligations. The state's [payment capacity rating](#) is therefore D,<sup>9</sup> based on the National Treasury Department (STN) fiscal risk rating methodology.
- 1.8 In light of this situation, the Government of Rio Grande do Sul is still negotiating with the federal government in 2019 to join the Fiscal Recovery System ([RRF](#)), created to assist states with financial imbalance in restoring balance to their public accounts. The RRF allows the state: (i) to suspend payment of the debt to the federal government for the term of the loan; and (ii) to potentially access new credit operations to advance income from privatizations or for modernizing fiscal administration. Temporary suspension of debt payment and income from new credit operations will allow the state to implement fiscal adjustment measures, to clean up public accounts and resume the sustainable path of long-term fiscal balance.
- 1.9 Current income grew 2.7% annually in real terms from 2014 to 2018, while annual growth was 5.4% during the period 2001-2013, before the start of the crisis. This result is heavily influenced by revenue from the goods and services sales tax (ICMS), which is on average 70% of current income. Despite little dependence on transfers from the federal government (13% in 2018), the state was negatively affected by decreased growth of the State Revenue Sharing Fund (FPE), which fell declined from average annual real growth of 8.7% in 2002-2011 to 2.4% in 2012-2018.
- 1.10 To address slowed revenue growth and the increase in current expenditures, part of the fiscal adjustment has been made by reducing investment costs. Investment costs, which reached 6.6% of total expenditures in 2010, retreated sharply in the last two years, falling to 1.4% of total expenditures in 2015, 1.7% in 2016, 1.9% in 2017, recovering to 2.8% in 2018. The state's investment capacity has been volatile in recent years and has relied on borrowing. The primary balance, as percentage of state GDP, went from a surplus of 1.08% in 2008 to -0.29% in 2014,

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<sup>5</sup> [IBGE](#) and [National Treasury Department \(STN\), 2019](#): data source for paragraphs 1.5 to 1.7.

<sup>6</sup> [IBGE](#). 2016 is the last year with statistics available for all the Brazilian states.

<sup>7</sup> The high debt load reflects the debt owed to the federal government (Law 9496/97).

<sup>8</sup> Human resources policy rules for public officials do not allow decisions to reduce payroll expenditure. Pension costs were 54% of personnel expenditure in 2016.

<sup>9</sup> The federal government gives states with a payment capacity rating of C and D an exemption to contract sovereign guarantee loan operations to modernize their fiscal management.

- 0.12% in 2015, and -0.16% in 2016, with strong impacts on the state's fiscal sustainability.
- 1.11 **Rationale.** The country's slow economic recovery and the state's vulnerability underscore the need for new fiscal management modernization actions, to keep public accounts in balance and consolidate their fiscal sustainability. The PROFISCO I/RS operation (loan 2371/OC-BR)<sup>10</sup> emphasized the improvement of tax administration, promoting: (i) fiscal integration of the state with other levels of government by implementing the Digital Public Accounting System (SPED); (ii) improved audit and revenue collection capability, by implementing an integrated management model using "business intelligence" data cross-referencing, and by implementing a new communications structure (INFOVIA); and (iii) improvements in management and control of tax litigation, which increased recovery of taxes owed. This project will take these lines of modernization further and promote: (i) strengthening of public expenditure management; (ii) use of the SPED and digital technologies to improve fiscal intelligence, electronic auditing, inspection, and public procurement, and other areas; and (iii) simplification of tax compliance, to enhance the state's competitiveness.
- 1.12 The effectiveness and efficiency of public institutions are constrained by the restrictions faced by their staff, access to information technology, availability of financial resources, and the legal framework (Arenas de Mesa, 2016, Finan et al., 2017). The empirical evidence demonstrates the need for strong fiscal institutions, to create a more robust environment that fosters fiscal sustainability (Poterba, 1999).
- 1.13 The State of Rio Grande do Sul Finance Department (SEFAZ/RS) thus needs to address lingering weaknesses holding back its fiscal performance. In terms of human resources, SEPAZ/RS has a staff of 1,427 (1,384 permanent employees and 43 consultants), 89% of whom have completed higher education. Despite the lack of a management model or procedures for assessing and sizing its workforce that would enable it to quantify and determine staff qualifications and composition, the process of improving human resources management began with mapping the 149 competencies of SEFAZ/RS and assessing the profile of 51% of its civil servants. Rio Grande do Sul has also had a [code of ethics and public ethics commission](#) for its employees since 2008, and a State Revenue Department [code of conduct](#) since 2014. Little training is available for professional qualification, considering that the average total SEFAZ/RS budget during 2015-2018, was US\$599.2 million, 59% for payroll and 40% for investment, but less than 1% for training. Considering that 30% of civil servants could retire immediately, there is no knowledge transfer and training program for staff or training program for new leaders.<sup>11</sup>
- 1.14 In terms of technological infrastructure constraints, SEFAZ/RS hardware and systems have been partially modernized with computers and improved storage and processing capacity. In recent years, however, the digitization of a large volume of tax documents in the SPED requires increasingly more storage capacity; currently, 81.01% of this capacity is already used by data and documents. Storage

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<sup>10</sup> [PROFISCO I/RS project completion report \(loan 2371/OC-BR\)](#).

<sup>11</sup> [Human Resources - SEFAZ/RS](#).

- capacity should therefore be expanded, given data and information protection, retrieval, and data integrity needs.<sup>12</sup> Network monitoring, server, and system software deficiencies, constraints, and obsolescence cause delayed response times and longer processing times for services.<sup>13</sup>
- 1.15 SEFAZ/RS currently manages 2,500 workstations.<sup>14</sup> Given an average usage life of six years, many have low processing power and operational instability, resulting in slowness and lost work. The user satisfaction index in 2018 was 88.8%. The SEFAZ/RS information and communications technology (ICT) section maintains all 40 SEFAZ/RS computer systems and coordinates 53 computer systems based at the State of Rio Grande do Sul Data Processing Company (PROCERGS), 40 of which are on obsolete platforms.<sup>15</sup> Lastly, tools to support information technology (IT) management and governance processes are makeshift and inadequate,<sup>16</sup> complicating decision-making processes.
- 1.16 In terms of the legal framework, there is uncertainty surrounding how tax incentives (exemptions) are granted and monitored, given that there are still [920 regulations](#) related to tax exemptions. Currently 282,287 businesses<sup>17</sup> benefit from tax exemptions, which adds complexity to tax administration and makes them difficult for auditors, accountants, and taxpayers to consult. Additionally, to satisfy their ICMS tax commitments, taxpayers must file several different tax returns, which could be done through a single return to avoid duplication.<sup>18</sup>
- 1.17 Other important challenges involved in strengthening fiscal sustainability in Rio Grande do Sul were identified using the Fiscal Management Maturity and Performance Assessment (MD-GEFIS) methodology,<sup>19</sup> the Institutional Capacity Assessment System (ICAS), and in the [Matrix of Problems, Solutions, and Results](#), which is used to define products and activities, based on the problems and challenges identified, as described below:
- 1.18 **Fiscal management and transparency.** SEFAZ/RS corporate processes relating to institutional governance, personnel and technology management, and fiscal citizenship and transparency are insufficiently developed and integrated,<sup>20</sup> which limits their institutional performance. This is a consequence of:

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<sup>12</sup> The hardware and software equipment acquired in PROFISCO I/RS was meant to receive a large volume of data and information resulting from electronic invoicing. Now these data are to be cross-referenced to generate information for the business sector.

<sup>13</sup> [IT report - SEFAZ/RS.](#)

<sup>14</sup> Work stations for employees, interns, and subcontractors.

<sup>15</sup> [SEFAZ/RS Information systems](#) and [PROCERGS Computer Systems.](#)

<sup>16</sup> [IT Master Plan – SEFAZ/RS.](#)

<sup>17</sup> [Report – Tax exemptions RS.](#)

<sup>18</sup> [Flow for issuing tax returns.](#)

<sup>19</sup> [MD-GEFIS report](#) and [MD-GEFIS matrix.](#)

<sup>20</sup> MD-GEFIS report: Two of the six dimensions of financial management display low maturity; three intermediate; and one is advanced.

