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BRASIL

NATIONAL PROGRAM TO SUPPORT THE ADMINISTRATIVE AND FISCAL MANAGEMENT OF BRAZILIAN MUNICIPALITIES
(PNAFM III)

(BR-L1377)

LOAN PROPOSAL

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17. Tax Me, But Spend Wisely The Political Economy of Taxes, Theory and Evidence from Brazilian Local Governments
http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=39211754

ABBREVIATIONS

CEF	Caixa Econômica Federal [Federal Savings Bank]
CGU	Controladoria-Geral da União [Office of the Comptroller General]
COGEP	Comitê Gestor da Rede PNAFM [PNAFM Network Management Committee]
COOPE	Cooperation Program and Project Administration General Coordination Unit
DEPs	Distance Education Programs
FFF	Flexible Financing Facility
FPM	Fundo de Participação dos Municípios [Municipal Participation Fund]
ICB	International Competitive Bidding
IPTU	Imposto sobre a Propriedade Predial e Territorial Urbana [Rural and Urban Property Tax]
ISS	Imposto sobre Serviços de Qualquer Natureza [Services Tax]
ITBI	Imposto Sobre a Transmissão Inter Vivos de Bens Imóveis [Property Transfer Tax]
PCU	Project Coordination Unit
PCU/MF	Ministry of Finance Project Coordination Unit
PMR	Project Monitoring Report
PNAFM	Program to Support the Administrative and Fiscal Management of Brazilian Municipalities
SIAFI	Federal Government Integrated Financial Administration System
STN	Secretaria do Tesouro Nacional [National Treasury Department]

PROJECT SUMMARY
BRAZIL
NATIONAL PROGRAM TO SUPPORT THE ADMINISTRATIVE AND FISCAL MANAGEMENT OF BRAZILIAN MUNICIPALITIES
(PNAFM III)
(BR-L1377)

<table>
<tr><th colspan="6">Financial terms and conditions</th></tr>
<tr><td colspan="4" rowspan="3">Borrower: Federative Republic of Brazil</td><td colspan="2">Flexible Financing Facility (FFF)*</td></tr>
<tr><td>Amortization period:</td><td>24 years</td></tr>
<tr><td>Original Weighted Average Life:</td><td>15.25 years</td></tr>
<tr><td colspan="4" rowspan="2">Executing agency: Ministry of Finance</td><td>Grace period:</td><td>6.5 years</td></tr>
<tr><td>Disbursement period:</td><td>6 years</td></tr>
<tr><td rowspan="2">Source</td><td colspan="3">Phases (US$ million)</td><td rowspan="2">Inspection and supervision fee:</td><td rowspan="2">**</td></tr>
<tr><td>III</td><td>IV</td><td>V</td></tr>
<tr><td>IDB: Ordinary Capital</td><td>150.0</td><td>250.0</td><td>250.0</td><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td>Local</td><td>16.7</td><td>25.0</td><td>25.0</td><td>Credit fee:</td><td>**</td></tr>
<tr><td>Total</td><td>166.7</td><td>275.0</td><td>275.0</td><td>Currency:</td><td>U.S. dollars from the Bank’s Ordinary Capital, under the FFF</td></tr>
<tr><th colspan="6">Project Outline</th></tr>
<tr><td colspan="6">Objective. The general objective of this Phase III of five phases of the National Program to Support the Administrative and Fiscal Management of Brazilian Municipalities (PNAFM) is to enhance municipal fiscal autonomy by modernizing administrative, fiscal, financial, and asset management in Brazil’s municipalities.</td></tr>
<tr><td colspan="6">Special contractual clauses precedent to the first disbursement. The first disbursement of loan proceeds is subject to the borrower’s submission of the following, under terms acceptable to the Bank: (i) the program Operations Manual; (ii) the contract between the Ministry of Finance and Caixa Econômica Federal [Federal Savings Bank] (CEF), establishing that the CEF will act as joint executing agency and financial agent under Component II of the program; (iii) the draft subloan contract to be signed by the CEF and each municipality; and (iv) evidence of the entry into force of the program Operating Regulations for PNAFM Phase III (see paragraph 3.6).</td></tr>
<tr><td colspan="6">Exceptions to Bank policy. As under PNAFM Phase II, a partial waiver is requested with respect to the Bank’s procurement policies (documents GN-2349-9 and GN-2350-9) so that the Ministry of Finance may apply national legislation for the procurement of goods, works, and nonconsulting services in amounts below the thresholds for international competitive bidding (ICB). It is also proposed that municipal sub-borrowers be able to apply national legislation for the procurement of goods and works in amounts below the thresholds for ICB, and for consulting contracts with an estimated cost of less than US$1,000,000. In all cases, the principles of competition, economy, equality, dissemination, due process, and other provisions of Section I of the aforementioned procurement policies will be observed (see paragraph 3.9). As in the case of PNAFM Phase II, a waiver is requested of the provisions of document GP-30-1 (Global Loans to Development Finance Institutions), of 7 May 1975, with respect to the use of recoveries (see paragraph 3.12).</td></tr>
<tr><td colspan="6">Project qualifies as: SEQ [ ] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]</td></tr>
</table>

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

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

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 **Brazil's macroeconomic context.** Brazil's macroeconomic context is characterized by a moderate level of risk. The current account of the balance of payments yielded a deficit of US$49.3 billion in the January-July 2014 period. This was financed by capital account inflows of US$63.4 billion over the same period. International reserves stood at US$379 billion at the end of July 2014. Growth projections for 2014 have been revised, standing at around 0.5%, below the 2013 rate of 0.9%. Inflation is expected to continue to exceed the Central Bank of Brazil's target rate (6.75%).[1]

1.2 **Fiscal issues in the municipalities.** Brazil is a federative republic, with three levels of government: federal, state (26 states and the federal district), and municipal (5,564 municipalities). All of these enjoy autonomy in their exercise of tax powers and in defining and implementing public spending policies. Based on the powers of taxation allocated in the constitution, the municipalities are responsible for administering the following taxes: the Imposto sobre a Propriedade Predial e Territorial Urbana [Rural and Urban Property Tax] (IPTU), Imposto sobre Serviços de Qualquer Natureza [Services Tax] (ISS), and the Imposto Sobre a Transmissão Inter Vivos de Bens Imóveis [Property Transfer Tax] (ITBI).

1.3 In addition to revenues from these taxes, the municipalities receive constitutional transfers[2] based on federal and state tax collections.[3] A municipality's share of federal transfers is calculated on the basis of its population and per capita income. State transfers are based on value added generated in the municipality in relation to the Imposto sobre Circulação de Mercadorias e Serviços [Goods and Services Circulation Tax] (ICMS). The distribution criteria for constitutional transfers are enshrined in law, and the level of transfers thus depends mainly on the macroeconomic cycle. For this reason it has barely risen in recent years. Most municipalities depend heavily on transfers from the Fundo de Participação dos Municípios [Municipal Participation Fund] (FPM), which are equivalent, on average, to more than 88% of municipal tax revenues.[4] This is a consequence of institutional weaknesses, which undermine the municipalities' tax collection capacities.[5] Studies indicate that these transfers have a negative impact on fiscal

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1 September 2014 Consumer Price Index, estimated year-on-year increase.

2 The main transfers are (i) the FPM, which is financed by a share of taxes on income and manufactured goods; (ii) 25% of ICMS revenues; and (iii) the Fundo de Manutenção e Desenvolvimento da Educação Básica [Maintenance and Development Fund for Basic Education] (FUNDEB).

3 For further information, see the Evaluation of the Structure and Performance of the Brazilian Tax System (document IDB-DP-265, optional electronic link 6)

4 National Treasury Department, 2012.

5 See details in "Os Desafios da Governança Interfederativa," page 5.

effort in Brazil's municipalities.[6] In order to increase fiscal autonomy in the municipalities, local tax collections must be raised and expenditure management improved, thus reducing the dependency on constitutional transfers.[7]

1.4 At the same time, expenditure management needs to be improved if additional local revenues are to be put to good use. National legislation earmarks approximately 40% of public spending for health and education. Another 40%, on average, is devoted to other payroll and pension expenses. The rest is used for debt payments and other current expenditure. Given these restrictions on expenditure, resources need to be used in the most efficient manner possible.

1.5 **Modernization of the municipalities.** From 1997 to 1999, the Ministry of Finance—through its Executive Secretariat and with Bank support—developed the Program to Support the Administrative and Fiscal Management of Brazilian Municipalities (PNAFM), with US$1.1 billion in financing. The program's objective is to contribute to macroeconomic stability through self-sustaining fiscal balance, supported by efficient and transparent public policies for the management of municipal revenue and spending.

1.6 The PNAFM was originally formulated and approved to be executed in three phases, each with the same components, subcomponents, and outputs. The municipalities targeted under each one were different, however. In 2009, during the approval process for Phase II, it was agreed that the number of PNAFM phases would be increased from three to five in order to fulfill the Bank's portfolio programming agreements with the country. The total original amount of US$1.1 billion was maintained, as well as the structure of program components, subcomponents, and outputs.

