

Ceara PforR - Full Fiduciary Systems Assessment

1. This assessment refers to the fiduciary arrangements governing the PforR Program. Those governing the TA component are described in Annex 9 of the PAD.

1: Program Fiduciary Legal Framework, Institutional Arrangements and Procedures:

2. The fiduciary assessment found that the procurement and financial management arrangements are in line with OP 9.00 and that the capacity and performance of the implementing agencies are adequate for the purposes of the Program.

1.1 Fiduciary legal framework

3. The fiduciary arrangements for the Program are anchored in the Brazilian Federal Constitution. A public accountability law (Lei 4.320 of 1964) regulates financial controls, budgeting and reporting at the federal, state and municipal levels. The Law of Fiscal Responsibility (LRF) of 2000 established particular requirements for macroeconomic and fiscal discipline that define many aspects of the PFM environment. Federal accounting and finance laws and the FRL define the public accounting regulations that are followed by Ceará. The federal National Treasury Secretariat (*Secretaria do Tesouro Nacional* - STN) is responsible for issuing instructions to the States on how to apply the requirements of the law. It also prepares consolidated financial statements for the public sector in Brazil (at the federal, state and municipal levels).

4. For procurement, the federal framework of laws and regulations is solid and transparent, and is familiar to both public officials and to the private sector¹. These laws and regulations take precedence over those for the sub-national levels. States and municipalities may complement federal legislation but not contradict it, nor may they create new procurement methods. Open competitive bidding is the default procurement method, as defined by Article 37 of the Constitution, and provides fair opportunities for bidders to contest decisions including through appeal to an independent entity. All procurement opportunities, regardless of estimated cost, are published via the internet. Companies are required to have local representation to bid on government contracts. This involves establishing a local office or designating a local agent to serve as local representative and obtaining a taxpayer identification number or CNPJ (*Cadastro Nacional de Pessoas Jurídicas*). Once incorporated in Brazil, foreign companies are treated as locals and subject to the same rules and conditions as domestic companies.

5. The provisions in the federal Brazilian legal framework governing fraud and corruption are also binding on state and municipal public administrations. The Bank's assessment is that they are adequate. The Federal Constitution and principal anti-corruption statute, the 1992 Law on Administrative Improbability (LIA), define various categories of misconduct and provide for such

¹ This assessment draws heavily on the 'Assessment of the Procurement Systems of the Brazilian Federal Government and the Brazilian State of São Paulo - In Support of a Use of Country Systems Pilot Project in Procurement in São Paulo State' ('The UCS Report').

sanctions as the suspension of political rights, removal from public office, freezing of assets and financial compensation for damages caused to public treasury. The Constitution also stipulates that there is no statute of limitations when seeking reparations for damages caused to the public treasury by government officials. Legal action can be filed in court by the public entity that suffered the losses or by the *Ministério Público*; in practice, it is almost always the *Ministério Público* that initiates. Any person can file a complaint requesting an investigation of suspected wrongdoing. The Constitution and LIA have been complemented by other federal and state legislation inter alia regulating citizens' access to information and establishing a code of ethics for state officials.²

1.2 Fiduciary institutional arrangements

6. The institutional framework for the management of public finances in Ceará features a clear definition of responsibilities and institutional arrangements for the management of public finances. This framework will be adopted for the Program, for which the key agencies responsible for the fiduciary arrangements (and the main responsibilities) will be as follows:

- SEPLAG - Coordination of the budget preparation process; procurement policies and regulations, manages IT systems supporting procurement, ensures procurement compliance and financial reporting (on the program)
- PGE – Competitive procurement;
- Sector agencies – Non-competitive procurement, preparation of technical specifications, terms of reference, bid evaluation, contract signature and contract management;
- SEFAZ – Financial planning, treasury operations, accounting;
- *Ministério Público* (MP): fighting corruption, criminal and civil investigations;
- CGE – Internal audit and ensuring compliance with internal controls; and
- TCE – Undertaking the external audit.

7. The capacity of each of these agencies is assessed below. In summary, these agencies have the necessary capacity to manage the resources and to execute procurement under the program. The assessment identified opportunities for strengthening the agencies, including the continuation of training and dissemination of new accounting regulations, staff training and supporting the implementation of risk focused approaches for internal audit, the continuation of the modernization of the external audit methodologies that place more emphasis of performance and results, the additional upgrade of the integrated management information system to allow the better monitoring and evaluating of procurement implementation, setting up an IT system which could help improving contract management of works and drafting standard bidding documents.