- a. **Low maturity of results-based SEFAZ/RS institutional management strategy,**<sup>21</sup> owing to: (i) weaknesses and lack of clarity in the institutional management model, involving the strategic, tactical, and operational levels; (ii) current strategic planning method is complex, with difficulty in monitoring the prioritization of strategic projects, allocation of resources, and business risk management; and (iii) difficulty in strategic alignment among areas lacking performance reviews to consolidate information for project, process, and results management.
- b. **Human resources management is not aligned with the institutional strategy, limiting the scope of institutional results,**<sup>22</sup> owing to: (i) SEFAZ/RS human resources management is not aligned with the institutional strategy, with management information on independent systems and no skills-based training plan; (ii) no structured knowledge and innovation management model; (iii) high rate of SEFAZ/RS employee absenteeism due to work-related health problems;<sup>23</sup> and (iv) no integrated data for managing PGE/RS workforce management or institutional communication mechanisms in line with the organizational strategy.
- c. **High risk of information technology service unavailability,**<sup>24</sup> owing to: (i) no SEFAZ/RS ICT process, project, or risk management methodology or formally established security policy; (ii) IT modules and systems programmed in an obsolete language, complicating support and maintenance, and addressing demands for new technology solutions; and (iii) outdated processing infrastructure requiring storage expansion, as well as insufficient and/or obsolete network and security infrastructure.<sup>25</sup>
- d. **Low procurement and contracts management capacity at SEFAZ/RS,**<sup>26</sup> owing to: (i) manual routines with no standardized process flow and poor communication among participants; (ii) limited alignment of procurement/contracting with regard to strategy; (iii) obsolete procurement and contracting modules, not integrated with other SEFAZ/RS systems; and (iv) failure to update procurement technical team.
- e. **Limited effectiveness of institutional communication with the public,**<sup>27</sup> owing to: (i) outdated, ineffective communication channels, considering new instruments and the reach of modern society; (ii) low public understanding of tax policy and public expenditure management due to the lack of a strategy; and (iii) information to the public offered on multiple channels, using varied language that is difficult for the public to access and understand.

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<sup>21</sup> [Institutional management report – SEFAZ/RS.](#)

<sup>22</sup> [SEFAZ/RS human resources management report](#) and [PGE/RS human resources management.](#)

<sup>23</sup> The most common health problems are: (i) mental and behavioral health disorders (34%); (ii) musculoskeletal disorders (24%); and (iii) injuries.

<sup>24</sup> [SEFAZ/RS IT services report](#); [IT management report](#); [Enterprise systems](#); [IT infrastructure.](#)

<sup>25</sup> SEFAZ/RS also uses cloud services to back up data and information.

<sup>26</sup> [SEFAZ/RS purchasing report.](#)

<sup>27</sup> [Institutional communication channels](#); [fiscal education](#) and [transparency.](#)

- 1.19 In **tax administration**, revenue performance falls short of potential.<sup>28</sup> This is a result of:
- a. **Insufficient input for tax policy decision-making and tax policy evaluation**,<sup>29</sup> owing to: (i) absence of a formal methodology to assess the impacts of tax policy when a large volume of information is manually processed; (ii) unofficial availability of tax legislation, resulting in diverse interpretations; (iii) inadequate procedure for handling legal challenges to tax laws, complicating real time action by the state.
  - b. **High cost of compliance with tax obligations**,<sup>30</sup> because: (i) taxpayers file two documents monthly to calculate their tax owed—the digital tax record (EFD) and the Information and Calculation Guide (GIA)—without knowing the impact of eliminating tax calculation documents on users (SEFAZ/RS and taxpayers); (ii) outdated systems make it difficult to implement new functions and integration according to Economy Ministry guidelines; and (iii) the lack of integration between federal and state foreign trade systems results in differing information about the same process.
  - c. **Limited effectiveness of enforcement with actions distant in time from the event triggering the tax owed**,<sup>31</sup> owing to: (i) weakness in the treatment of large volumes of data, making it difficult to obtain qualified, structured data to identify taxpayer compliance; (ii) no management tools to investigate structured tax fraud; and (iii) inspection of goods in transit is not systematic and not integrated with other areas of SEFAZ/RS.
  - d. **High cost of tax litigation to taxpayer and to state government**,<sup>32</sup> due to: (i) phases of process preparation, records of collection, and notifications of decisions are decentralized and nonstandardized, aggravated by low integration of administrative and judicial entities; and (ii) low integration among systems of the PGE/RS, state government, and judiciary, owing to the lack of systematic litigation risk management and the state's contingent liabilities.
  - e. **Weak taxpayer customer service**,<sup>33</sup> owing to: (i) in-person, decentralized customer service with limited standard operating procedures, manual data processing, and weak physical infrastructure for taxpayer access; and (ii) taxpayer services relating to the vehicle tax are only available in-person, and control procedures are manual.

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<sup>28</sup> Tax evasion in Brazil is estimated at 7.6% of national GDP (National Association of National Treasury Attorneys General, 2016). The fiscal gap for states, including tax exemptions, tax evasion, and declared but unpaid taxes, is much greater. For example, using the federal government's School of Finance Administration methodology, the State of Piauí Finance Department estimated the ICMS fiscal gap in 2012 at 34.6%, and the State of Pará Finance Department estimated an ICMS fiscal gap of 27.6% in 2014.

<sup>29</sup> [Tax policy report](#); [tax law report](#); [lawsuit report](#).

<sup>30</sup> [Tax obligation report](#).

<sup>31</sup> [Fiscal action report](#).

<sup>32</sup> Rio Grande do Sul tax litigation reports – [administrative](#) and [judicial](#).

<sup>33</sup> [Customer service](#) and [taxpayer service](#) reports.

- f. **Limited efficiency of administrative collection**,<sup>34</sup> owing to: (i) excess operational/manual activities and large number of government employees with collection duties; (ii) systems developed on outdated platforms, making new functionality and integration difficult; (iii) fragmented data for collection management actions; and (iv) insufficient collections regulation to link collection actions to the profile of taxpayers in arrears.
  - g. **High cost to taxpayer and tax authorities to pay taxes**,<sup>35</sup> owing to: (i) taxpayer difficulty in making tax payment, because of the complexity of issuing tax forms through the State Revenue Service portal; (ii) manual processing of data revenue estimates; and (iii) complex tax collection system is not user-friendly for taxpayer, and has limited integration with other SEFAZ/RS systems.
- 1.20 Shortcomings in **financial administration** and **public expenditure management** make it difficult to improve results in terms of fiscal discipline and public expenditure efficiency and effectiveness. The causes are:
- a. **Shortcomings in state budgetary and financial resource management, with limits on the control and lack of punctuality in accounting records**,<sup>36</sup> due to: (i) inadequate integration of budgetary, financial, and accounting processes, with shortcomings in the flow of information, which creates a risk of errors due to manual and sectorized treatment; (ii) undocumented knowledge in areas of budget, financial, and payroll management; (iii) technology gap in systems and data processing; and (iv) no integration of FPE and different state enterprise systems.
  - b. **Inefficient and insecure payroll management**,<sup>37</sup> because: (i) the system is limited in scope and relies on low efficiency manual procedures in payment control, opening the way for systemic and recording errors; and (ii) the pension application and approval process is manual and lacks data and automated control of beneficiaries and dependents, and of payment of employer and social security contributions, resulting in differing information, hindering tax collection management and application of fines.
  - c. **Inefficient management of state liabilities**,<sup>38</sup> owing to the absence of reliable information about the value of legal proceedings, due to physical processes with multiple lenders and manual processing, resulting in errors.
  - d. **Elevated operational risk in public debt management**,<sup>39</sup> owing to: (i) insufficient integration of public debt management with budgetary and financial management; (ii) system rules are not updated; and (iii) the debt management system is not compatible with the diversity and complexity of contracts law, resulting in manual processing of data.