1.7 The first phase, for US$300 million, was approved by the Bank's Board of Executive Directors on 11 August 1999.[8] It targeted 60 municipalities and was completed on 31 December 2012.[9] The second phase began execution on 29 December 2009, with US$150 million in financing.[10] The 22 municipalities targeted are still in the final stages of execution, and project completion is expected in December 2015. Under this third phase—also for US$150 million—

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[6] In 2012, transfers accounted for 67.4% of current revenues, while municipal tax collections accounted for 20.3%. See O Impacto das Transferências Constitucionais sobre o Comportamento Fiscal dos Municípios Brasileiros.

[7] See Tax Me, But Spend Wisely The Political Economy of Taxes, Theory and Evidence from Brazilian Local Governments (optional electronic link 17).

[8] See the executive summary of the PNAFM Phase I loan proposal (optional electronic link 7). Although Phase I was approved in August 1999, execution effectively began in January 2002.

[9] The municipalities' lack of experience with the Bank's procurement policies was the main reason for the delay in execution. In addition, although this phase had been approved by the Bank and the federal Senate in 1999, the loan contract was formalized on 18 May 2001 and it was only declared eligible in 2002. The delays with respect to the contract and eligibility, together with the change in federal government in 2003, caused substantial delays to the launch of execution of the phase.

[10] See the executive summary of the PNAFM Phase II loan proposal (optional electronic link 8).

approximately 18 municipalities are expected to participate.[11] The objective is to continue supporting the strengthening of administrative and fiscal management in Brazil's municipalities by incorporating the municipalities that did not participate in the first and second phases.

Table 1. Summary of the first three phases of the PNAFM (US$ million)

Phases	Operation	No. municipalities	Amount	Disbursed	Launch	Completion
I	BR0286	60	300	100%	Jan. 2002	Dec. 2012
II	BR-L1252	22	150	67%	Dec. 2009	Dec. 2015*
III	BR-L1377	18	150	-	Jan. 2015*	Dec. 2020*
Total	-	100	600	-	-	-

* Projected

1.8 **Execution of PNAFM Phase II.** In the semiannual Phase II Project Monitoring Report (PMR) for June 2014, the following outcomes were listed:

Table 2. Phase II Outcomes and Eligibility Criteria for Phase III

Targets	Outcomes	Means of verification
General		
1. **Commitment of resources.** 75% of resources committed.	**Fulfilled**. 98.6%, US$148 million committed as of 2014.	Semiannual PMR, June 2014
Component I. National coordination and technical assistance		
2. **Support for project preparation and review.** Contracts signed for 6 subloans.[12]	**Fulfilled**. Contracts signed for 22 subloans as of 2014.	Semiannual PMR, June 2014
3. **Best practices in the fiscal area.** 2 events held to disseminate best practices.	**Fulfilled**. 12 dissemination events held as of 2014.	
4. **Distance Education Programs (DEPs).** 2 DEPs established.	**Fulfilled**. 4 DEPs established as of 2014.	
Component II. Municipal institutional strengthening		
5. **Potential tax collection by the municipalities.** 50% of participating municipalities assessed.	**Fulfilled**. 81%, 18 assessments completed as of 2014.	Semiannual PMR, June 2014
6. **Baseline for the program's four structural elements.** 50% of studies completed.	**Fulfilled**. 81%, 18 studies completed as of 2014.	

[11] The 18 municipalities that are candidates for the third phase were preselected based on the following criteria: (i) population of over 50,000 in most cases; (ii) submission of a project preapproved by the project execution unit (on a first-come, first-served basis); (iii) availability of resources based on the order in which the projects were submitted; and (iv) municipalities that did not participate in previous phases. In the event that one of the 18 projects does not ultimately qualify, the next project on the list will replace it. There is a list of projects awaiting financing. See the list of municipalities that are candidates for PNAFM Phase III (optional electronic link 9).

[12] A subloan refers to a loan contract signed between the CEF and a municipality, based on a project approved by the project execution unit.

1.9 **Future challenges.**[13] Despite substantial progress under PNAFM Phase II (as presented in Table 2), significant challenges still need to be addressed in terms of the modernization of fiscal management in Brazil's municipalities. The main challenge for the PNAFM is to improve the institutional capacity of Brazil's municipalities to increase tax revenues and improve public expenditure management, thus reducing the dependence on transfers, enhancing fiscal autonomy, and ensuring that any additional revenues raised will be used efficiently. The main causes fall into three categories, described below:

1.10 **Weaknesses in fiscal management mechanisms:** (i) revenue: poor levels of service to citizens resulting from fragmented services,[14] and weak municipal tax collections, stemming from out-of-date municipal databases and an absence of geoprocessing tools;[15] (ii) spending: deficient budget, financial, and accounting management owing to a lack of automated support tools;[16] (iii) management: weak use of municipal powers due to the lack of ongoing technical and management training programs,[17] and poor project management, monitoring, and evaluation, stemming from the lack of support and training tools in the area of project management;[18] and (iv) low levels of automation in municipal management processes due to the lack of integration among municipal systems and databases.[19]

1.11 **Weak municipal project management:** (i) lengthy project preparation times[20] owing to the lack of a culture of strategic planning in the municipalities, as well as the absence of methodologies and technological tools to support project

[13] The Matrix of Problems, Causes, Solutions, and Outcomes (optional electronic link 10) provides details of the challenges presented.

[14] Of the 18 municipalities, 6 have a single window for taxpayer services. These municipalities are able to serve a taxpayer with problems regarding the three taxes in 30 minutes, compared to 60 minutes for those without a single window (source: Project Coordination Unit (PCU)).

[15] Multifunctional registries and geoprocessing systems are available in 10 of the 18 municipalities. In the municipalities that do have them, the cadastral database for calculation of the property tax is 90% up-to-date, on average, compared to 50% in the other municipalities (source: PCU).

[16] Integrated financial management systems are available in 5 of the 18 municipalities. These muncipios prepare their annual accounting reports within one month on average, while in the others it takes an average of five months.

[17] Training programs are implemented in 10 of the 18 municipalities. Of a total of approximately 450 staff in the expenditure and revenue sections of the 18 municipalities, only 55% receive specialized training (source: PCU).

[18] Project execution units exist in 10 of the 18 municipalities. Municipalities with such units manage to prepare their projects within 100 days on average, whereas it takes an average of 150 days in the others (source: PCU).

[19] Of the 18 municipalities, 8 have updated information technology infrastructure. The technological environment risk index for those municipalities that do not have it is 60%, while in those that do it is 30% (source: PCU).

[20] The average preparation and eligibility period for the 22 projects contracted under Phase II was 120 days. With implementation of a supporting IT system, this period can be reduced to 100 days.

preparation; (ii) lengthy municipal project execution periods[21] owing to weak municipal institutional capacity with respect to procurement and contracting processes, as well as a lack of technological tools to support project execution; and (iii) weaknesses in supervision processes for municipal projects, owing to difficulties in accountability and reporting procedures,[22] as well as the insufficient number of technical visits conducted by the Ministry of Finance Project Coordination Unit (PCU/MF).[23]

1.12 **Limits to cooperation and integration between tax authorities:** (i) little leveraging of successful experiences and lessons learned at the national and subnational levels,[24] due to limited participation by the PCU/MF and municipal PCUs in subnational, national, and international tax forums and seminars; (ii) limited knowledge of fiscal management problems in the municipalities, as a result of a lack of available information (studies and reports) on the issue;[25] (iii) weak coordination among municipalities in terms of exchanging common solutions at the municipal level, as a consequence of low participation in events organized for this purpose;[26] and (iv) weaknesses in instruments for managing municipal tax administration, resulting from the limited integration of national and municipal databases.[27]

1.13 **Strategic alignment.** The program will support the regional goal for "institutions for growth and social welfare" established under the Ninth General Increase in the Resources of the Inter-American Development Bank (CGI-9) (document AB-2764). It will do this by supporting (i) an increase in the tax ratio (municipal tax revenues/municipal GDP), bringing this closer to potential levels; and (ii) an increase in municipal revenues with the objective of increasing municipal spending. It will also contribute to the following outputs: (i) integrated financial management systems implemented, and (ii) support for municipal fiscal autonomy through actions to improve local tax collection and public spending efficiency, as defined in the Results Matrix. The program is aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) in the following areas:

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[21] The execution performance index for the 22 Phase II projects was 0.77 in the fifth year of the six years of execution (2007-2012), with 64.26% of funds disbursed. This index comprises two percentages: the percentage disbursed under Component II (64.26%) divided by the amount of time that has passed as of the fifth year of project execution, expressed as a percentage (83% = 5 years/6 years).

[22] Progress reports were submitted on time by 14 of the 22 municipalities in Phase II.

[23] The number of technical visits made by the PCU/MF during the second phase was 40—an average of 2 per municipality. Past experience suggests that the ideal number of visits would be 120.