² These include Federal Law 10.028 (2000) extending the scope of crimes against public finances to reflect the FRL, Federal Law 12.527 (2011) regulating citizens' access to information rights enshrined in the Constitution and Federal Decree 5.151 (2004) barring federal government agencies from contracting active duty federal, state and municipal employees in international technical cooperation projects. In addition Ceará State Decree 31.198 (2013) establishes a Code of Ethics and Conduct for all officials and employees and State Decree No. 31.199 (2013) regulates the organization and functioning of the state's access to information sector committees, whose mission is to enforce transparency and citizen access to information rules within the state's executive branch.

1.3 Fiduciary procedures and capacity of the implementing agencies.

Budget preparation:

8. SEPLAG oversees the state-wide public sector planning and budget preparation. The agencies responsible for implementing the Program will prepare initial budget proposals containing the expected program expenditures. Within the sectoral agencies such as SEDUC, a central planning unit coordinates proposals from sub-agencies before transmission to SEPLAG. Planning and budget preparation activities for the program follow an established annual budget calendar. Budget ceilings are communicated by SEPLAG to sector agencies through a budget circular. In addition, SEPLAG (through IPECE) will be responsible for supervising and monitoring the Program.

9. The PPA, currently for 2012-2015, is the state's main multi-year planning tool. The PPA describes the objectives, indicators, financial physical and targets of government programs, for at least four years. Investment programs in which expenditures are incurred over a period exceeding a single fiscal year are required to be reflected in the PPA covering that period. Additional resource requests for projects/programs have to be explicitly authorized by the Legislature. This normally occurs during the annual PPA revisions; in any other case, a specific bill relating to the program would need to be passed. The annual budget preparation process is guided by a specific Budget Guidelines Law (*Lei das Diretrizes do Orçamento - LDO*) approved by the Legislative assembly. In addition to budget preparation guidelines, the LDO specifies budget priorities and targets, budget structure and organization, conditions for transfer of government resources to the private sector and estimated recurrent and capital expenses for the coming year. It also includes specific directives for the preparation of the State's Annual Budget Law (*Lei do Orçamento Anual - LOA*). The LOA is a comprehensive document that covers all state entities, including central administrative units and organizations. The budget classification system is governed by federal rules that are consistent with international standards. These rules also lay down specific requirements relating to the inclusion of comprehensive information in the budget documents.

10. The initiatives to be supported by the Program, their location within the PPA for 2012-15, the agencies responsible and the approximate volume of financing associated with each over the course of the Bank operation (from all sources) is indicated in the section on the scope of the program above.

11. SEPLAG has sufficient capacity to undertake and coordinate the planning and budgeting for the program, and Ceará has consistently met deadlines for the preparation of key budget documents and for submitting them to the legislature for consideration and approval. The level of stakeholder participation and coordination with sectoral agencies and discussion is also adequate. The State Assembly has also reviewed and approved the proposed budget documents in a timely manner. The existence of an inter-Secretariat Results and Fiscal Management committee (*Conselho de Gestão por Resultados e Gestão Fiscal - COGERF*) helps to ensure that the overall budgeting process is a fair reflection of execution agency proposals in the final budget. Where necessary, SEPLAG provides technical assistance to sector agencies on the development and execution of plans, programs and budgets and monitoring and evaluation of the budget, program and project execution.

12. Despite the existence of this strong legal framework, however, institutional weaknesses hinder proper linkages between medium term planning and annual budget preparation. Expenditure policy decisions have been tied to the development of select priority programs and projects, chosen on the basis of generic studies and the administration's political platform. Multiyear costs are often only roughly estimated, and on an aggregate basis. There is a general absence of sector strategies, vital for the identification of relevant investment and recurrent expenditures.

Procurement planning:

13. Procurement planning in Ceará is sophisticated, the result of years of fine tuning. Competitive procurement is the responsibility of a central team housed at PGE (*Central de Licitações*) which implements all competitive bidding processes for the entire government. Its activities include preparing and issuing bidding documents and request for proposals, responding to bidders' questions and reviewing the bid/proposal evaluation reports. The central procurement team is staffed by around 170 employees and is organized around particular processes. Teams are assigned to a procurement method for a year and then rotated. The central procurement team also has an internal audit team from PGE that is assigned to review procurement processes.