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<sup>34</sup> [Collections report.](#)

<sup>35</sup> [Revenue report.](#)

<sup>36</sup> [SIAF report.](#)

<sup>37</sup> [Payroll management report.](#)

<sup>38</sup> [Liability management report.](#)

<sup>39</sup> [Public debt report.](#)

- e. **Limited knowledge of fiscal risks**,<sup>40</sup> owing to: (i) limited capacity for medium-term fiscal projections; (ii) insufficient studies to support fiscal policy projections; (iii) limited risk management methodology; and (iv) manual processing of fiscal risk projections.
  - f. **Inefficient audit management and integrity controls**,<sup>41</sup> owing to: (i) audit management system not based on international auditing standards; (ii) lack of management tools for monitoring recurring audit recommendations; and (iii) no compliance or administrative process control.
  - g. **Ineffective public expenditure**,<sup>42</sup> owing to: (i) absence of systematically documented public expenditure process data;<sup>43</sup> (ii) priority sectors lack quality monitoring of public expenditure; (iii) limited use of electronic invoicing in public purchasing; (iv) electronic fiscal invoicing data for municípios not shared; (v) absence of public policy impact assessment methodologies in the state; and (vi) limited knowledge of new cost verification methodologies.
- 1.21 **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) (loan 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.<sup>44</sup> At other levels of government, the Bank supported the Federal Revenue Service Fiscal Modernization Program (1996) and the Fiscal Management Program for Brazilian Municipalities (PNAFM loans I/1194/OC-BR, II/2248/OC-BR, and III/3391/OC-BR). The following operations have already been approved under the PROFISCO II CCLIP (BR-X1039): Piauí (loan 4460/OC-BR); Maranhão (loan 4458/OC-BR); Ceará (loan 4436/OC-BR); Pará (loan 4459/OC-BR); Pernambuco (loan 4554/OC-BR); Mato Grosso do Sul (loan 4597/OC-BR); São Paulo (loan 4706/OC-BR) and Espírito Santo (loan 4741/OC-BR).
- 1.22 According to the [midterm evaluation](#) of the PROFISCO I CCLIP, between 2009 and 2013, states with a PROFISCO project at an advanced stage of execution took in an average of 6% more ICMS revenue than states with a PROFISCO program in the early stages. Based on the [PROFISCO I/RS project completion report \(loan 2371/OC-BR\)](#), project performance was successful (relevance-excellent; effectiveness-satisfactory; efficiency-satisfactory; and sustainability-satisfactory). Of the seven originally planned outcome targets, six were achieved (86.0%).<sup>45</sup> In terms of tax revenue, the implementation of electronic

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<sup>40</sup> [Fiscal risk report](#).

<sup>41</sup> [Audit and control report](#).

<sup>42</sup> [Public expenditure report](#).

<sup>43</sup> [Better Spending for Better Lives, IDB](#).

<sup>44</sup> Policy-based loan programs: 2081/OC-BR; 2841/OC-BR; 2850/OC-BR; 3039/OC-BR; 3061/OC-BR; 3138/OC-BR; and 3139/OC-BR.

<sup>45</sup> Two additional outcome targets were added during execution. See the [PROFISCO I/RS project completion \(loan 2371/OC-BR\)](#).

invoicing (US\$26.5 billion), of the data center (US\$14.2 billion), and the tax litigation management model (US\$3.5 billion) directly contributed to an increase in state tax revenue. In regard to public expenditure, the implementation of state human resources system (US\$2.5 billion), public accounting system (US\$772,000), and governance mechanisms (US\$774,000) contributed to more efficient financial administration, promoting greater accountability and enhanced levels of control and transparency among the state's public financing systems (budgetary, treasury, and auditing). The performance of the executing agency and the Bank were rated satisfactory. The PROFISCO II/RS actions will focus on: (i) reducing personnel expenditure and cost savings related to procurement and service delivery; and (ii) increasing revenue through fiscal action and recovery of taxes owed.

1.23 **Lessons learned.** The lessons learned from the PROFISCO I CCLIP and the PROFISCO I/RS program include the following:

- a. **Design.** The need for a tool to identify innovative solutions to fiscal management processes. The MD-GEFIS was designed for this reason, to identify the maturity and opportunities to strengthen the states' fiscal management processes.<sup>46</sup>
- b. **Development.** Participation by SEFAZ/RS in the [Fiscal Management Commission Network](#) fostered an exchange of know-how and solutions for modernization of fiscal management with other states.
- c. **Execution.** To make up for delays in execution, the Bank created a monitoring tool known as the execution acceleration plan, which uses the progress monitoring report (PMR) to identify outputs with delays and prepares mitigating measures until execution is normalized.
- d. **Results.** The SPED, including the NF-e, the EFD, and the digital bookkeeping system were identified as the outputs that contributed the most to increasing the efficiency of the states' fiscal controls.<sup>47</sup> This operation will invest in the SPED, and seek to maximize its potential by expanding the use of the data generated by it to automate tax auditing<sup>48</sup> and simplify tax compliance, among other areas, leveraging the new technologies of the digital economy.
- e. **PROFISCO I/RS** A 24-month extension of the disbursement period was obtained, to achieve the program outcomes, recognizing that the negative factors affecting it were: (i) difficulty preparing terms of reference and technical specifications; (ii) difficulty with technical acceptance of the technical specification documents, according to internal approval flows; and (iii) insufficient knowledge of Bank procurement standards and policies in the early years of execution. The following lessons learned have therefore been incorporated into the PROFISCO II/RS program: (i) engage specialized

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<sup>46</sup> [Inter-American Center of Tax Administrations \(CIAT\), 2017.](#)

<sup>47</sup> [McKinsey & Company, 2014](#): NF-e and SPED increased the risk to tax evaders that they will be identified and contributed to a reduction in informal employment in Brazil over the last ten years (from 55% to 40%).

<sup>48</sup> Araujo, 2013: The use of SPED and artificial intelligence will increase the identification of tax fraud.

consulting support to prepare terms of reference and specifications; (ii) training for all actors involved in the procurement process, creation of a special bidding committee and use of the state electronic system; and (iii) redesign of internal dialogue between the PCU and the other SEFAZ/RS technical areas. Actions are also proposed to: (i) guarantee the sustainability of IT investments through planning and prioritization of resources to upgrade and maintain data infrastructure and security; and (ii) strategically plan interdependent products and anticipate the preparation of complex terms of reference, with the support of specialized consultants.

1.24 **The Bank's experience in other countries of the region.** The Bank's recent experience with tax reform in Costa Rica (loan 4819/OC-CR); Ecuador (loan 3325/OC-EC), El Salvador (loan 3852/OC-ES), Honduras (loan 3541/BL-HO), Jamaica (loan 2658/OC-JA) and Peru (loan 3214/OC-PE); modernization of financial management modernization systems in Guyana (loan 1550/SF-GY and 1551/SF-GY), Honduras (loan 2032/BL-HO), and Nicaragua (loan 2422/BL-NI); and management of public investment in Argentina (loan 3835/OC-AR), Bolivia (loan 3534/BL-BO), Chile (loan 1281/OC-CH), Ecuador (loan 2585/OC-EC), Mexico (loan 2550/OC-ME), Paraguay (loan 3628/OC-PR), Panama (loan 2568/OC-PN) and Peru (loan 2703/OC-PE), 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](#).

1.25 In terms of taxation, tax collection performance is highly dependent on institutional strengthening of the tax administration and its organizational structure, processes, and supporting tools: (i) improving the accessibility and quality of the information available;<sup>49</sup> (ii) implementing data-intensive inspection models;<sup>50</sup> (iii) simplifying procedures to facilitate tax compliance;<sup>51</sup> and (iv) defining strategies to ensure the suitability and motivation of staff.<sup>52</sup> Several Latin American tax administrations have strengthened these elements, particularly Brazil and Uruguay.<sup>53</sup> In terms of financial management strengthening, the available evidence shows that automation without improving processes does not produce the expected results.<sup>54</sup> In terms of cost efficiency and effectiveness, various studies indicate the need to establish a public expenditure management system that adopts a multiyear outlook for budget development, such as the medium-term budgetary framework.<sup>55</sup> Countries that have a solid medium-term budgetary framework tend to be more effective in reaching their fiscal targets.<sup>56</sup>

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<sup>49</sup> Slemrod et al. (2015); Pomeranz (2015); Kleven et al. (2011).

<sup>50</sup> Almunia and López Rodríguez (2016).

<sup>51</sup> Hallsworth et al. (2014).

<sup>52</sup> Khan et al. (2016).

<sup>53</sup> PCR 1783/OC-UR. Barreix and Zambrano (2018).

<sup>54</sup> PCR 1550/SF-GY and 1551/SF-GY.

<sup>55</sup> [World Bank \(2013\)](#) and [1998](#).

<sup>56</sup> [IMF, 2013](#) and [World Bank, 2013](#).