[24] During Phase II of the PNAFM, there were only two instances of participation by the Ministry of Finance and municipal PCUs in national and international forums promoted by the Encontro Nacional dos Administradores Tributários [National Conference of Tax Administrators] (ENAT). Of the 23 modernization proposals presented at these forums, only five were adopted by the municipalities.

[25] In four years, only two studies were produced under Component I of PNAFM Phase II.

[26] Only four meetings of the PNAFM Network Management Committee (COGEP) were held during the second phase of PNAFM, compared to a recommendation of at least three per year (for a total of 12).

[27] Federal databases are not integrated with municipal ones (e.g. the ITBI and the IPTU).

(i) improvements in service delivery; (ii) revenue generation; (iii) strengthening of fiscal sustainability; and (iv) strengthening and consolidation of decentralization processes. The program is also aligned with the Country Strategy with Brazil, 2012-2014 (document GN-2662-1), which emphasizes the following objectives: (i) promote sustainable fiscal balance at the subnational level; and (ii) improve the efficiency and quality of public expenditure.

1.14 **Lessons learned under PNAFM Phases I and II.** During the first phase it was observed that the execution of projects in municipalities with fewer than 1,000,000 residents was weak, due to limited institutional capacity. As a result, the second phase focused on 22 medium-sized and large municipalities. During the second phase, deadlines were not met for project preparation, execution, and supervision,[28] due to shortcomings in the monitoring of those processes. Thus, in phase III, it was decided to strengthen Component I with actions to underpin greater institutional support for the attainment of better results in: (i) reducing the average time for approval of municipal projects by the PCU/MF; and (ii) improving project preparation, execution, and supervision with the use of the Project Preparation, Execution, Monitoring, and Supervision System (SEEMP).

1.15 **Lessons learned from other subnational Bank programs.** The Bank has implemented a variety of fiscal modernization programs for subnational entities, which are considered to have been successful. This program is part of a long-term process of support by the Bank in this area, which has included the National Fiscal Administration Program for the Brazilian States (PNAFE, 980/OC-BR)[29] and several operations under the state-focused Program to Support the Management and Integration of Finance Administrations in Brazil (PROFISCO). Important lessons have been learned in the fiscal area from these experiences.[30] The PNAFM draws on these experiences,[31] and this has earned it the recognition of the Brazilian authorities (728/SE-MF) and their desire to continue working with the Bank to strengthen fiscal management.

1.16 **Evidence from successful experiences at the subnational level in other countries.** A report by the World Bank's Operations Evaluation Department

[28] PNAFM Phase II midterm evaluation report (lessons learned) (optional electronic link 11).

[29] PNAFE was very similar in nature to PROFISCO, and—according to a dissertation by Jocelino Demuner ("Reflexos do PNAFE na modernização das Administrações Tributárias Estaduais Brasileiras" [The Impact of PNAFE on State Tax Administrations], optional electronic link 12)—it achieved substantial progress in terms of fiscal modernization in Brazil. The dissertation shows that the PNAFE led to a real increase of 8.01% in ICMS collections (page 79), which in 2006 was 11 times higher than the entire amount of US$500 million invested under the program.

[30] The midterm evaluation for the PROFISCO credit line (optional electronic link 13) reported that in the 14 states in which PROFISCO was being executed, ICMS collections increased by 5.6% over the 2009-2012 period, compared to a 4.8% increase in GDP.

[31] The main lessons learned, which have been incorporated into Phase III, are as follows: (i) intensification of the horizontal exchange of information through knowledge networks to enhance efficiency; (ii) intensive use of information technologies to support the fiscal modernization process; and (iii) use of country procurement systems in the three levels of government.

presents the results of a fiscal management institutional strengthening program in a number of municipalities in the Philippines and in municipalities in the Brazilian states of Paraná and Rio Grande do Sul. This project is very similar to the PNAFM, particularly in terms of the objectives for financial autonomy and the generation of local revenues (pages 2 and 3 of the report), as well as the strengthening actions included in its components (page 4 of the report). As a result, property tax collections increased more rapidly in the targeted municipalities than in those that did not participate in the project. Over the 1990-1996 period, property tax collections in the Philippine municipalities that participated in the project rose by 86.8% in relation to per capita income, compared to only 31.9% in municipalities that did not participate.[32] In Brazil, this proportion was 547.1% and 434.7%, respectively (see Figure 2, page 3 of the report). The essay, "Tax Me, But Spend Wisely," cited above, presents the results of 330 Brazilian municipalities that benefitted from the Program to Modernize Tax Administrations (PMAT), implemented by Banco Nacional de Desenvolvimento Econômico e Social (BNDES). It shows a permanent increase of 11% of tax revenues per capita, and this increase has been used to enhance the delivery of public services.

1.17 **Rationale for Phase III.** As mentioned in the introduction to the document, one of the objectives of the PNAFM since its inception has been the quest for fiscal balance in Brazil, for which it is important to promote fiscal sustainability among its subnational governments. The best way of showing that the program is fulfilling this objective is to present the results obtained under the first phase of the PNAFM.[33] Table 3 shows the increase in tax revenues under the first phase. This was higher than the growth seen in a control group of 60 municipalities with similar characteristics, demonstrating the successful design of the intervention. This justifies the Bank's continued support to the other municipalities.

Table 3. Growth Trend in Tax Revenues/Transfers, PNAFM I (R$ million)

Municipalities	Tax Revenues				Autonomy
	Contract date	2011	% change	Annual average	Tax revenues/ transfers trend*
Treatment group (PNAFM I)	7,550	12,461	65.05	13.08	1.16
Control group	9,434	14,073	49.17	9.31	0.91
Variation			16.33	3.77	0.25

***Growth trend in tax revenues to transfers**
Treatment group – tax revenues = 65% / real variation transfers = 56%, rate: 1.16
Control group – tax revenues = 49% / real variation transfers = 45%, rate: 0.91.

[32] See Successful experiences at the subnational level in other countries.

[33] See Evidence of the success of other projects in Brazil similar to the PNAFM.

B. Objectives, components, and cost

1.18 The objective of Phase III is to enhance municipal fiscal autonomy by modernizing administrative, fiscal, financial, and asset management in Brazil's municipalities. This objective directly supports the overall objective of the PNAFM, as described in paragraph 1.5

1.19 The project will benefit (i) municipal governments, as increased collections will enable implementation of their public policies; and (ii) the population, through the expansion of services provided by municipal governments. PNAFM Phase III is structured into two components. The first targets the national level, and is executed by the federal government. The second targets the municipalities, and is executed by the municipal governments. The components and their respective subcomponents are as follows:

1.20 **Component I. National coordination and technical assistance (US$16.47 million).** This component seeks to support actions relating to integration, cooperation, and evaluation at the national level.

1.21 **Technical assistance for municipalities and project supervision subcomponent.** This subcomponent will finance (i) technical assistance and training for municipal teams in the preparation, execution, and supervision of municipal projects prepared using the SEEMP and approved by the PCU; (ii) development and implementation of training courses for municipal staff using project execution tools and methodologies; and (iii) development and execution of a program of technical supervision visits by the PCU to the municipalities.

1.22 **Subcomponent on cooperation and integration between tax authorities.** This subcomponent will finance (i) a program supporting participation in meetings of national technical groups on fiscal matters;[34] (ii) technical studies in the areas of municipal management, taxation, finances, and public spending,[35] as well as experiences under PNAFM and other municipal projects; (iii) a program to strengthen and integrate the PNAFM Network Management Committee (COGEP) with other similar networks,[36] including issues related to public procurement, strategic planning, project management, the transparency portal, and the Electronic Services Invoice (NFS-e); and (iv) development and implementation of a real estate database in Brazil, a web service integrating registry and notarial services for real property and title registries (SINTER) with the National Registry for Real Property

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[34] ENCAT – Conference of Tax Administrators; GEFIN – Subnational Public Financial Managers' Group; GDFAZ – Group for the Development of Public Finance Professionals, CIAT – Inter-American Tax Administration Center, CLAD – Latin American Center for Development Administration, etc.

[35] IPTU, ISS, Rural Land Tax (ITR),

[36] CONFAZ – National Council for Public Finance Policy, ESAF – School of Public Finance Administration, STN – the National Treasury Department, the PGFN – Office of the Attorney General, SEAIN – Department for International Affairs of the Ministry of Planning, etc.

and the National Registry for Titles, Documents, and Legal Entities, administered by Brazil's Federal Revenue Department with access for municipal governments.[37]

1.23 **Component II. Municipal institutional strengthening (US$150 million).** This component will finance municipal projects in the following areas:[38]

1.24 **Integrated fiscal management:** (i) management-for-results model and planning; (ii) territorial management using economic, social, and urban planning methodologies and instruments, and preparation and/or revision of master plans; (iii) knowledge sharing and learning networks; (iv) mechanisms for transparency and communication with society, and fiscal education programs; (v) human resources management, staff policies, and continuing technical and management training programs; and (vi) information and communication technology services, updating of technology infrastructure.