14. Non-competitive procurement (via *'dispensa'* and *'inexigibilidade'*)³ is implemented by sector agencies, which in 2010 and 2011 represented 15% and 22 % respectively of the total State's expenditures. It should be noted that this figure includes utilities, such as power, water, payment of postal services and such, are recurrent costs and no subject to competitive bidding. Thus the amount of procurement carried out by the sectors is relatively small and largely for simple items. The sectors are responsible for all steps in the process including securing budget allocation, preparing terms of reference or technical specifications and cost estimates, providing technical opinions during bid evaluations, managing contracts, receiving goods, works and services, and paying suppliers, contractors and consultants. SEPLAG provides regular training on low-value procurement (up to BRL 8,000, equivalent to US\$ 4,000 for goods and BRL 14,000 equivalent to US\$ 7,000 for works), which constitutes the bulk of *'dispensa'* processes. Sector agencies also rely on advice from legal advisors assigned by the PGE.

15. All seven agencies implementing the Program will be handling procurement activities. These will include the acquisition of environmental and rainfall stations, water testing and monitoring equipment, pipes, teaching materials, refurbishment of schools and construction of child education centers (each following the same model for an estimated cost of USD 50,000). There are no high value contracts expected under the Program and specifically no contracts above the OPRC threshold.

16. SRH, COGERH, CAGECE, FUNCEME and SEDUC have previously worked on Bank funded operations. Based on the assessment conducted in November 2012 and their performance under previous operations, they are considered to have demonstrated sufficient capacity to exercise their functions.

³ *dispensa*: competition exists and bidding is possible but it is not mandatory (art 17 and 24- Law 8666) – *inexigibilidade*: no competition and bidding is not possible (art. 25 - law 8666)

17. The capacity assessment analyzed a high volume of contracts executed in 2010 and 2011 and concluded that SRH and SEDUC awarded contracts through competitive procurement procedures. The assessment showed that contract execution delays and contract amendments to works contracts are quite frequent, as explained in section 2.2.

18. Procurement has to be undertaken using the state's information systems, which thus provide the state with a strong control on the processes. These processes are embedded in information systems and are automatic. Low-value and high volume items are typically purchased through framework agreements that aggregate demand from sector agencies to achieve economies of scale.⁴ All government agencies are required to buy from framework agreements if one is available. The most significant framework agreements by value are those for school meals and pharmaceuticals. Also notable are the agreements governing vehicle maintenance and fuel purchases, which must be made by special credit card that monitors usage and flags any unusual consumption patterns.

Procurement initiation and the budget execution cycle:

19. Sector agencies initiate procurement through an '*intenção de gasto*' or declaration of intent. The budget execution cycle in Ceará, as in the rest of Brazil, is comprised of three phases: commitment (*empenho*), verification (*liquidação*) and payment (*pagamento*). The State Secretariats and agencies responsible for the implementation of the Program (e.g SEDUC for the Skills Development component) will undertake the first two phases of the transaction cycle following completion of the necessary procurement procedures. Once bidding processes are concluded and before contract signature, they will lock in the financial resources at the commitment stage. No contract can be awarded until the commitment has been approved, and it represents an obligation on the part of the state pending the implementation of the delivery of goods or services. The primary requirement to initiate any expenditure transaction is that it should have a corresponding allocation in the LOA as approved by the assembly: no bidding process can start unless it is linked to a line item in the LOA. Financial quotas are set for each quarter and released in monthly installments. In order to secure proper authorization, Secretariats and agencies will have to remain within their financial limits when processing commitments. The commitment stage is recorded in the State's integrated financial management system, SIC, using a Commitment Note (*Nota de Empenho* - NE) and observing credit allocation limits. These commitment notes are sequentially assigned a unique identification number. Similar controls are exercised at the subsequent stages of execution using SIC.

20. The various accounting procedures used to capture expenditure program transactions will be undertaken electronically, directly on SIC. The executing agency will be responsible for ensuring that goods or services have been delivered. Once this is done and an invoice is received from the supplier, the financial administration units within the State Secretariats implementing the programs will issue a bank payment notice (*Nota de Pagamento* - NP) and register the payment request within the SIC. SEFAZ will regularly monitor the bank payment notices generated in the system in order to issue payment instructions from the Single Treasury Account. Payments are made in the form of electronic bank transfers.

⁴ In 2011, Ceará had 164 framework agreements encompassing 2,154 items for a total amount of R\$ 856 million Source: SEPLAG, Report named "Participação nas atas de registro de preços vigentes", March 2012.