- 1.26 **Strategic alignment.** The project is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008), and strategically aligned with the development challenge of productivity and innovation, by reducing tax collection costs through the use of information and digital technology; and with the crosscutting theme of institutional capacity and rule of law, by strengthening tax systems and public resource management and planning systems. The project contributes to the Corporate Results Framework (CRF) 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 Integrated Financial Administration System (SIAF); (iii) subnational governments benefited by decentralization, fiscal management, and institutional capacity projects; (iv) countries that use national fiduciary systems; and (v) accountability institutions strengthened. The project is also aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) and consistent with the following sector framework documents: 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) promoting greater transparency and accountability.
- 1.27 **The Bank's country strategy.** The project is aligned with the IDB Group country strategy with Brazil 2019-2022 (document GN-2973) through the following strategic objectives: (i) reform the structure of public expenditure (Components 1 and 3); (ii) refine the public investment system (Component 3); and (iii) use of e-government and digital solutions to promote transparency, accountability (Component 1), and efficiency, refining citizen and business services (Component 2). The project is also aligned with the crosscutting theme of digital innovation and transformation (Components 2 and 3). Lastly, the operation is included in the Update of Annex III of the 2019 Operational Programming Report (document GN-2948-2).

**B. Objectives, components, and cost**

- 1.28 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. The project will finance the following components:
- 1.29 **Component 1. Fiscal management and transparency (US\$28,814,580).** This component seeks to improve management instruments, modernize the technology infrastructure, and make the tax administration more transparent to the general public, by enhancing SEFAZ/RS's institutional performance. It will finance the implementation of the following:

- a. **Institutional governance model<sup>57</sup> (US\$2,538,657),<sup>58</sup>** including: (i) process mapping and redesign; (ii) institutional strategy management methodology; and (iii) institutional performance assessment system, including project monitoring modules; processes and strategy/results.
  - b. **Human resources management model<sup>59</sup> (US\$7,723,150),** including: (i) quality of life plan;<sup>60</sup> (ii) knowledge management plan, including implementation of a knowledge portal; and (iii) purpose- and competency-based human resources management at SEFAZ/RS and the PGE/RS through the implementation of human resources management systems integrated into existing enterprise systems.<sup>61</sup>
  - c. **IT management model (US\$15,892,000),<sup>62</sup>** including: (i) implementation of enterprise systems; (ii) IT governance and management plans by implementing an IT risk management system;<sup>63</sup> and (iii) IT platforms with business intelligence, communication (VOIP), backup, and with expanded IT security actions, expanded storage and data processing capacity.<sup>64</sup>
  - d. **SEFAZ/RS procurement and contracting planning and management model (US\$610,000),** including: (i) process mapping and redesign; (ii) normalization of internal flows; (iii) procurement management methodology; (iv) procurement management system; and (v) training plan.
  - e. **Transparency and fiscal citizenship model (US\$2,050,773),** including: (i) institutional communication channels (intranet, Internet, mobile applications); (ii) fiscal education plans; and (iii) unified transparency portal.<sup>65</sup>
- 1.30 **Component 2. Tax administration and litigation (US\$22,433,513).** This component seeks to make tax collection more efficient, increase revenues and simplify compliance with tax obligations. It will finance implementation of the following:

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<sup>57</sup> Model means a set of activities that may include: (i) diagnostic assessment of the current situation; (ii) a methodology and change proposal; (iii) process re-engineering; (iv) an information technology solution; and (v) training on new processes and tools.

<sup>58</sup> Amounts for each output are indicative.

<sup>59</sup> List of the stages of the model at [MEP](#).

<sup>60</sup> The quality of life plan sets out guidelines and planning of entertainment and behavioral development actions for SEFAZ employees.

<sup>61</sup> Systematic. IT systems means software that comprises a set of rules to support operationalization of the business model.

<sup>62</sup> The IT governance and management model and data security plan will specify responsibilities and resources for IT infrastructure maintenance and upgrading, and data security actions, respectively.

<sup>63</sup> With the definition of responsibilities and resources for the maintenance and upgrading of IT infrastructure.

<sup>64</sup> The information security plan establishes guidelines and [data protection and cybersecurity actions](#), based on solution of firewall protection, management and monitoring tools.

<sup>65</sup> Transparency implies opening, communication, accountability, and access to public information is a fundamental for achieving it.

- a. **Tax policy management model (US\$1,724,269)**, including: (i) system for managing tax policy lawsuits by implementing impact assessment methodology and developing a tax concession management system; (ii) structured tax legislation consultation portal; and (iii) tax policy management system.
- b. **Tax simplification system (US\$1,320,480)**, including: (i) uniform ICMS expedited document module with the EFD adaptation for substituting the information and calculation guide and develop a technological solution for calculating tax based on the EFD; (ii) module for integration with the National Network for Simplification of Business Registration, with upgrades of legacy systems; and (iii) module for integration with the Foreign Trade Single Window ([Siscomex](#)).
- c. **Audit model (US\$7,628,933)**, including (i) audit actions planning system (planning/execution and information processing); (ii) IT solutions for asset recovery through the development of an IT solution to analyze linkages and bank transactions; and (iii) inspection system of goods in transit.
- d. **Tax litigation model (US\$5,709,911)**, including (i) electronic tax administration process (e-PAT) management system, with a solution for automation of tax litigation and modules to integrate the SEFAZ/RS and PGE/RS systems; and (ii) legal tax litigation management system, including the following modules: collection, advanced investigation of duplicate processing, control of legal processes and of contingent liabilities.
- e. **Taxpayer services management model (US\$4,630,720)**, including: (i) online customer service available to ICMS taxpayers with the available self-service options, such as portal, chatbot, mobile device applications; and (ii) taxpayer services system for the motor vehicle ownership tax (IPVA) and ICMS on vehicles with a technological solution for registration, exemptions, and collection through online electronic forms and process automation.
- f. **Administrative collection system (US\$862,000)**, including: (i) collection system modules with the migration of registration and adjudicated tax debt systems to the credit management system; and (ii) development of a collection system with the following modules: selection of debtors; debtor portfolio management, procedural safeguards, automatic debit to checking account, integration of tax litigation systems databases.
- g. **Revenue collection system (US\$557,200)**, including: (i) revenue forecast methodology; (ii) process automation; and (iii) modules to upgrade obsolete computer systems.

1.31 **Component 3. Financial administration and public expenditure (US\$12,751,907)**. This component seeks to enhance fiscal discipline and increase the efficiency and effectiveness of public expenditure. It will finance the implementation of:

- a. **Budget, financial, and accounting management system (US\$6,666,663)**, including: (i) mapping, conceptual and functional designs, and process redesign; (ii) normalization of budget management procedures; and (iii) budget, financial, and accounting management system modules: (a) finances; and (b) integration with the budget management system.
  - b. **Payroll management system for active employees and retirees US\$1,783,229**, including: (i) process mapping and redesign; (ii) automated virtual service mechanism; and (iii) active employee and retiree payroll management system modules: (a) active payroll management; and (b) management of retirees and pensioners.
  - c. **Liability management system, including court-ordered payments, legal agreements, and trials (US\$490,667)**, including: (i) process mapping and redesign; and (ii) court-ordered payment management system, with control of procedural periods and integration between the PGE/RS and the Rio Grande do Sul Court of Justice systems.
  - d. **Public debt management system (US\$239,200)**, including court-ordered payment management system modules: (i) contract administration rules; (ii) projections and scenarios; and (iii) integration with the finance system.
  - e. **Fiscal risk management system (US\$198,934)**, covering: (i) fiscal scenario projection methodology and fiscal risk management; (ii) economic and fiscal studies; and (iii) fiscal risk monitoring system.
  - f. **Risk-analysis based fiscal management auditing model (US\$1,054,334)**, including: (i) audit management modules; (ii) audit panel; and (iii) compliance control and related administrative processes system.
  - g. **Cost quality model (US\$2,318,880)**, including: (i) matrix management model; (ii) price setting systems for public purchasing; (iii) public prices portal; and (iv) impact assessment methodology applied in the sector.
- 1.32 The project will finance US\$11.9 million in consulting services (individual consultants and firms); US\$22.3 million in nonconsulting services; US\$21.3 million in goods; US\$4.6 million in training; US\$4.6 million in civil works, which consists of remodeling existing SEFAZ/RS unit physical spaces; and US\$2 million in contingencies.
- 1.33 **Beneficiaries.** By enhancing the performance of public finances, increasing tax revenue intake, and increasing the efficiency of public expenditure, the greater fiscal sustainability of the state will benefit its citizens, business and individual taxpayers, and public and nongovernmental entities through better service delivery, facilities, and lower costs of tax compliance, as well as greater availability of information and data for public management and transparency in public accounts.
- C. Key results indicators**
- 1.34 The expected impacts are: (i) a decrease in the state's primary fiscal deficit/GDP ratio; (ii) an increase in state's tax revenue intake/GDP-RS ratio; and (iii) a decrease in state's net current debt/GDP ratio. The expected outcomes are: (i) an increase in the ratio between strategic planning targets met to total targets

planned; (ii) a decrease in in the ratio of collection cost to tax revenue intake; and (iii) a decrease in the discrepancy between the budget as planned and as executed.