1.25 **Tax administration and tax dispute resolution procedures.** (i) fiscal-economic studies, urban and rural property assessment rolls, and automation of tax collection, administrative collection, oversight, tax intelligence, and administrative law processes; (ii) taxpayer registry and implementation of the Sistema Público de Escrituração Digital [Public Digital Bookkeeping System] (SPED); (iii) land use management, for the adoption of geoprocessing and cross-referenced databases; and (iv) automation of active debt collection processes, legal and out-of-court representation, and delinquent taxpayer control.

1.26 **Budget, financial, accounting, and asset administration and fiscal management control.** (i) budget and financial management, automation of budget processes, financial and budget programming and execution, cash flow, social control of public spending, cost systems, and public debt management; (ii) asset accounting, in keeping with progress towards international accounting standards; (iii) management of real and personal property: logistics management and automation, contracts, and agreements; and (iv) financial and disciplinary control: automation of operational risk control processes, audits, outcomes, and ethical and disciplinary issues.

1.27 **Project management, monitoring, and evaluation.** Support for project evaluation and monitoring in the administrative, tax, and financial area.

1.28 **Economic evaluation.** A cost-benefit analysis was carried out based on the main outcome expected under the program: an increase in tax ratio in the municipalities included in Phase III. The financial cost-benefit analysis for the program yielded an internal rate of return of 26% and a net present value of US$65.8 million in 10 years (2024), thus justifying the investment. A discount rate of 12% was applied to net benefit flows (optional electronic link 1). The results of the simulations do not change the conclusion regarding the program's feasibility, as the net present

[37] These will include data from SINTER, the ITR, and the Network for the Integration of Ministry of Development Registries (REDESIN).

[38] Footnote 9 and paragraphs 3.4 and 3.5 provide additional information regarding eligibility for these loans.

value remains positive under all scenarios, while the internal rate of return remains positive at over 22% in the worst-case scenario.

C. Key results indicators

1.29 The most significant outcomes expected by the end of the third phase of PNAFM are as follows:[39]

Table 4. Phase III Expected Outcomes

Description	Baseline (2012)	Target (2020)
IMPACT		
1. Increase in the ratio of tax revenues to intergovernmental transfers[40] (tax revenue trend as a % / trend in revenues from intergovernmental transfers as a %)	0.78% (2007-2011)	1.16% (2016-2020)
OUTCOMES		
1. Reduction in the average period required for the PCU/MF to approve municipal projects (days)	120	100 (2017)
2. Increase in the execution performance index for municipal projects (% disbursed / % time passed) in year 5 of execution.	0.77	0.83 (2019)
3. % increase in the number of municipalities that submit the project monitoring report within the expected time frame (number of municipalities reporting on time / total number of municipalities)	63%	100%
4. Real increase in municipal tax revenues compared to the average for the previous five years.	7.54% (2007-2011)	11.31% (2016-2020)

II. STRUCTURE OF THE OPERATION AND MAIN RISKS

A. Financing instruments

2.1 The selection of a multi-phase instrument is justified where there is a large number of beneficiary entities, allowing the progressive implementation of individual projects and any necessary adjustments in response to lessons learned under earlier phases.

2.2 The total cost of this Phase III of five phases of PNAFM is US$166.7 million—US$150 million (90%) in Bank financing and US$16.7 million (10%) in local counterpart funding, as set out in the total budget presented in Table 5. To access funds under the third phase, the municipalities must commit to provide local counterpart funding equivalent to 10% of the respective loan amount.[41]

[39] See Annex II, Results Matrix.

[40] In the absence of an appropriate indicator that would also include spending, this indicator is used as a proxy for fiscal autonomy. Nonetheless, fiscal autonomy does depend to a greater degree on revenue than on spending, given that high spending rigidity allows little leeway for change.

[41] Credit operations with the municipalities will be carried out through the CEF.

Table 5. Overall budget for Phase III of the PNAFM (US$ million)

Investment category	Bank	Local	Total	%
1. PNAFM administration	**0.23**	**0.00**	**0.23**	**0.14**
1.1 Monitoring and Evaluation	0.23	0.00	0.23	0.14
2. Components	**149.77**	**16.70**	**166.47**	**99.86**
2.1 National coordination and technical assistance	14.77	1.70	16.47	9.86
2.2 Municipal institutional strengthening	135.00	15.00	150.00	90.00
3. Unallocated resources[42]				**0.00**
Total	**150.00**	**16.70**	**166.70**	**100.00**
%	**90.00**	**10.00**	**100.00**	

2.3 **Disbursement schedule.** Once the contract enters into force, funds will be disbursed over a six-year period, in accordance with the disbursement schedule set out in Table 6.

Table 6. PNAFM Phase III Disbursement Schedule (US$ million)

Source	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Total	%
IDB	15.56	23.95	38.72	38.80	21.42	11.56	150.00	90
Local	2.84	2.84	2.84	2.84	2.84	2.50	16.7	10
Total	**18.4**	**26.79**	**41.56**	**41.64**	**24.26**	**14.06**	**166.7**	
%	11%	16%	25%	25%	15%	8%	100%	---

2.4 **Eligibility for Phases IV and V.** These phases are structured in the same way as the rest of the program, with components, outputs, and outcomes identical to those of earlier phases. They will target municipalities that have not participated in the program.

Table 7. Eligibility Criteria for Phases IV and V

Indicator	Phases		Means of verification
	IV	V	
1. **Commitment of funds**—resources committed through subloans out of the total amount (US$150 million, local currency equivalent).	75%	75%	Subloan contracts
Component I – National coordination and technical assistance			
2. **Support for project preparation and review** – number of subloan projects contracted.	15	15	Semiannual progress report
3. **Best practices in the fiscal area** – number of dissemination events held.	6	6	
4. **Distance Education Programs (DEPs)** – programs implemented.	3	4	
Component II – Municipal institutional strengthening			
5. **Potential for municipal tax collection** – percentage of assessments completed vs. total number of municipalities participating in the phase.	70%	70%	Semiannual progress report
6. **Baseline for the program's four structural elements** – percentage of assessments completed vs. total number of municipalities participating in the phase.	70%	70%	

42 No contingencies are foreseen as the subloan contracts will be based on the availability of resources under Component II.

B. Environmental and social risks

2.5 In accordance with the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this program has been classified as a category "C" operation. It involves the modernization of fiscal institutions and no negative environmental impacts are expected (Annex IV).

C. Program risks

2.6 The risk analysis was carried out in meetings with the agencies involved in program execution.[43] The main risks have been classified as medium-level, as set out below.

2.7 **Fiduciary risk.** There is a medium-level risk of delay to bidding processes, to the possible detriment of the established execution schedule. This risk stems from:

a. **Component I.** The executing agencies' limited knowledge of policies governing the selection of consultants. This will be mitigated by (i) creation of a special tenders committee in the Executive Secretariat of the Ministry of Finance to apply the policies of international organizations; (ii) training of teams involved in the Bank's procurement policies; and (iii) the inclusion in project design of the ability to contract government schools and research institutions, as well as the use of direct contracting of federal enterprises.

b. **Component II.** The municipalities' limited knowledge of Bank policies. This risk will be mitigated by authorization of the use of national legislation for procurement carried out by the municipalities using subloan funds.

2.8 **Public management and governance:** Component II. There is a medium-level risk of delays in the execution of municipal projects, owing to possible changes in government and a consequent reduction in the priority assigned to the municipal projects (given that elections will take place in 2016). This risk will be mitigated through the issuance of a mayoral decree designating the project team for the duration of the project execution period.

III. Implementation and Management Plan

A. Summary of implementation arrangements

3.1 The borrower is the Federative Republic of Brazil, and the executing agency will be the Ministry of Finance, acting through the Project Coordination Unit (PCU/MF) created in the Cooperation Program and Project Administration General Coordination Unit (COOPE)[44] of the Ministry's Executive Secretariat. The Caixa

[43] Including the Executive Secretariat of the Ministry of Finance, the National Treasury Department, the Office of the Comptroller General (CGU), the Department for International Affairs (SEAIN), Caixa Econômica Federal, and two municipalities.

[44] COOPE is an entity within the Ministry of Finance that coordinates all modernization projects.

Econômica Federal [Federal Savings Bank] (CEF) will act as coexecuting agency and financial agent under Component II of the program, under the general coordination of COOPE.

3.2 The main functions of the PCU/MF include: (i) program execution, monitoring, and evaluation, preparation of progress and financial reports, and support for external audits; (ii) support for preparing municipal projects; and (iii) coordinating the approval, eligibility, disbursement, and accountability processes for municipal projects with the CEF. The CEF—in addition to coordinating with the PCU/MF—will be responsible for signing contracts with the municipalities and processing payments to goods and services providers in the municipal projects. It will report to the PCU/MF regarding these activities.

3.3 **Sub-borrowers and project executing agencies under Component II.** As under PNAFM Phase II, the borrower (through the CEF) may use resources under Component II to grant subloans to municipalities participating in the program.[45] The municipalities will act as sub-borrowers and executing agencies for the respective projects, through municipal government structures (particularly municipal finance departments). The municipalities will implement the projects using a PCU created in each one for execution of its respective project.