Procurement methods:

21. *Works and engineering services:* The non-auction open competitive bidding procurement method required by Law 8.666/93 applies equally to all processes, regardless of size or the type of item. In practice, however, it is used mainly for works and consulting services. The mode of invitation varies by size of award. For works/engineering services with an estimated cost of up to BRL 150,000 (US\$ 75,000) and goods up to BRL 80,000 (US\$ 40,000) , public agencies can use ‘*convite*,’ where the invitation of at least three interested bidders is enough to launch the bidding process. For those between BRL 150,000 and BRL 1.5 million, public agencies must use a procurement method known as ‘*tomada de preços*,’ where the process is open to any interested bidder provided they have registered in the government supplier database. For works/engineering services over BRL 1.5 million (US\$ 750,000) and BRL 650,000 (US\$ 325,000) for goods, public agencies must use the ‘*concorrência*’ method, which is open to any interested bidder regardless of registration status. As the most open of the three invitation modes, ‘*concorrência*’ can be used for any procurement, regardless of size, at the discretion of the implementing agency.

22. *Goods and non-consulting services:* Goods and non-consulting services are usually procured by reverse auction, either electronically or offline. In the case of electronic reverse auctions, participating bidders must be registered in the government supplier database. For awards below BRL 650,000, auctions must be advertised in the official gazette and via the procurement web portal; for those between BRL 650,000 and below BRL 1.3 million (about US\$ 720,000), the advertisement must also appear in a local newspaper; and, for those above BRL 1.3 million, it must also appear in a regional or national newspaper. All offline reverse auctions must be advertised in the official gazette, but only optionally via the procurement web portal and a newspaper of “wide circulation”. In practice all offline reverse auctions are published via the state’s procurement web portal.

23. *Consulting services:* The Brazilian procurement framework does not distinguish between goods, works and consultants. The same rules apply to both, except for reverse auctions, from which consultants and works are excluded. For consultants, the legal framework provides for award criteria based on “quality and cost” or “quality only”.⁵ Under these methods, bidding documents always require the proposal to be an integral part of the bid package and bidders must submit three sealed envelopes: the first contains the legal, financial, fiscal, and technical qualification documents; the second the technical proposal; and the third the price proposal. Qualification envelopes are opened first. Only qualified bidders move to the second stage of technical evaluation. Technical proposals are scored on the basis of objective criteria, and only those which attain a minimum pre-defined score move to the third and final price stage. The price of the winner is negotiated with reference to that received from the lowest qualified consultant.

Contract administration:

24. There are several controls to ensure that goods, works and services delivered to sector agencies comply with bid specifications. The terms of reference used as technical inputs for the bidding documents are prepared by sector agencies and provide a means of comparison with what is actually delivered. For procurement of goods, the central procurement team usually

⁵ As defined in Articles 45 and 46 of Law 8.666/93.

requests samples which are sent to sectors as a benchmark for verification upon delivery. When items do not comply with bid terms, suppliers are subject to monetary penalties and can be debarred. However, most of the mechanisms for quality control revolve around the bidding process. Tools for correcting supplier performance post-award are limited to penalties and sanctions.

Procurement performance:

25. The procurement system of the State of Ceará is a combination of highly centralized procurement process and decentralized contract management supported by multiple information systems. The capacity assessment indicates that it functions efficiently. The central procurement entity (PGE) has the capacity and resources to handle a high volume of procurement processes, PGE carries out 85% of the State's value put out for bidding and in 2012 PGE conducted 2,600 bidding processes for a total value of BRL 6,370,000,000 (US\$ 3,000,000,000). The Bank did not find any complaints from the sector agencies about PGE's performance. However, PGE's bidding management system, "*Licitar*" has some limitations. While it provides some statistical data (total number of bidding processes conducted during the year, the volume of bidding and contracts awarded), it is not designed to generate reports on PGE's performance in the bidding processes. The TA component will support its upgrade to improve its monitoring capacity. Although the state's procurement arrangements appear sufficient in general, there are a number of weaknesses that need to be addressed. The first concerns cost estimates for the procurement of goods. Since there is no current data base available, the contract estimates for goods are made with reliance on three quotations from prospective suppliers, and this may not be the best manner in which to determine the estimates. A second difficulty is the fact that the State relies on the Federal system (Comprasnet – Banco do Brasil) to conduct its reverse auction. Since there is no IT linkage to the contract monitoring system (*Sistema de Acompanhamento de Convênios e Contratos - SACC*), the information for each bidding process has to be manually entered into SACC at the end of each bidding process. This weakens the enforcement of budget controls and limits the availability of data for statistical analyses and audits. The Government is aware of this shortcoming and has developed its own reverse auction information system which is yet to become operational. Finally, the state lacks standardized bidding documents and each agency uses its own set. This may cause delays in their approval by PGE.

26. The TA component will support SEPLAG in upgrading its integrated management information system to better monitor and evaluate procurement implementation. This will help to reduce transactional costs and fragmentation in small value procurement and allow SEPLAG to craft better procurement strategies and policies. In addition, the TA component will help to produce a set of standardized bidding documents for goods, e-reverse auction and works.