- 1.35 **Cost effectiveness analysis.** A cost-benefit [economic analysis](#) of the project was based on its economic/financial benefits: (i) increase in tax revenue by adopting a new collection model; (ii) cost savings through process automation, greatly reducing the time spent by auditors and tax agents performing tasks that are currently manual; and (iii) reduced cost to taxpayers by shortening service times by replacing in-person access channels with virtual access channels. By end-2029 (10 years), the project's investments will have a net present value of US\$17.3 million and an internal rate of return (IRR) of 33.9%.<sup>66</sup> These results are robust to a sensitivity analysis that considered three different scenarios: a 30% devaluation of the Brazilian real (IRR of 36.1%), a 25% reduction in all benefits (IRR of 32.7%), and a scenario that combines both devaluation and reduction in benefits (IRR of 15.7%).

## II. FINANCING STRUCTURE AND MAIN RISKS

### A. Financing instruments

- 2.1 This operation was designed as a specific investment loan under the PROFISCO II CCLIP (BR-X1039) with an estimated total cost of US\$66.7 million, to be financed by an investment loan of US\$60.0 million from the Bank's Ordinary Capital resources (90% of total project cost), and a local counterpart contribution of US\$6.7 million (10% of total project cost). The following table provides a breakdown of resources by funding source and category:

**Table 1. Total budget (US\$)**

Categories	IDB	Local	Total	%
<b>A. Direct costs</b>	<b>57,300,000</b>	<b>6,700,000</b>	<b>64,000,000</b>	<b>96.0</b>
<b>Component 1.</b> Fiscal management and transparency	26,414,580	2,400,000	28,814,580	43.2
<b>Component 2.</b> Tax administration and litigation	21,100,179	1,333,334	22,433,513	33.6
<b>Component 3.</b> Financial administration and public expenditure	9,785,241	2,966,666	12,751,907	19.1
<b>B. Project management</b>	<b>700,000</b>	-	<b>700,000</b>	<b>1.0</b>
1. Monitoring and evaluation	520,000	-	520,000	0.8
2. Auditing	180,000	-	180,000	0.2
<b>C. Contingencies<sup>67</sup></b>	<b>2,000,000</b>	-	<b>2,000,000</b>	<b>3.0</b>
<b>Total</b>	<b>60,000,000</b>	<b>6,700,000</b>	<b>66,700,000</b>	<b>100</b>
<b>%</b>	<b>90</b>	<b>10</b>	<b>100</b>	

<sup>66</sup> Base-case scenario, excluding increase in tax revenue intake.

<sup>67</sup> Contingencies: resources that can be used for eligible expenditures in relation to any of the project components.

- 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	4,780,101	9,036,015	14,124,701	18,122,130	13,937,053	60,000,000
Local	268,333	792,667	1,998,000	2,090,001	1,550,999	6,700,000
<b>Total</b>	<b>5,048,434</b>	<b>9,828,682</b>	<b>16,122,701</b>	<b>20,212,131</b>	<b>15,488,052</b>	<b>66,700,000</b>
%	8	15	24	30	23	100%

- 2.3 **Compliance with the PROFISCO II CCLIP eligibility conditions (BR-X1039).** This project is the eleventh individual loan operation under the PROFISCO II CCLIP (BR-X1039), approved by the Board of Executive Directors pursuant to Resolution DE-113/17. The project meets the eligibility criteria of the CCLIP policy (document GN-2246-9)<sup>68</sup> and its operational guidelines for individual loan operations, given that: (i) the project falls within the fiscal sector and is compatible with all components of the PROFISCO II CCLIP; (ii) the project is included in the Update of Annex III of the 2019 Operational Programming Report (document GN-2948-2); (iii) the state will implement the operation through SEFAZ/RS, which was the same executing agency as for the first individual operation under the PROFISCO I CCLIP (loan 2371/OC-BR); and (iv) the state satisfactorily executed the PROFISCO I/RS program, meeting seven of the nine stated outcome targets at program close, according to the [PROFISCO I/RS project completion report \(loan 2371/OC-BR\)](#). The executing agency also complied with the Bank's contractual requirements and disbursement policies, and its accounts were audited and found to meet the required quality standards; and (v) the findings of the institutional analysis show that the performance level of the SEFAZ/RS has not deteriorated, and the same project execution and monitoring tools may be used for this new operation as for the previous one. The project coordination unit (PCU) staff will be the same.

**B. Environmental and social safeguard risks**

- 2.4 In accordance with the Bank's Environment and Safeguards Compliance Policy (Operational Policy OP-703), Directive B.03, this project is classified as category "C." The project only includes remodeling of interior spaces, so no socioenvironmental risks are anticipated.

**C. Fiduciary risks**

- 2.5 The following high-level fiduciary risk was identified: If procurement processes and flows are not streamlined from publication through contract signature, it will generate uncertainty as to the law and duplication of effort, which will delay the delivery of Loan Contract outputs. This risk will be mitigated through: (i) redesign of procurement flows; (ii) creation of an SBC; and (iii) encouraging training of the team directly involved in the processes.

<sup>68</sup> This operation has been prepared pursuant to eligibility criteria set forth in document GN-2246-9, in accordance with paragraph 3.12 of document GN-2246-13.

## D. Other key risks and issues

2.6 The operation was found to be medium risk. The following risks were identified:

- a. **Fiscal sustainability (medium-high risk).** If the state of Rio Grande do Sul does not adhere to the [Fiscal Recovery System \(RRF\)](#), the expected adjustment will not occur, and the unfavorable fiscal position will continue, which will affect meeting the proposed impact indicator targets during project execution. This risk will be mitigated through: (i) signature of the RRF and frequent coordination with the STN; and (ii) other actions to improve fiscal management: (a) [renegotiation of the debt to the federal government](#); (b) [creation of a complementary pension system](#); (c) [passage of the State Fiscal Responsibility Law](#); and (d) compliance with [legislative authorizations to adhere to the RRF](#).
- b. **Development (medium-high risks).** The following risks were identified: (i) If the STN's response capacity is insufficient due to the high degree of dependence on information and communications technology to implement outputs, prioritization of IT outputs will be inadequate, which will cause delays in the project's fiscal/financial timeline. To mitigate this risk, the procurement flows for IT-related outputs will be reviewed (see paragraphs 1.29(c) and 1.29(d)); and (ii) if there is a lack of technical capacity or time to prepare terms of reference and process training, there will be delays in initiating the procurement of outputs within the scope of the project, extending the physical and financial timeline. To mitigate this risk specialized technical support and training will be contracted; and a procurement consultant will be assigned to the PCU (see paragraph 1.29(d)).

2.7 **Financial analysis.** The [analysis of Rio Grande do Sul's financial conditions](#) indicates improvement in the state's financial accounts and expansion of its payment capacity to address debt servicing observations, which is 0.0044% of state GDP in 2018, and 0.051% of net current income in 2018. Although the STN rates the state as category D (see paragraphs 1.7, 1.8, and 2.6(a)), substantial improvements in the state's financial conditions are expected through the negotiation of the RRF with the federal government, and Rio Grande do Sul's adjustment measures to rebalance its public accounts.<sup>69</sup> Additionally, with the signing of the RRF, STN will suspend penalties for noncompliance with the personnel expenditure limit and allow loan contracts to be signed in anticipation of privatizations. Lastly, Rio Grande do Sul already meets the minimum constitutionally mandated expenditure amounts in education and health.

2.8 **Project sustainability.** In addition to the steps the government is already taking (see paragraph 2.6(a)), the project includes measures conducive to fiscal sustainability in the medium and long term, such as cutting spending and reducing tax evasion, which will generate higher income.<sup>70</sup> To ensure that the capabilities developed by the project are sustainable once execution is complete, the PROFISCO II/RS program includes actions to reduce personnel expenditures and create savings in procurement costs and service delivery. It will also increase revenues by improving tax inspection actions and recovery of tax debt, with the

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<sup>69</sup> [STN Report](#).