3.4 **Eligibility, contracts, and disbursements for municipal subloans.** The same mechanism approved for the second phase of the PNAFM will be used; the details of this are described in paragraphs 5.2 to 5.4 of Annex III.

3.5 **PNAFM Operating Regulations and Operations Manual.** The program will be governed by program Operating Regulations for the PNAFM previously approved by the Bank. These will include eligibility criteria for project sub-borrowers and outputs. The Operating Regulations describe in detail the responsibilities, functions, and authority of the PCU/MF and the CEF. The operations manual—which will govern operating procedures, financial terms and conditions for subloans, and the authority of the municipal PCUs—will be approved by the Bank and the PCU/MF.

3.6 **The borrower's submission of the following, to the Bank's satisfaction, will be special contractual conditions precedent to the first disbursement: (i) the program operations manual; (ii) the contract to be signed between the Ministry of Finance and the CEF, establishing that the latter will act as coexecuting agency and financial agent under Component II; (iii) the draft subloan contract to be signed by the CEF and each municipality; and (iv) evidence of the entry into force of the program Operating Regulations for Phase III.**

3.7 **Determination of the criteria for converting local currency expenditures to U.S. dollars.** The applicable exchange rate will be the same one used to convert U.S. dollar disbursements into the borrower's national currency. For purposes of

[45] For the rendering of accounts, the Bank will accept disbursements by the PCU to the CEF. See point 7.6 of Annex III.

expenditure reimbursements using loan proceeds and recognition of expenditures chargeable to local counterpart funding, the applicable exchange rate in this case will be the one prevailing on the date of submission of the request to the Bank.

3.8 **Audited financial statements.** The program will be audited by the Controladoria-Geral da União [Office of the Comptroller General] (CGU). Audited financial statements as of 31 December of each year will be submitted to the Bank on an annual basis within 120 days of the end of each calendar year, beginning with the first year of disbursement. These will include a review of disbursement and procurement processes. The supporting documentation for expenses incurred will be subject to ex post review by the CGU.

3.9 **Procurement of goods, works, and consulting and nonconsulting services.** As under Phase II of the PNAFM,[46] a partial waiver is requested from the Bank's procurement policies (documents GN-2349-9 and GN-2350-9) so that the Ministry of Finance may apply national legislation for the procurement of goods, works, and nonconsulting services in amounts below the thresholds for international competitive bidding (ICB).[47] It is also proposed that municipal sub-borrowers be able to apply national legislation for the procurement of goods and works in amounts below the thresholds for ICB, and for consulting contracts with an estimated cost of less than US$1,000,000. In all cases, the principles of competition, economy, equality, dissemination, due process, and other provisions of Section I of the aforementioned procurement policies will be observed.

3.10 The rationale for the aforementioned exception is the same as the one for Phase II. It is based on the experience of Phase I, which showed that mandatory use of the Bank's procurement policies and procedures—different from those used by the sub-borrowers—creates conflicts in legal interpretation and difficulties for the municipalities' internal and external control in processing bidding documents. This results in increased paperwork and creates legal uncertainty, reducing the municipalities' execution capacity and impairing disbursement flows.

3.11 **Direct contracting:** As permitted under the second phase, and in accordance with paragraph 3.8 (a and d) of document GN-2350-9, the Bank may authorize the direct contracting of [48] (i) School of Public Finance Administration of the Ministry of Finance; (ii) the School of Public Administration of the Ministry of Planning, Budget, and Management to provide training for federal or municipal civil servants; (iii) schools of government or financial administration to provide training services, provided the Bank has determined that such schools have the capacity to provide the services, and their cost is in line with market prices; and (iv) the Institute of Applied Economic Research, the Federal Data Processing Service, and the

[46] This exception was approved by the Board for PNAFM Phase II (loan 2248/OC-BR).

[47] This partial exception is identical to the one authorized by the Bank for the Ministry of Finance Integrated Modernization Program (loan 3142/OC-BR), which is executed by the same executing unit.

[48] The cost of these contracts is estimated at less than 3% of the total loan amount.

Brazilian Association of Finance Secretaries of State Capitals (see rationale in Annex III).[49]

3.12 **Use of resources from the amortization of subloans.** As in the case of PNAFM Phase II, an exception is requested to the provisions of the document Global Loans to Development Finance Institutions (document GP-30-1, of 7 May 1975), with respect to the use of recoveries. This exception would remove the requirement that the borrower reinvest subloan recoveries in new projects that are similar to those financed under the program, given that (i) the terms of the loan to the borrower will be transferred entirely to the subloans, including grace and amortization periods where compatible; (ii) the exchange rate to be used will not generate exchange variations; and (iii) the government does not use a special accounting system that would make it possible to determine the existence of surpluses in its accounting and financial system.

B. Monitoring and evaluation arrangements

3.13 **Monitoring.** The objective of monitoring is to identify the factors that facilitate or hinder an output from achieving its outcomes. The monitoring of Phase III of the program will be based on the Results Matrix; programmed activities; the details of physical and financial execution of the output included in the semiannual progress reports; procedures under the project supervision and preparation support methodology; and the descriptions of procurement transactions contained in the procurement plan.[50] The borrower will submit semiannual progress reports.

3.14 **Evaluation.** Phase III will be evaluated using three methods:[51] (i) reflexive, conducted every two years based on the targets and respective annual indicators for outputs and outcomes included in the program's Results Matrix; (ii) ex post economic, aimed at confirming the program's financial returns, performed at completion of the phase using a methodology comparable to the one used in program preparation;[52] and (iii) ex post impact, performed at completion of the phase, using the difference in differences methodology to measure the difference between outcomes in a group of municipalities strengthened under the program and those in a control group of municipalities that did not receive this treatment. The economic and impact evaluations will be carried out only once, when 90% of loan proceeds have been disbursed. The last reflexive evaluation will be subject to the same criterion.

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[49] Document GN-2350-9 (paragraph 3.10): (a) for tasks that represent a natural continuation of previous work carried out by the firm and (d) when only one firm is qualified or has experience of exceptional worth for the assignment.

[50] Monitoring will be carried out by PCU staff; there are no related costs (see required electronic link 3).

[51] The three evaluations will cost US$180,000, to be financed by loan proceeds. The PCU will be responsible for coordinating the evaluations (see required electronic link 3).

[52] The objective of the ex post evaluation will be to verify whether the projections that justify the Bank's financing are confirmed in the subsequent period.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Lending Program			
Regional Development Goals	**i) Ratio of actual to potential tax revenue; and ii) Public expenditure managed at the decentralized level as percent of total public expenditure.**		
Bank Output Contribution (as defined in Results Framework of IDB-9)	**i) Public financial systems implemented or upgraded; and ii) Municipal or other sub-national governments supported.**		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2662-1**	**i) Reduce institutional disparities and inequalities between Brazilian tax administrations and promote cooperation and integration of finance administrations in three levels of government; ii) Promote sustainable fiscal balance at the subnational level; and iii) Improve tax education and citizenship programs and initiatives on transparency and dialogue with society.**	
Country Program Results Matrix	**GN-2756-2**	**The intervention is included in the 2014 Operational Program.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Evaluable**	**Weight**	**Maximum Score**
	8.0		**10**
3. Evidence-based Assessment & Solution	**8.1**	**33.33%**	**10**
3.1 Program Diagnosis	**1.8**		
3.2 Proposed Interventions or Solutions	**3.6**		
3.3 Results Matrix Quality	**2.7**		
4. Ex ante Economic Analysis	**8.5**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**4.0**		
4.2 Identified and Quantified Benefits	**0.0**		
4.3 Identified and Quantified Costs	**1.5**		
4.4 Reasonable Assumptions	**1.5**		
4.5 Sensitivity Analysis	**1.5**		
5. Monitoring and Evaluation	**7.4**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**2.5**		
5.2 Evaluation Plan	**4.9**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Medium**		
Identified risks have been rated for magnitude and likelihood	**Yes**		
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation			
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/PDP Criteria)	**Yes**	**Financial Management: i) Budget; ii) Treasury; iii) Accounting and Reporting; and iv) External Control.** **Procurement: i) Information System; ii) Shopping Method; Contracting individual consultant; and iv) National Public Bidding.**	
Non-Fiduciary	**Yes**	**i) Strategic Planning National System; and ii) Monitoring and Evaluation National System.**	
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

The main problems affecting Brazilian municipalities' institutional capacity to increase tax revenues and improve public expenditure management have been identified, as well as their determinants. The POD does not satisfactorily quantify the extent to which the major problems can be explained by the factors identified. The project provides evidence regarding the internal validity of the proposed solutions. However, it lacks some empirical evidence to strengthen the external validity of the intervention.

The results matrix included in the POD presents some problems in the definition of impact and output indicators. It is also limited in establishing base lines and targets, as a result of the problems previously mentioned. All this, among other elements, could hinder the project´s monitoring.