27. The procurement system (law 8666) is ineffective at recruiting high quality consultants. Because of the deficiency in the law, when hiring highly skilled individuals, agencies tend to do so through noncompetitive methods.⁶ TCE reports indicate that some agencies try to divide up consulting contracts to either avoid competitive procurement methods or bypass the central procurement team entirely. In addition, with the national procedures for selecting consultants it is sometimes hard to select the best quality proposal: agencies tend to design very precise bid

⁶ For example, there were only 71 competitive awards on a 'quality and cost' or 'quality only' basis between 2008 and 2012, compared to a total of 44,631 bidding processes for goods, works, consultants and non-consulting services.

evaluation criteria (e.g. years of experience or number of diplomas) in an attempt to show fairness and be consistent with the National Procurement law. The problem is that this procedure does not permit the exercise of professional judgment required to assess quality. These difficulties were apparent during the implementation of the SWAs.

Contract management performance:

28. This is the weakest link of the supply chain, particularly in agencies with decentralized operations. The deficiencies are more pronounced among contracts for works, which are subject to frequent delays and price increases during execution. In 2010, for example, 85% of works contracts ran late and 58% were subject to price increases after signing. The average contract extension was 372 days, representing an almost tripling of original delivery schedules. This is particularly relevant for the Program, given that it supports the maintenance, construction and refurbishment of vocational training schools and child centers. Construction projects of public facilities such as school buildings constitute an important risk for fraud and corrupt behavior in Brazil. It is not infrequent for construction projects to surpass initial budget estimates. Brazilian procurement and contracting legislation then allows for cost adjustments in order to preserve contractual ‘economic-financial equilibrium.’ The law also allows for additions to the initial contract of up to 25% or 50% of the original amount, respectively for construction and refurbishment of buildings. Such legal provisions can and are misused by corrupt officials and business to circumvent legitimate procurement objectives and generate illegal rents. Through the TA component the project will help the Government of Ceará to elaborate and implement a strategic program to improve contract management by setting up systems and methodologies for the improvement of internal controls of contracts of works. Furthermore, the TA component will help to strengthen the capacities of the key staff on contract management.

Resolution of contract disputes:

29. Contract disputes are either settled following administrative procedures described in the procurement law or are else referred to the judiciary. The mechanisms are well-known to government officials and to the private sector and function in a predictable manner. For contracts already under implementation, a firm’s first step is to file an administrative petition. If this is insufficient, it may take the dispute to court. Article 79 of the procurement law provides three grounds for rescinding a contract: (i) unilaterally by the hiring agency on account of malfeasance or non-delivery, for reasons of public interest or *force majeure*; (ii) by mutual agreement; (iii) by judicial act or order.

Treasury management, payments and flow of funds:

30. As mentioned above, Ceará maintains a single treasury account system that is managed by SEFAZ. Payments in respect of the Program will be made by SEFAZ in accordance with duly documented payment requests received from the implementing agencies. A Ceará state decree requires agencies to pay contracts for works in no more than five days⁷.

31. As part of its treasury management responsibilities, SEFAZ prepares the state’s annual financial plan and monthly cash flow projections, monitors its implementation, and consolidates the daily cash balances. COGERF will establish the monthly financial programming quotas for

⁷ State Decree 29.918 dated 09 October 2009 and “Instrução Normativa”001/2010.

the fiscal year at the beginning of that year. Working within these ceilings, SEFAZ will communicate authorized quarterly amounts to the sectoral implementing agencies. These will be used to guide the scheduling of activities to be supported by the program. The approved cash flow ceilings will be updated on a monthly basis. Reconciliations of all central government accounting records with commercial bank account statements are performed at least once a month.

32. For the SEDUC implemented program, financial resources will be transferred in advance by SEDUC and directly administered by the school administrators⁸. There are twenty-one SEDUC regional offices (CREDE) which are responsible for monitoring and oversight of nearly seven hundred schools. CREDEs are responsible for reviewing and approving financial requests made by school principals. They also analyze the schools' financial forecasts, bank accounts and reconciliation statements. Transfers to the schools will be made in quarterly advances in accordance with specific agreements that will set out the conditions of the transfers, the activities to be financed, and requirements for accountability. The transfers will be conditional upon satisfactory accountability for prior advances. To help in monitoring the use of such resources, SEDUC has issued a number of guidelines to such schools, including standard documentation that should be submitted in accounting for advances. This includes documentation in respect of bank reconciliations, accounting statements and physical reports. In addition, SEDUC has a modern public school administration system (*Sistema Integrado de Gestão Escolar*). The system has a financial management module where the manuals, guidelines and standard forms used by schools for recording commitments and payments and preparing financial reports can be downloaded. In such cases, the funds will be transferred in advance by SEDUC.