<sup>70</sup> Outputs of Components 2 and 3.

following related outputs: state active employee and retiree payroll management; unification of tax registry and simplification of tax obligations; tax concession management; the use of new auditing and fiscal intelligence technologies; among other factors (see [economic analysis](#)). In regard to ICT investments, SEFAZ/RS will mainly use permanent staff, PROCERGS support, and specialized consulting for in-house development. The project will also finance an IT Master Plan to maintain and upgrade IT infrastructure; and to implement the data security plan to ensure the cybersecurity of SEFAZ/RS data.

### III. IMPLEMENTATION AND MANAGEMENT PLAN

#### A. Summary of implementation arrangements

- 3.1 The borrower is the state of Rio Grande do Sul, which will execute the operation through the Rio Grande do Sul State Finance Department (SEFAZ/RS). The Federative Republic of Brazil will be the guarantor of the borrower's financial obligations, pursuant to the policy on Guarantees Required from Borrowers (document GP-104-2). SEFAZ/RS will establish a program coordination unit (PCU), which will have a general coordinator, two technical coordinators (one from SEFAZ/RS and one from the Office of the Rio Grande do Sul State Attorney General (PGE/RS)), an administrative and financial coordinator, a planning and monitoring advisor, and a procurement coordinator. Procurement processes, governed 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) (see paragraph 3.6), will be conducted by a Special Bidding Committee (SBC) established specifically for the project. The PCU will coordinate activities related to the project's monitoring, evaluation, and audit to monitor project execution and achievement of the objectives of the operation. PCU members will be RS government employees.
- 3.2 The PCU's main functions will be to: (i) plan the execution of activities; (ii) implement and update the project's operational tools: the [multiyear execution plan](#), [annual work plan](#) (AWP), and [procurement plan](#); (iii) supervise execution and deliver status reports: multiyear execution plan, AWP, procurement plan, and progress monitoring report (PMR); (iv) support processes for preparing terms of reference, procurement of goods, and the selection and contracting of services; (v) submit disbursement requests and supporting documentation to the Bank; (vi) prepare the audited financial statements; and (vii) deliver the project evaluation. The borrower will adhere to the program [Operating Regulations](#) approved by the Bank for the PROFISCO II CCLIP, which specify: (i) project eligibility criteria 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.
- 3.3 **Interagency coordination mechanism.** SEFAZ/RS will coordinate with the PGE/RS for the execution of activities benefiting that entity. A technical coordinator and output leaders will be appointed for the corresponding outputs at those institutions, who will coordinate their actions with the PCU and supervise their technical development and implementation. For the coordination of these activities related to human resources management and tax litigation, information flows will

be mapped and defined among the beneficiaries, the PCU, and the SBC, clarifying roles, responsibilities and time frames that will be built into the institutional structure through cooperation instruments (see paragraph 3.5).

- 3.4 **Special contractual conditions precedent to the first disbursement of the loan proceeds:** (i) the borrower adheres 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 (PCU) has been established, and its members appointed. These conditions are essential to ensure that the executing agency has detailed regulations on operational and fiduciary aspects of the program, and to mitigate the risks of delay in project execution. This practice was successfully adopted in the PROFISCO I program, having consolidated coordination and guidance issues relevant to the executing agencies, and having ensured more efficient, competency-based distribution of PCU member responsibilities, and for streamlining contracting procedures.<sup>71</sup>
- 3.5 **Special contractual execution condition.** Prior to the start of execution of activities with the Office of the Rio Grande do Sul State Attorney General (PGE/RS) as beneficiary, the executing agency will sign a cooperation agreement with that entity, specifying the roles and responsibilities of the parties during project implementation. The following activities will be coordinated with the PGE/RS: (i) human resources management, as provided in Component 1; and (ii) tax litigation management, as provided in Component 2. This condition was satisfactorily adopted in PROFISCO I and made it possible to identify specific responsibilities by entity, taking into account the implementation periods, and mitigating the risk of delays of outputs during execution. Adopting this practice again to ensure the cooperation mechanism with the PGE/RS is therefore justified, because PGE/RS is independent of SEFAZ/RS (see paragraph 2.6(b)).
- 3.6 **Procurement.** Project procurement and contracting processes will follow 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), as well as the provisions of the [procurement plan](#).
- 3.7 **Single-source selection.** Based on the policies in document GN-2349-9 and document GN-2350-9, the following will be engaged through single-source selection: (i) the National School of Public Administration (ENAP) of the Ministry of Economy, state government schools, federal and state universities, and data processing companies, specifically in the case of this project, State of Rio Grande do Sul Data Processing Company ([PROCERGS](#))<sup>72</sup> will be directly contracted to provide training for government employees and technical assistance in IT development; (ii) analysis, research, and consulting for IT buyers by the company [Gartner do Brasil Serviços de Pesquisas Ltda.](#);<sup>73</sup> and (iii) software

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<sup>71</sup> [PROFISCO I PCU, 2015](#).

<sup>72</sup> Paragraphs 3.6(b) and 3.6(c) of document GN-2349-9, due to the need to develop standardized software and unique technical nature.

<sup>73</sup> Paragraphs 3.10 and 3.11 of document GN-2350-9, for continuity of service, and for excellence and exceptional qualifications.

development for payment management and operational life by the company [Techne](#).<sup>74</sup> Single-source selection in the above cases is justified because the federal and state entities engage in training for government employees, because of their unique and exceptional nature as government centers for IT learning, research, and development; and the companies Gartner and Techne have already been performing these services satisfactorily (see Annex II, paragraphs 4.5 through 4.7) and [justification for direct contracting and single-source selection](#) ).

- 3.8 **Audited financial reports.** The borrower will deliver audited financial statements to the Bank annually, no later than 120 days after the close of each fiscal year. The external audit will be performed by an external audit firm acceptable to the Bank, or by the Rio Grande do Sul State Audit Office, which is eligible to perform external audits of Bank-financed operations. SEFAZ/SP will commission the audit of the entire project, the terms of reference for which will require the Bank's no objection.

**B. Summary of arrangements for monitoring results**

- 3.9 **Monitoring.** 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 PMR. The PCU will prepare six-monthly reports on progress toward outcomes, outputs, and financial targets for approval by the Bank, which will conduct inspection visits and ex post reviews as part of project monitoring.

- 3.10 **Evaluation.** The project will be evaluated against the annual targets and indicators for outcomes and outputs specified in the Results Matrix through before-and-after comparison of results. The [monitoring and evaluation plan](#) calls for an independent midterm evaluation, delivered within 90 days after 36 months have passed following signature of the loan contract, or after the date on which 50% of the loan proceeds for the project have been disbursed, whichever occurs first; and a final evaluation 90 days after the date of the last disbursement. The evaluation reports will serve as an input for the project completion report (PCR).

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<sup>74</sup> Paragraphs 3.10(d) and 3.11 of document GN-2350-9, to provide continuity of service.

Development Effectiveness Matrix		
Summary		BR-L1534
<b>I. Corporate and Country Priorities</b>		
<b>1. IDB Development Objectives</b>		
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 (#)* -Countries that use fiduciary country systems (#)* -Accountability institutions strengthened (#)*	
<b>2. Country Development Objectives</b>		
Country Strategy Results Matrix	GN-2973	(i) reform the structure of public expenditure; (ii) perfect the public investment system; and (iii) promote e-government and digital solutions to foster transparency, accountability, and efficiency in delivering public services to citizens and enterprises.
Country Program Results Matrix	GN-2948-2	The intervention is included in the 2019 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
<b>II. Development Outcomes - Evaluability</b>		Evaluable
<b>3. Evidence-based Assessment &amp; Solution</b>		10.0
3.1 Program Diagnosis		3.0
3.2 Proposed Interventions or Solutions		4.0
3.3 Results Matrix Quality		3.0
<b>4. Ex ante Economic Analysis</b>		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
<b>5. Monitoring and Evaluation</b>		10.0
5.1 Monitoring Mechanisms		2.5
5.2 Evaluation Plan		7.5
<b>III. Risks &amp; Mitigation Monitoring Matrix</b>		
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
<b>IV. IDB's Role - Additionality</b>		
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, Contracting Individual Consultant.
Non-Fiduciary	Yes	Strategic Planning National System, Statistics National System, Environmental Assessment 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 Rio Grande do Sul ná 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 Rio Grande do Sul. To achieve this end, the proposal defines three specific areas on which the project will intervene. The first area is fiscal management. The second area is tax administration. The third area is the administration of public expenditure. Each of these areas is associated to 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 BR-X1039.