The project proposes an impact evaluation using differences in differences, although it is not clearly specified why this is an appropriate method for the evaluation and why other methods where discarded. At the same time, an analysis justifying the criteria applied to select the municipalities is missing, as well as how to solve the selection bias. This problem is deepened by the limitations observed in control group definition.

Finally, the program's general risk rating is Medium. It is observed that some mitigation measures do not present adequate monitoring indicators.

RESULTS MATRIX

Program Phase III Objective	The general objective of PNAFM Phase III is to enhance municipal fiscal autonomy by modernizing administrative, fiscal, financial, and asset management in Brazil's municipalities.

EXPECTED IMPACT

Outcome Indicator	Unit of measurement	Baseline [1]	Target [2] (2020)	Source / Means of Verification	COMMENTS
IMPACT: Increase in the trend in tax revenues with respect to the trend in intergovernmental transfers (five-year average)					
% trend in tax revenues / % trend in revenues from intergovernmental transfers	Ratio	0.78 (2007-2011)	1.16 (2016-2020)	National Treasury System	Values in R$ millions. Trend in tax revenues (2007-2011) = 40.96% (R$1.734 – R$2.445) Trend in revenues from intergovernmental transfers (2007-2011) = 52.31% (R$2.125 – R$3.236)

EXPECTED OUTCOMES

Outcome Indicator	Unit of measurement	Baseline	Interim Target	Target (2020)	Source / Means of Verification	COMMENTS
OUTCOME 1: Reduction in the average period required for the PCU/MF to approve municipal projects						
Average period for PCU to declare projects eligible	Days	120 (2011)	100 (2017)	100	Report from the PCU's Project Preparation, Execution, Monitoring, and Supervision System (SEEMP).	Increase in productivity from automation of project preparation and approval process (SEEMP system)

[1] The baselines for the impact, outcome, and output indicators were calculated based on the data for the 18 candidate municipalities under Phase III of the program: Abreu e Lima/PE, Alfenas/MG, Anápolis/GO, Aparecida de Goiânia/GO, Bertioga/SP, Campo Maior/PI, Catanduva/SP, Hortolândia/SP, Ilhéus/BA, Itabaiana/SE, Jaraguá do Sul/SC, Niterói/RJ, Paragominas/PA, Parnaíba/PI, Rio Grande/RS, Porto Alegre/RS, Tubarão/SC, and VarginhaMG.

[2] Based on the results of phase I, an additional real annual increase of 3.77% is expected from tax revenues for phase III. In five years, this would amount to 18.85%, increasing the average for tax revenues to 59.81% (40.96% + 18.85%). The impact and outcome targets were estimated based on the results achieved by the 60 municipalities that participated in PNAFM Phase I.

Outcome Indicator	Unit of measurement	Baseline	Interim Target	Target (2020)	Source / Means of Verification	COMMENTS
OUTCOME 2: Increase in the execution performance index for municipal projects in Year 5 of program execution.						
% Component II disbursed / % time passed for municipal projects in Year 5 of execution.	Index	0.77 (2014)	1.0 (2019)	1.0	Report from the Federal Government Integrated Financial Administration System (SIAFI)	Baseline: 0.77 = 64.26% disbursed. / 83%. (% of time passed in Year 5 in relation to 6 years). The baseline was calculated based on execution in Phase II. This proportion is expected to improve in Phase III (from 0.77 to 0.83).
OUTCOME 3: Increase in the number of municipalities that submit the project monitoring report within the expected time frame						
Number of municipalities reporting on time/Total number of municipalities	%	63 (2014)		100	SEEMP report	Reports entered into the SEEMP
OUTCOME 4: Real increase in municipal tax revenues compared to the average for the previous five years.						
Real tax revenues (average)	%	7.54% (2007-2012)		11.31 % (2016-2020)	National Treasury System	Baseline: Total tax revenues 2005 = R$1.7 billion Total tax revenues 2012 = R$2.7 billion 3.77% increase based on Phase I evaluation.

OUTPUTS

Output Indicator	Unit of Measure-ment	Baseline	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Final Target	Source / Means of Verification	Comments
COMPONENT I: National coordination and technical assistance											
1. Projects standardized with automatic preparation (SEEMP Web systems)	Projects	0	8	10					18	PCU progress report based on SEEMP approvals report	
2. Municipal staff certified in the use of project execution tools and methodologies	Municipal staff certified	0	24	24	24	0	0	0	72	PCU progress report based on COOPE annual management report	An average of 4 staff members per municipality = 72 staff members.

Output Indicator	Unit of Measure-ment	Baseline	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Final Target	Source / Means of Verification	Comments
3. Technical support provided to municipalities on project execution	Technical support visits	0	8	24	36	22	15	15	120	PCU progress report based on COOPE annual management report	Average of 6 visits per municipality over 6 years.
4. Fiscal modernization solutions adopted	Solutions adopted (methodo-logies, systems, procedures)	0	10	10	10	10	10	10	60	PCU progress report based on COOPE annual management report	At least 60% of the 18 municipalities adopt a fiscal modernization solution.
5. Publications in the areas of management, taxation, finance, and municipal public spending	Publications	0		1	2	3			6	Study document	
6. Evaluation of program results completed	Evaluation of results	0	2	2	2	2	2	2	12	COGEP meeting minutes	
7. Web service integrating SINTER with the National Registry for Real Property and the National Registry for Titles, Documents, and Legal Entities	SINTER web service	0	*Technical visits by the Real Property Register to notaries*	*Decree issuing regula-tions*	*Project Seminar*	*1 Module in the Electro-nic Registr-ation System 1*			1	SINTER/RFB system reports	
COMPONENT II: Municipal institutional strengthening											
1. Administrative and fiscal modernization of municipalities undertaken	Municipal projects implemented	0				5	10	3	18	PCU progress reports	

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Brazil
Project no.:	BR-L1377
Name:	National Program to Support the Administrative and Fiscal Management of Brazilian Municipalities (PNAFM III)
Prepared by:	Leíse Estevanato (FMP/CBR) and Marília Santos (FMP/CBR)

I. EXECUTIVE SUMMARY

1.1 A fiduciary management assessment was carried out based on meetings with the Bank's project team; the Ministry of Finance's Subsecretaria de Gestão Estratégica [Strategic Management Division] (SGE/MF); the technical staff of the Coordenação-Geral de Programas e Projetos de Cooperação [Cooperation Program and Project Administration General Coordination Unit] (COOPE/SGE), which will be responsible for coordinating the program; and the staff responsible for the various sections of the Ministry of Finance and its National Treasury Department (STN) that will be involved in fiduciary execution of the program.

1.2 Preparation documents for the operation were also reviewed, along with the Risk Matrix and the Bank's experience under the PNAFE, PROFISCO, and PNAFM I/II projects. COOPE/SGE was responsible for coordination activities and financial control under these projects. The fiduciary agreements for program execution in the areas of procurement and financial administration are based on the results of this assessment of the executing agency.

II. THE COUNTRY'S FIDUCIARY CONTEXT

2.1 Brazil has solid and transparent institutional and regulatory frameworks, with robust national fiduciary systems that enable the satisfactory management of administrative, financial, internal control, and procurement processes, and uphold principles of transparency, economy, and efficiency. The Bank's fiduciary strategy with Brazil is geared towards progressive and sustainable use of the country's fiduciary systems.

2.2 It should be noted that the STN and the Serviço Federal de Processamento de Dados [Federal Data Processing Service] (SERPRO) have finalized operational adjustments to the Sistema Integrado de Administração Financeira do Governo Federal [Federal Government Integrated Financial Administration System] (SIAFI), allowing it to be used as a financial control and management tool in externally-financed projects, based on the nomenclature of the categories or components established in each project. The application developed also includes tools for generating basic financial reports according to the time schedules required by executing agencies. The information is always drawn from the SIAFI, which is the budget and financial database used by the entire public sector. The information available in the system will not only facilitate greater transparency in the use of these resources, but it will also facilitate the audit and control work performed by the Office of the Comptroller General (CGU) through the Secretaria Federal de Controle Interno [Federal Internal Audit Department] (SFCI) in relation to all external credit operations. The growing use of country procurement systems (particularly COMPRASNET, administered by the federal government) is also of considerable significance for the Bank.

2.3 Brazil has supported the use of country systems in recent years, and has monitored their performance with a view to perfecting them and achieving levels of efficiency and economy that meet the country's needs. Substantial progress has been made in developing these systems in other levels of government, with the recent implementation of PNAFE and PROFISCO in the states, and PNAFM I and II in the municipalities.

III. The Executing Agency's Fiduciary Context

3.1 The borrower is the Federative Republic of Brazil, and the executing agency will be the Ministry of Finance, acting through the Project Execution Unit (PCU/MF) created in the Program and Project Administration Unit (COOPE)[1] of the Ministry's Executive Secretariat. The Caixa Econômica Federal [Federal Savings Bank] (CEF) will act as coexecuting agency and financial agent under Component II of the program, under the general coordination of COOPE.