Accounting and financial reporting:

33. SEFAZ will be responsible for maintaining the accounting records for the Programs. In addition to federal accounting and finance laws, the federal National Treasury Secretariat (STN) has issued accounting instructions that will be applied by the *Coordenação do Tesouro* (COTES) within SEFAZ in recording the transactions of the Program. COTES has two units that have direct responsibility for administering the State's accounting records, and issuing financial statements and reports. From 2013 all federal entities in Brazil have adopted international public sector accounting standards. The state's financial accounting system (SIC/S2GPR), administered by SEFAZ is key in ensuring the successful implementation of the new accounting rules. The accounting module in the system is used to record data for all accounting transactions, and it enables the preparation of the State's financial reports. Additional steps taken to support the introduction of the new accounting system include a stock take and evaluation of all its fixed assets, training and sensitization programs, and the upgrade of its information systems. Overall, it provides timely and regular information on actual budget performance. SIC users have direct access to information, thus helping manage approved funds and implement their budgets. The most used status reports on budget execution as well as monthly statements are preprogrammed in the mainframe system.

34. SIC/S2GPR, which will be used for the maintenance of the program's accounting records. The system will enable Ceará to adequately record the program financial transactions using a Chart of Accounts that was introduced recently following the adoption of accrual accounting

8 As part of the "Programa Dinheiro Direto na Escola" (PDEE).

35. SEFAZ periodically prepares and publishes the government's financial reports. Budget execution reports are prepared on bi-monthly and quarterly bases. Interim Financial Reports specific to the program will be prepared in a semi-annual basis by SEPLAG/IPECE, showing program expenditures by program, budget line and activity. The reports will be submitted to the bank within 60 days after the end of each semester. Annual Program Financial Statements will also be prepared for the Program and will show the total revenues and expenditures related to the Program. The format of these has been agreed between the Bank and the GOC. Periodic bank reconciliations also facilitate preparation of the annual consolidated financial statements. Ceará has consistently been able to prepare its financial statements in a timely manner in each of the last three years. These same systems will be used to prepare the financial statements for the Program.

36. In general, from the audits of the Ceará SWAP operations and reports prepared by the CGE and the TCE, accounting regulations have been found to be properly and consistently applied. Minor exceptions have been detected and noted in CGE and TCE reports. The 2012 report, for instance, highlights the inclusion of some classes of transactions in the financial statements without the inclusion of explanatory notes. The audit reports contained recommendations for remedial actions to be taken. The implementation of a new Chart of Accounts, improvements in the integrated financial management system and the training that has accompanied these are bound to strengthen the state's accounting performance further.

37. In the past, the TCE has recommended to SEFAZ and SEPLAG the update of the skills and knowledge of their staff as a way of limiting errors in the recording of accounting information. The TCE was subsequently satisfied that this recommendation has been fully implemented, with the *Escola Pública de Gestão* running regular training programs for staff in accounting procedures. These programs are also intended to help provide staff with the requisite knowledge on the new international public sector accounting standards.

Controls:

38. *Payroll controls:* Civil servant payroll is centralized at SEPLAG's *Coordenadoria de Remuneração de Pessoas* which maintains the personnel database and manages the monthly wage bill. The payroll is run using a mainframe based system. Administrative units at each state agency are technically responsible for the maintenance of individual personnel records and staff status changes. Sector units, nevertheless, have been slow to update their personnel information on the electronic payroll database. As a result personnel records and payroll are not updated monthly. Some employee related administrative tasks related to employees require formal publication in the State Register. Any necessary retroactive adjustments are then performed. SEPLAG checks the payroll for accuracy every month, comparing taxpayer IDs with personnel records to identify possible ghost workers and other inconsistencies. Nonetheless, these safeguards have, at least in some cases, proved insufficient. CGE audits and an SGE audit of SEDUC have previously found lapses, including unjustified payments for overtime, inadequate verification of employee attendance, improper accumulation of jobs by individuals and questionable awarding of vacation time.