The project proposal diagnoses a primary balance as a share of the State PIB of -0.8 percent in 2018, and a Current Net Debt as a share of the State PIB of 18.9 Percent in 2018 (SEFAZ, 2018). 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 19 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. The costs include investment in technology and fund for its operation. The analysis concludes with a net present value of US\$17 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 using reference prices based on electronic bill information on expenditure. The evaluation relies on a randomized control trial.

The project identifies six risks and one is classified as high, four as medium, and one as low. The risk classified as high is the delay on the acquisition and processes impacting the delivery of outputs. The matrix proposes to mitigate the risk by designing new processes, creating a Special Procurement Commission, and training the team directly involved.

## RESULTS MATRIX

<b>Project objective:</b>	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.
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### EXPECTED IMPACT

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
<b>Impact 1: Decrease in the state's primary fiscal deficit/GDP ratio</b>												
Primary balance/GDP-RS	%	-0.81	2018	-0.78	-0.46	-0.36	-0.31	-0.26	-0.26	2024	Rio Grande do Sul State Finance Department (SEFAZ/RS) Treasury report	See <a href="#">monitoring and evaluation plan (MEP)</a>
<b>Impact 2: Increase in state's tax revenue intake/GDP-RS ratio</b>												
Tax revenue intake/GDP-RS	%	8.01	2018	7.96	7.98	8.01	8.04	8.09	8.09	2024	SEFAZ Tax administration report	See <a href="#">MEP</a>
<b>Impact 3: Decrease in state's net current debt/GDP ratio</b>												
Net current debt <sup>1</sup> /GDP-RS	%	18.9	2018	19.2	19.2	19.4	19.1	18.5	18.5	2024	SEFAZ/RS Treasury report	See <a href="#">MEP</a>

<sup>1</sup> Defined as the amount of consolidated debt less the balance of financial assets (cash and other financial assets). Source: National Treasury Department (STN).

### EXPECTED OUTCOMES<sup>2</sup>

Outcome 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
<b>Outcome 1: Increase in the ratio between strategic planning targets met to total targets planned</b>												
Number of targets met/Total targets	%	59.72	2018	62.0	64.0	67.0	70.0	75.0	75.0	2024	SEFAZ Annual strategic planning report	See <a href="#">MEP</a>
<b>Outcome 2: Decrease in the ratio of collection cost to tax revenue intake</b>												
SEFAZ operating budget/Total tax revenue intake	%	1.15	2018	1.15	1.15	1.13	1.11	1.09	1.09	2024	RS State summary balance sheet, and SEFAZ/RS financial report	See <a href="#">MEP</a>
<b>Outcome 3: Decrease in the discrepancy between the budget as planned and as executed</b>												
Budget as executed/Budget as planned <sup>3</sup>	%	1.02	2018	5.00	5.00	5.00	5.00	5.00	5.00	2024	RS State summary balance sheet and Annual Budget Law – SEFAZ/RS	See <a href="#">MEP</a>

### OUTPUTS<sup>4,5</sup>

Outputs	Unit of measure	Baseline	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of Verification	Comments
<b>Component 1: Fiscal management and transparency</b>											
1.1 Institutional governance model <sup>6</sup> implemented	Model	0	2019	0	0	0	1	0	1	SEFAZ/RS management report	See <a href="#">MEP</a>
1.2 Human resources model implemented	Model	0	2019	0	0	0	0	1	1		
1.3 Information technology management model implemented	Model	0	2019	0	0	0	0	1	1		

<sup>2</sup> Expected outcomes are not cumulative.

<sup>3</sup> The discrepancy between the budget as executed and budget as planned is only 1.02%, because the RS planning methodology is based on real income. The target is to maintain performance within the range of 5%, which is the recommendation of the Public Expenditure and Financial Accountability ([PEFA](#)) methodology.

<sup>4</sup> Outputs are annual.

<sup>5</sup> Systems, models, and software will only be considered complete once they are in use by public officials.

<sup>6</sup> Model means a set of activities that may include: (i) diagnostic assessment of the current situation; (ii) a methodology and change proposal; (iii) process re-engineering; (iv) an information technology solution; and (v) training on new processes and tools.

Outputs	Unit of measure	Baseline	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of Verification	Comments
1.4 SEFAZ planning, procurement and contracts management model implemented	Model	0	2019	0	0	0	1	0	1		
1.5 Social communication and transparency model implemented	Model	0	2019	0	0	0	0	1	1		
<b>Component 2: Tax administration and litigation</b>											
2.1 Tax policy management model implemented	Model	0	2019	0	0	0	1	0	1	SEFAZ/RS management report	See <a href="#">MEP</a>
2.2 Tax simplification system <sup>7</sup> implemented	System	0	2019	0	0	0	0	1	1		
2.3 Tax audit model implemented	Model	0	2019	0	0	0	0	1	1		
2.4 Litigation management model implemented	Model	0	2019	0	0	0	0	1	1		See <a href="#">MEP</a>
2.5 Taxpayer services management model implemented	Model	0	2019	0	0	0	0	1	1		
2.6 Administrative collection management system implemented	System	0	2019	0	0	0	0	1	1		
2.7 Collection system implemented	System	0	2019	0	0	0	1	0	1		
<b>Component 3: Financial administration and public expenditure</b>											
3.1 Budgetary, financial, and accounting management system implemented	System	0	2019	0	0	0	0	1	1	SEFAZ/RS management report	See <a href="#">MEP</a>
3.2 Active employee and retiree payroll management system implemented	System	0	2019	0	0	0	0	1	1		

<sup>7</sup> Software system comprises a set of rules to support operationalization of the business model.

Outputs	Unit of measure	Baseline	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5	Final Target	Means of Verification	Comments
3.3 Taxpayer management system implemented, including court-ordered payments, legal agreements, and procedural events	System	0	2019	0	0	0	1	0	1		
3.4 Public debt management system implemented	System	0	2019	0	0	0	1	0	1		
3.5 Fiscal risk management model implemented	Model	0	2019	0	0	0	1	0	1		
3.6 Risk analysis-based fiscal management audit model implemented	Model	0	2019	0	0	0	0	1	1		
3.7 Quality of expenditure model implemented	Model	0	2019	0	0	0	0	1	1		

## FIDUCIARY AGREEMENTS AND REQUIREMENTS

<b>Country:</b>	Brazil
<b>Project number:</b>	BR-L1534
<b>Project name:</b>	Fiscal Management Modernization Project for the State of Rio Grande do Sul (PROFISCO II/RS)
<b>Executing agency:</b>	State of Rio Grande do Sul (RS), acting through the Rio Grande do Sul State Finance Department (SEFAZ/RS)
<b>Fiduciary team:</b>	David Salazar and Fábía Bueno (VPC/FMP)

### I. EXECUTIVE SUMMARY

- 1.1 The institutional evaluation for the project's fiduciary management was based on: (i) the country's current fiduciary context; (ii) the findings of the 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 on the first Program to Support the Management and Integration of Tax Administrations in Brazil (PROFISCO I); and (vi) working meetings with the project team and the team of the Rio Grande do Sul State Finance Department (SEFAZ/RS).
- 1.2 Brazil has robust country fiduciary systems enabling sound management of administrative, financial, control, and procurement processes, in accordance with the principles of transparency, economy, and efficiency. The executing agency's planning and organization, execution and control systems have a medium level of development and represents a medium level of risk.
- 1.3 SEFAZ/RS has the legal capacity and experience to execute project activities, having already implemented projects with the Bank—the Fiscal Modernization Project (PROMOFAZ) and PROFISCO I—using its own structure with a project coordination unit (PCU). The structure already implemented and consolidated will be used, drawing on lessons learned from the execution of the first phase.

### II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

- 2.1 The SEFAZ/RS structure comprises: Bureau and Advisory Chief; Internal Affairs and Ethics; Tax Appeals Court; Financial Coordination; Steering Committee; State Accounting and Auditor General (CAGE/PR); Finance and Revenue Collection.
- 2.2 The project will benefit SEFAZ/RS as the executing agency and the Office of the Rio Grande do Sul State Attorney General (PGE/RS).
- 2.3 The project activities will be executed by SEFAZ/RS, acting through its PCU, responsible for institutional and technical coordination, affiliated with the Office of the Treasury Secretary.