3.2 The main functions of the PCU/MF include (i) program execution, monitoring, and evaluation, preparation of progress and financial reports, and support for external audits; (ii) support for preparing municipal projects; and (iii) coordinating the approval, eligibility, disbursement, and accountability processes for municipal projects with the CEF. The CEF—in addition to coordinating with the PCU/MF—will be responsible for signing contracts with the municipalities and processing payments to goods and services providers in the municipal projects. It will report to the PCU/MF regarding these activities.

3.3 The program will be governed by program Operating Regulations for the PNAFM previously approved by the Bank. These will include eligibility criteria for project sub-borrowers and outputs. The Operating Regulations describe in detail the responsibilities, functions, and authority of the PCU/MF and the CEF. The operations manual—which will govern operating procedures, financial terms and

[1] COOPE is an entity within the Ministry of Finance that coordinates all modernization projects.

conditions for subloans, and the authority of the municipal PCUs—will be approved by the Bank and the PCU/MF.

IV. Fiduciary Risk Evaluation and Mitigation Actions

4.1 The following risks—classified as medium-level—were identified as a result of the risk assessment exercise:

a. Component I. The executing agencies' limited knowledge of policies governing the selection of consultants. This will be mitigated by (a) creation of a special tenders committee in the Executive Secretariat of the Ministry of Finance to apply the policies of international organizations; (b) training of teams involved in the Bank's procurement policies; and (c) the inclusion in program design of the ability to contract government schools and research institutions, as well as the use of direct contracting of federal enterprises.

b. Component II. The municipalities' limited knowledge of Bank policies. This risk will be mitigated by authorization for the use of national legislation for procurement carried out by the municipalities using subloan funds.

V. Considerations for the Special Provisions of Contracts

5.1 The aspects to be considered with respect to special fiduciary conditions are as follows:

a. **Conditions precedent to the first disbursement.** The initial disbursement of loan proceeds is subject to the borrower's submission of the following, under temrs acceptable to the Bank: (i) the program operations manual; (ii) the contract to be signed between the Ministry of Finance and the CEF, establishing that the latter will act as coexecuting agency and financial agent under Component II of the program; (iii) the draft subloan contract to be signed by the CEF and each municipality; and (iv) evidence of the entry into force of the program Operating Regulations for Phase III.

b. **Determination of the criteria for converting local currency expenditures to U.S. dollars.** The applicable exchange rate will be the same one used to convert U.S. dollar disbursements into the borrower's national currency. For purposes of expenditure reimbursements using loan funds and recognition of expenditures chargeable to local counterpart funding, the applicable exchange rate in this case will be the one prevailing on the date of submission of the request to the Bank.

c. **Audited financial statements.** The program will be audited by the CGU through the SFCI. Audited financial statements as of 31 December of each year will be submitted to the Bank on an annual basis within 120 days following the end of each calendar year, beginning with the first year of disbursement. These shall include a review of disbursement and procurement processes. The supporting documentation for expenses incurred will be subject to ex post review by the SFCI.

5.2 **Eligibility of municipal projects.** Projects that meet the following requirements will be eligible for financing under Phase III of PNAFM: (i) they must be prepared in accordance with the project preparation methodology established by the COOPE, and using the Project Preparation, Execution, Monitoring, and Supervision System (SEEMP); (ii) their content must be consistent with the guidelines set out in the program Operating Regulations for Component II; (iii) they must contain a description (where not included in the activities of a municipal project) of progress towards compliance with (a) Brazilian Public Sector Accounting Standards (NBCASP) and (b) the transparency requirements included in the Access to Information Law; and (iv) the Bank's no objection must be obtained.

5.3 **Subloan agreements.** Prior to signing the subloans, the municipalities will need to submit evidence that (i) the municipal PCU has been created; (ii) the budget estimates for the loan resources and local counterpart funds have been included in the annual budget law; (iii) legislative authorization has been obtained for the credit operation; and (iv) the STN authorization on compliance with the limits for the credit operation has been obtained.

5.4 **Subloan disbursements.** Maintaining the same arrangements approved for PNAFM Phase II, the documentation of expenditures in support of new disbursements will be based on the transfer of funds by the borrower to each municipal sub-borrower, with the CEF as intermediary. The borrower, with the CEF as intermediary, will transfer resources to sub-borrowers once they have demonstrated that program funds have been used, in accordance with the program's operations manual.

VI. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

6.1 **Procurement of goods, works, and consulting and nonconsulting services.** Bank procurement policies (documents GN-2349-9 and GN-2350-9) will apply to the procurement of goods, works, and services by the Ministry of Finance. However, as under Phase II of the PNAFM,[2] a partial exception is requested from the Bank's procurement policies such that the Ministry of Finance may apply national legislation for the procurement of goods, works and nonconsulting services in amounts below the thresholds for international competitive bidding (ICB).[3] It is also proposed that municipal sub-borrowers be able to apply national legislation for the

[2] This exception was approved by the Board for Phase II of PNAFM (BR-L1252), as justified in point 2.4 of the aforementioned document (Annex).

[3] This partial exception is identical to the one authorized by the Bank for the Ministry of Finance Integrated Modernization Program (BR-L1349), which is executed by the same agency as this operation.

procurement of goods and works in amounts below the thresholds for ICB, and for consulting contracts with an estimated cost of less than US$1,000,000. In all cases, the principles of competition, economy, equality, dissemination, due process, and other provisions of Section I of the aforementioned procurement policies will be observed.

6.2 The rationale for the aforementioned exception is the same as the one approved for Phase II. It is based on the experience of Phase I, which showed that mandatory use of the Bank's procurement policies and procedures—different from those used by the sub-borrowers—creates conflicts in legal interpretation and difficulties for the municipalities' internal and external control in processing bidding documents. This results in increased paperwork and creates legal uncertainty, reducing the municipalities' execution capacity and impairing disbursement flows.

6.3 **The selection and contracting of consulting services** will be carried out by the executing agency in accordance with Policies for the Selection and Contracting of Consultants (document GN-2350-9, March 2011). For the selection of consulting services with an estimated cost of more than US$200,000, international advertising will be required through United Nations Development Business On-Line. In the case of contracts with an estimated cost of less than US$1 million, shortlists may consist entirely of national consulting firms. Similar to the proposal under Phase II of the PNAFM, a partial exception is proposed to the Bank's procurement policies under Phase III, such that municipal sub-borrowers may apply national legislation in the case of consulting services (individuals and firms) contracted in amounts below the threshold for ICB.

6.4 **The selection and contracting of individual consultants** by the executing agency, financed either in whole or in part with Bank resources must be carried out in accordance with Section V of the Policies for the Selection and Contracting of Consultants (document GN-2350-9). Individual consultants will be selected on the strength of their qualifications for the assignment, following a comparison of the qualifications of at least three candidates. Where warranted, advertisements may be placed in the local or international press with a view to obtaining information on qualified consultants.

6.5 **Use of the National Procurement System.** As of the effective date of the corresponding agreement (to be signed by the country and the Bank), the Ministry of Finance may use the national procurement system approved by the Bank for the procurement of goods, works, and services, in accordance with the terms of the Validação de Normas e Procedimentos de Sistemas da República Federativa do Brasil (Administração Direta da União) [Validation of System Standards and Procedures in the Federative Republic of Brazil—Direct Federal Administration], as well as the aforementioned agreement. Any system or subsystem that is subsequently approved will be applicable to the operation. The Procurement Plan for the operation and its updates will indicate the contracts to be executed using approved country systems.[4] All procurement carried out by municipal sub-borrowers under Component II of the project is excluded from the agreement regarding the use of the national procurement system.

6.6 **The main procurement items** expected under this operation are listed below:

Activity	Type of Bidding Process	Estimated Date	Estimated Cost (US$ 000)
Goods			
Development and implementation of the system module for financial and accounting management	DC	2016	5,040,000
Development CTM Web Cloud for use in small municipalities Extension of SIGEF software (used for rural properties) to include urban land tenure regularization and rectification of urban property records	DC	2016	5,760,000
Development of SIG WEB - web-based graphic module for spatial layers (2,000 function points)	DC	2016	2,880,000
Consulting services			
Preparation of the PNAFM Book - Type 28	NICQ	2016	900,000
International workshop for the exchange of experiences among Latin American municipalities - Type 14	NICQ	2016	308,000
Preparation of a technical magazine (one per year) - Type 26	NICQ	2016	240,000

6.7 **Direct contracting:** As planned under Phase II, and in accordance with paragraph 3.10 (a and d) of document GN-2350-9, the Bank may authorize the direct contracting of the School of Public Finance Administration (ESAF) of the Ministry of Finance of the Federative Republic of Brazil. Based on paragraph 3.10 (d), the School of Public Administration (ENAP) of the Ministry of Planning, Budget, and Management may be contracted directly to provide training for federal or municipal civil servants. The Bank may also, based on paragraph 3.10 (d), authorize the direct contracting of a school of government or financial administration to provide training services, provided the Bank has determined that such schools have the installed capacity to carry out the training services, and their cost is in line with market prices.