39. *Non-payroll controls:* Various laws and regulations exist to underpin the internal control environment that will be used for the program. These controls will limit program expenditures to those approved within the LOA and for which financial resources have been sufficiently

programmed. As mentioned above, once the annual budget is passed, information on the budget allocations and financial quotas for the various budget units is captured in SIC/S2GPR by SEFAZ/COTES, initiating the budget execution phase. In accordance with the LOA, financial quotas are aggregated by both economic classification and source of funds. The primary requirement to initiate any expenditure transaction is that it should have a corresponding allocation in the LOA as approved by the assembly. Financial quotas are set for each quarter and released in monthly installments. In order to secure proper authorization, units and agencies must remain within their financial limits when processing commitments. Responsibility for budget execution is decentralized (see above under procurement).

40. All state units except independent public enterprises are required to use SIC/S2GPR for recording financial transactions. The system contains a series of controls which effectively limit expenditure commitments and payments to cash availability and approved budget appropriations. The system also helps to keep track of expenditures for goods and services, casual labor wages and discretionary staff allowances. The system is thus an effective mechanism to control the budget execution cycle.

Audits:

41. *Internal audits:* The internal audit of the Program will be undertaken by the CGE, which also functions as the state ombudsman and is responsible for enforcing disciplinary actions across the executive branch. In addition the CGE is responsible for developing and maintaining the state's transparency portal. Its procurement-related activities include reviewing the use of non-competitive methods (*'dispensa'* & *'ineligibilidade'*) and supporting the monitoring of contract performance. The CGE also verifies the extent to which contracts awarded correspond to the LOA. The CGE plays a key role in monitoring the implementation of the recommendations contained in the TCE's annual report on the Government's financial statements. It is expected that the CGE will play this role specifically in relation to recommendations in respect of the expenditure programs supported under the Program.

42. The CGE enjoys a satisfactory level of professional independence and is legally empowered to access information and report its findings. Promotions are based on employee performance and demonstrated improvement of technical skills. However, the agency has had difficulty in retaining staff attracted by the prospect of better-paying jobs in the private sector. It currently has 60 vacancies – almost double the number of auditors it employs – and operates at well below the staffing levels specified in the regulatory framework. A number of reforms are underway to strengthen the capacity of the CGE. These include the introduction of risk based methodologies to better target internal audit efforts, and training for staff. Some of these reforms will be supported under the Program and are described in the TA Section.

43. *External audits and scrutiny:* The state's audit agency, the TCE, is mandated to conduct audits of all uses of public funds in Ceará. The TCE is an independent agency that reports to the legislature. It audits the Government's annual financial statements, the state administrator's annual accounts and reviews the bimonthly and quarterly fiscal reports issued by SEFAZ for accuracy and fairness. The TCE audit approach has sufficient focus on risks and performance. The TCE's performance is widely seen to be satisfactory, and its reports contain detailed findings and recommendations. With the support of the CGE, it also regularly assesses the extent to which its recommendations are implemented. All audits are carried out according to national

auditing standards. The TCE also carries out detailed audits of procurement by sector agencies, principally with the aim of limiting the use of non-competitive methods. The TCE has recently undertaken a number of reforms to enhance the impact of its audits and increase the skills and knowledge of its staff. These include the adoption of international standards for supreme audit standards and the introduction of new methodologies in respect of financial and performance audits. The TCE has also undertaken a rigorous training regime to update the skills and knowledge of its staff in respect of the new methodologies.

44. The TCE will be responsible for auditing the program's annual financial statements. The scope of the audit will be defined in the terms of reference to be agreed between the Government and the Bank. A copy of the audit report will be submitted to the Bank no later than 12 months after the end of the financial year to which the financial statements relate.

Access to information:

45. Public access to financial and procurement information is guaranteed through the Federal Access to Information Act of May 2012. The Law requires the disclosure of annual budget documents (PPA, LDO, LOA), budget execution reports and the mandatory bi-monthly and quarterly FRL reports published by SEFAZ. These are available online via the state's web portal, as are the state's year-end financial statements. The Act also requires online disclosure of all bidding documents, contract awards and signed contracts. Bidders have access to an online pre-registration site through the state's procurement web portal.⁹ Tender invitations for 'convite' processes are published online; those for 'tomada de preços' or 'concorrência' processes are published in the official gazette, on the procurement website and in at least one widely circulated regional or local newspaper. All reverse auctions are advertised on the procurement website. The wide use of the internet in Brazil facilitates public access.

46. Complaint mechanisms:

47. The procurement complaint mechanism in Brazil is regulated by Federal law 8.666/93. Complaints by bidding firms or individual members of the public may be directed to either: (i) the bid evaluation committee for the relevant sector agency, in which case a decision is taken by the 'ordenador de despesa;' (ii) the TCE, which can stop a procurement process by special order if it finds strong evidence of wrongdoing; or (iii) the courts. Whichever the channel, it is unusual for a procurement process to be interrupted unless there is a strong suspicion of fraud.