- 2.4 Procurement processes will be conducted by a Special Bidding Committee (SBC) established specifically for the program, in accordance with Bank policies. The executing agency will also use a Bank-approved e-procurement system for the electronic reverse auction and price list modalities.
- 2.5 The executing agency is subject to both internal and external control. Internal control is exercised by CAGE/RS, and external control by the Rio Grande do Sul State Audit Office (TCE/RS), which audits all state entities and is eligible to conduct external audits of Bank-financed operations.

### **III. INSTITUTIONAL CAPACITY ASSESSMENT, FIDUCIARY RISK EVALUATION, AND MITIGATION ACTIONS**

- 3.1 The institutional capacity assessment and validation with SEFAZ/RS staff concluded that executing agency has sufficient and adequate institutional capacity with specific opportunities for improvement for the execution of operations with the Bank.
- 3.2 The following high-level fiduciary risk was identified: (i) If procurement processes and flows are not streamlined from publication through contract signature, it will generate uncertainty as to the law and duplication of effort, which will delay the delivery of Loan Contract outputs. This risk will be mitigated through: (i) redesign of procurement flows; (ii) creation of an SBC; and (iii) encouraging training of the team directly involved in the processes.

### **IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION**

#### **A. Procurement execution**

- 4.1 **Procurement of works, goods, and nonconsulting services** Contracts will be subject to international competitive bidding (ICB) and executed using the standard bidding documents (SBDs) issued by the Bank. Bidding processes subject to national competitive bidding (NCB) will be executed using national competitive bidding documents agreed upon with the Bank.
- 4.2 **Selection and contracting of consultants** Contracts will be executed using the standard request for proposals (RFP) issued by the Bank. Selection and contracting will follow the Policies for the Selection and Contracting of Consultants Financed by the Inter-American Development Bank (document GN-2350-9).
- 4.3 **Use of country procurement system.** The country procurement (sub)system approved by the Bank, *Pregão Eletrônico*, will be used to purchase off-the-shelf goods in amounts up to US\$5 million. Any system or subsystem that may be approved subsequently will be applicable to the operation. The procurement plan and its updates will identify which procurements are to be executed using the approved country systems.

#### **B. Direct contracting and single-source selection**

- 4.4 **Schools and government agencies.** Taking into account the structure of Brazil's finance departments, there are entities responsible for knowledge and capacity building: (i) the National School of Public Administration (ENAP) of the Ministry of Economy; (ii) government training schools for public officials; (iii) data-processing

companies responsible for developing state information technology (IT) systems; and (iv) federal and state universities offering technical assistance on new IT solutions. Federal and state agencies providing training to public officials and IT development will be engaged via single-source selection, in accordance with the terms of paragraphs 1.11(c) and 3.10 of document GN-2350-9, and to provide sustainability to project-financed and developed products. Specific to this project, the state-run Rio Grande do Sul Data Processing Company (PROCERGS) will be contracted in the amount of US\$8.5 million.

- 4.5 **Research and advisory support for information technology.** The firm Gartner do Brasil Serviços de Pesquisas Ltda. will be engaged via single-source selection under paragraph 3.10 of document GN-2350-9, given its exceptional experience and qualifications to deliver the required consulting services. The estimated value of this contract is US\$460,000.
- 4.6 **Technical support to implement technological solutions to payment management and operational life.** Given the need to standardize the systems to be developed with existing systems, and the unique service requirement, the firm Techne will be engaged via direct contracting under paragraph 3.6, subparagraphs (b) and (c) of document GN-2349-9. The estimated value of this contract is US\$1.2 million.

**Table 1. Thresholds for ICB and international short list**

Method	ICB Works	ICB Goods and nonconsulting services	International short list for consulting services
<b>Threshold</b>	US\$25 million	US\$5 million	US\$1 million

**Table 2. Main Procurements**

Procurement item	Selection method	Estimated date	Estimated amount (US\$ million)
<b>Goods and nonconsulting services</b>			
IT solution for audit process	<i>Pregão eletrônico</i>	2021-II	3.2
Enterprise systems development	Direct	2021-I	8.5
<b>Consulting firms</b>			
Gartner	Direct	2020-II	0.45
Institutional governance model	QCBS	2021-III	2.0

### C. Procurement supervision

- 4.7 The ex post supervision method will be used, except where justification is shown for ex ante supervision and direct contracting/single-source selection. Procurements executed using the country system will also be supervised via the country system.
- 4.8 The supervision method will be determined for each selection process. Ex post reviews will be every 12 months in accordance with the project supervision plan.

**Table 3. Threshold for ex post review**

Works	Goods	Consulting services
NCB and Shopping	NCB	Less than US\$1 million

#### **D. Records and files**

- 4.9 The PCU will be responsible for process documentation and will retain the necessary documentation for supervision and audit purposes.

### **V. FINANCIAL MANAGEMENT**

- 5.1 **Programming and budget.** SEFAZ/RS will be responsible for planning of the PROFISCO II activities, and the PCU for execution and oversight of activities, as indicated in the project execution plan and the annual work plan. State entities use the following planning instruments: the multiyear execution plan, the Budget Guidelines Law (LDO), which establishes budgetary parameters, and the Annual Budget Law (LOA). The project budget will be included in the LOA.
- 5.2 The PCU will ensure that the budgetary resources for the project, Bank, and local contribution are budgeted annually, and earmarked for execution in accordance with the project programming. The budgetary resources will be recorded as an external source in the year of execution in the Budget Preparation System (SEO). The LOA will include the necessary funds for execution of both the external loan and the local contribution.
- 5.3 **Accounting and information systems.** Public entities in RS work with the State Public Finance System (FPE), which integrates the State's financial, budgetary, and account management. The system is auditable and has access profiles and security protocols. It also meets the Bank's requirements on controls and will be used for the execution of the PROFISCO II program. For PROFISCO I, disbursement and external audit reports required by the Bank were prepared in Excel, based on FPE system data (by data extraction). The project will benefit from the experience of other states that have already implemented their financial management system under PROFISCO II to generate such reports.
- 5.4 **Disbursements and cash flow.** The project will use the SEFAZ/RS treasury system. Expenditures will be subject to the financial and budgetary execution process and must be duly recorded in the FPE System.
- 5.5 As in the PROFISCO I program, Bank resources will be administered through the State Single Account, operated at a public bank. Use of a subaccount will enable loan proceeds to be identified and reconciled, including credits and debits.
- 5.6 Disbursements will be made in U.S. dollars in the form of form of advances of funds. Advances will be based on a projection of financial resources of up to 180 days. Future advances will be subject to accounting for at least 80% of total funds previously disbursed.
- 5.7 Expenditures considered ineligible by the Bank will be reimbursed from the local contribution or from other funds, as the Bank's discretion, depending on the nature of the ineligibility.
- 5.8 The exchange rate agreed upon with the executing agency for use in accounting for expenditures paid from advances of loan funds will be the internalization rate. To determine the equivalence of expenditures incurred as the local contribution or as reimbursement of expenditures chargeable to the loan, the agreed rate will be the

exchange rate set by the Central Bank of Brazil on the payment date of eligible expenditures to the project.

- 5.9 **Internal control and internal audit.** The CAGE/RS is the agency responsible for state internal control. CAGE/RS activities are conducted through offices of internal control, public hearings, transparency, and internal affairs and ethics. It will oversee the project activities.
- 5.10 **External control and reports.** External control will be exercised by the Rio Grande do Sul State Audit Office (TCE/RS).
- 5.11 The annual audited financial reports will be delivered within 120 days after the close of each fiscal year, pursuant to procedures and terms of reference previously agreed upon with the Bank.
- 5.12 **Financial supervision plan.** This plan may be amended during project execution, in response to evolving risk levels or additional control needs.

**Table 4. Supervision plan**

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

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/19

Brazil. Loan \_\_\_\_/OC-BR to the State of Rio Grande do Sul. Fiscal Management Modernization Project for the State of Rio Grande do Sul – PROFISCO II – RS. Eleventh Individual Loan 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 Rio Grande do Sul, 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 Rio Grande do Sul – PROFISCO II – RS, which constitutes the eleventh individual loan operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 – Fiscal Management Modernization Program in Brazil – PROFISCO II, approved on 8 December 2017 by Resolution DE-113/17. Such financing will be for the amount of up to US\$60,000,000, from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on \_\_\_\_\_ 2019)