6.8 Under Component I, and based on paragraph 3.10 (d), the Bank may also authorize the direct contracting[5] of the Institute of Applied Economic Research (IPEA), SERPRO, and the Brazilian Association of Finance Secretaries of State Capitals (ABRASF). The justification for these contracts is as follows: (i) IPEA is Brazil's most important research center, with one of the best complements of technical staff in the country and recognized capacity for the production of data and scientific studies; (ii) SERPRO is justified on the basis of paragraph 3.10 (sections a and d) of document GN-2350-9, as the activities relating to development and adjustment of systems correspond entirely to systems that have already been developed by

[4] If the Bank validates another system or subsystem, this will be applicable for the operation in accordance with the terms of the loan contract.

[5] The cost of these contracts is estimated at less than 3% of the total loan amount.

SERPRO under Phase II.[6] SERPRO is one of the public enterprises attached to the Ministry of Finance, responsible for the development and maintenance of the management systems currently used in the Ministry;[7] and (iii) for 30 years, the ABRASF has been supporting the municipalities in developing research and disseminating good practices to improve financial and tax management, as well as making management instruments and training for public servants available to the municipalities at no charge.[8]

6.9 In the case of these contracts, prior to transferring loan proceeds to these entities, the borrower will submit a suitable legal instrument to the Bank in which the respective school commits to: (i) comply with prevailing national procurement standards; and (ii) allow the Bank and the program auditors access to documentation supporting said contracts. The ongoing nature of the direct contracting of these entities should also be noted, as the specificity and characteristics of their services will contribute to project sustainability, the dissemination of knowledge and experiences, and—above all—the continued supply of these services and products after program completion.

6.10 **Specialized agency.** Using its own resources, the borrower may directly contract the services of a specialized agency to provide technical support exclusively for the procurement of goods and selection of individual consultants or consulting firms (for activities related to program execution), as long as the following conditions are met: (i) the Bank will give its prior approval for the contract to be signed with the specialized agency; (ii) the specialized agency will agree to follow Bank procurement policies and procedures; and (iii) the hiring of consultants for routine program execution activities will not be permitted.

a. **Procurement process thresholds.** The threshold for ICB will be made available to the borrower and the executing agency via the www.iadb.org/procurement website. Below this threshold, the selection method will be determined according to the complexity and characteristics of each procurement transaction or contract, as will be reflected in the Procurement Plan approved by the Bank.

b. **Initial Procurement Plan.** The initial procurement plan agreed during the analysis mission is attached as a link (see procurement plan link).

c. **Retroactive financing and recognition of expenditures.** There will be no recognition of expenditures.

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[6] Project Preparation, Execution, Monitoring, and Supervision System (SEEMP).

[7] SIAF – Integrated Financial Management System; SISCOMEX – Customs Process Management System; SIC – Integrated Cost System; SICONFI – Public Sector Accounting and Fiscal Information System. Moreover, all federal tax management support systems have been developed by SERPRO.

[8] Section 3.10 (a): for tasks that represent a natural continuation of previous work carried out by the firm. Section 3.10 (d): when only one firm is qualified or has experience of exceptional worth for the assignment.

d. **National preference.** National preference margins will not be considered.

e. **Procurement supervision.** All ICB and direct contracting processes will be subject to ex ante review. In light of the special characteristics of the project and the PCU's capacity in operational matters, an ex post review will be conducted annually. Based on the annual audit reviews, the Bank may modify the review method contained in the procurement plan. The procurement supervision method will be defined by the Bank. It will be ex post, with the exception of those cases in which ex ante supervision is justified. Where procurement is executed through the national system, supervision will also be carried out through the country system. The supervision method will be determined for each selection process. Ex post reviews will be conducted every 12 months in accordance with the project supervision plan. The ex post review reports will include at least one physical inspection visit,[9] selected from among the procurement processes subject to ex post review.

f. **Special provisions.** The executing agency will update the Procurement Plan each year (or as required by the Bank) to reflect the actual execution needs of the project and progress achieved.

g. **Records and files.** Program records and files will be located in Ministry of Finance offices, with appropriate levels of security.

VII. Financial Management Agreements and Requirements

A. Programming and budget

7.1 The annual program and budget for external and counterpart financing will be prepared by the COOPE with the support of all Product Leaders and the SPOA. The budget will be managed using the SIAFI. The proposed annual budget allocation for the program will be included in the federal government's general budget and will be reflected in the SIAFI for the activities committed to under the program.

B. Accounting and information system

7.2 The program's budget and financial execution will be undertaken and monitored through the SIAFI, pursuant to the Bank's guidelines for acceptance of the use of country management systems, and considering that the process of adjusting the SIAFI has been completed to enable both financial control by program component and the generation of financial reports required by the Bank for disbursements. In this regard, internal plans will be created to make it possible to insert budget items by component, depending on the control needs agreed with the Bank.

[9] The inspections will verify the existence of the items procured, while leaving verification of quality and specifications compliance to the sector specialist.

C. Disbursements and cash flow

7.3 The program will use the federal government's treasury system. Expenditures will be subject to the budget and financial execution process and will be duly recorded in the SIAFI. The resources used for the payment of expenses will be managed through the Treasury Single Account. The program will operate with resources advanced by the Bank to meet the program's actual liquidity needs, based on expenditure projections for 120 days. This will require presentation of a disbursement request along with a financial plan reflecting the need for funds for the period in question, as previously agreed with the Bank. In principle, this period will be 120 days so that each transfer may be fully utilized within the 180 days following its delivery.

7.4 The execution unit will provide the Bank with an initial financial plan for the program, reflecting the annual disbursement schedule for the entire program execution period. This initial plan will give rise to a detailed plan, reflecting the first fiscal year of execution, based on which the first advance of funds will be planned. For subsequent advances, it will be necessary to provide a rendering of accounts for at least 80% of previously advanced funds. As part of the same process, or wherever necessary, a new request for an advance of funds will be submitted, supported by informed projections contained in a new financial plan for the period requested.

7.5 For **Component I,** the supporting documentation for expenditures will be subject to ex post review as part of the annual audit process, or as required by the Bank. The ex post review will be duly documented in a report structured in accordance with Bank audit requirements.

7.6 For the rendering of accounts under **Component II**, the Bank will accept disbursements by the PCU to the Caixa Econômica Federal. Review of the supporting documentation for these disbursements will be carried out on an ex post basis as part of the annual audit process, or as required by the Bank. The ex post review will be duly documented in a report structured in accordance with Bank audit requirements. Expenses deemed ineligible by the Bank will be reimbursed with local counterpart or other resources, at the Bank's discretion, depending on the nature of the ineligibility.

7.7 **Use of resources from the amortization of subloans.** As in the case of Phase II, an exception is requested to the provisions of document GP-30-1 (Global Loans to Development Finance Institutions), of 7 May 1975, with respect to the use of recoveries. This exception would remove the requirement that the borrower reinvest subloan repayments in new projects that are similar to those financed under the program, given that (i) the terms of the loan to the borrower will be transferred entirely to the subloans, including grace and amortization periods where compatible; (ii) the exchange rate to be used will not generate exchange variations; and (iii) the Brazilian government does not use a special accounting system that would make it possible to determine the existence of surpluses in its accounting and financial system.

D. Internal control and audit

7.8 The internal control environment and procedures and the communication, reporting, and monitoring of PCU activities will comply with Brazilian standards as laid out in the Office of the Comptroller General's regulations.

E. External control and reports

7.9 The CGU will exercise external control through the SFCI, which will be responsible for annual audits of project financial statements. The reports and corresponding opinions will abide by the Bank's standard for external audits and the terms of reference previously approved by the Bank, and they will be delivered to the Bank within the time frame stipulated in the loan contract. Given the nature of Component II, the scope of the SFCI's audit in this case will be limited to a review of the executing agency's disbursements to the CEF, with evidence of these disbursements accepted as sufficient for the rendering of accounts to the Bank. Audits of expenditures incurred by the municipalities will be carried out by each state or municipal Court of Auditors and/or by the CGU, in accordance with the standards and procedures of each. These audits are not part of program audit, and they will follow national external and internal audit policies.

F. Financial Supervision Plan

7.10 The supervision plan is designed for a low-risk operation. It may be modified during program execution based on observed risk circumstances or in the event of additional control needs, as determined by the Bank.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

RESOLUTION DE-____/__

Brazil. Loan _____/OC-BR to the Federative Republic of Brazil
National Program to Support the Administrative and Fiscal
Management of Brazilian Municípios (PNAFM III)

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 Federative Republic of Brazil, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the National Program to Support the Administrative and Fiscal Management of Brazilian Municípios (PNAFM III). Such financing will be for an amount of up to US$150,000,000 from the Ordinary Capital resources of the Bank, 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 ___ ____________ 20__)

LEG/SGO/CSC/IDBDOCS#39135407
Pipeline No. BR-L1377