48. Responsibility for ensuring that complaints are properly handled lies with the ombudsman (*Ouvidoria*). It ensures that they are addressed to the relevant party and monitors their progress through the system. The ombudsman also acts as a watchdog and can intervene itself if it suspects fraud. It may even independently recommend the suspension of a procurement process to the Governor.

Fraud and anti-corruption

49. The CGE and the TCE play key roles in ensuring compliance with laws and regulations. In addition to these institutions, the *Ministério Público* (MP) is an independent state agency responsible for public prosecution. It plays a prominent role in fighting public corruption and can

⁹<http://www.portalcompras.ce.gov.br/categoria2>.

undertake criminal and civil investigations either with the police or independently. The MP is not subordinate to any other branch of government: it can and routinely does file litigation against government itself and government officials, including high-ranking ones. Each prosecutor benefits from independence safeguards similar to those held by judges (*i.e.*, he cannot be fired or transferred at will) and has full autonomy in handling his cases. Each Public Ministry branch has its own Attorney General (who manages the agency's administrative matters) and Inspector General (who provides disciplinary oversight over all prosecutors), but they cannot dictate the decisions prosecutor should take in each individual case.

50. Any case involving the misuse of public funds may reach the state court system, particularly if the Public Ministry is involved. Ceará has no specialized courts to try organized fraud, corruption or money laundering. There also exists a separate Municipal Court of Accounts (TCM) which exercises financial oversight over the use of public funds at the municipal level. Its role and powers are very similar to the TCE but its mandate is limited to funds originating with municipalities.

2: Assessment of Program fiduciary risks:

51. Overall fiduciary risks are considered moderate. The FM risk is moderate. FM arrangements meet the Bank's minimum requirements. There are however some weaknesses in internal controls, delays in the submission of audit reports and high rates of staff turnover. Procurement risks are also moderate. Ceará's procurement system provides reasonable assurance that the fiduciary principles of transparency, economy, efficiency, effectiveness and accountability will be met. The main risks are in contract management, recruitment of highly qualified consultants and small value procurement. The fraud and corruption risk is moderate.

Financial management risks:

52. The key financial management risks arise from (i) weaknesses in the planning process, particularly the linkages between sector plans and budgets, (ii) the introduction of new accounting rules following the adoption of international accounting standards and (iii) the capacity of the CGE to monitor the implementation of internal controls and TCE recommendations.

53. The linkage between Government priorities and the annual budget, including allocations for the Program, could be strengthened. In addition, the costs of sector plans are sometimes not properly assessed due to a lack of cost accounting information (see Technical Assessment, Component A1: Cross-Cutting Public Sector Management).

54. The recent adoption of international accounting standards requires the preparation of government financial statements on an accruals accounting basis. It is envisaged that this will result in the availability of accurate information and this improve decision making. However, it also requires more sophisticated accounting knowledge and skills on the part of staff, and sensitization of government officials to ensure that information is properly understood and used. To address the resultant risks, the government has undertaken extensive training and sensitization programs. There is also a wide availability of guidance materials that were prepared and disseminated by the Federal Government. In addition, improvements in the information

system architecture are likely to provide tools for the better application of the new accounting rules.

55. Finally, there is a risk that implementing agencies may not fully comply with existing internal controls, as indicated in some of the recent internal and external audit reports. In mitigation of this risk, both the CGE and the TCE are developing their capacity to identify areas of key risks and support the government's focus on performance and results.

Procurement risks:

56. The procurement system provides reasonable assurance that the fiduciary principles of transparency, economy, efficiency, effectiveness and accountability will be met. It also provides an adequate mechanism to ensure fairness and guarantees the right to appeal decisions on individual bidding processes.

57. *Transparency:* All competitive procurement processes are published online at the state's open-access procurement webportal. The procurement regulatory body at SEPLAG carries out periodic workshops with private sector companies to explain how to become a supplier of the State government. The initiative aims at broadening the base of suppliers of the government and at encouraging the participation of small and medium enterprises. The procurement webportal was designed with the objective of becoming a one-stop shop for the State government procurement and, as a result, facilitating private sector companies to supply to the government. At the portal, companies can register to receive emails and text messages with bidding opportunities and to enroll on the State's database of suppliers (also known as CRC). Once enrolled at CRC, companies are able to verify the status of their applications online and to update this information through the internet, pending delivery of supporting documentation. On the flip side of the coin, the State is able to quickly verify at the CRC if bidders are legally and technically qualified, therefore, speeding up a process known in Brazil as '*habilitação*.' A manual explaining how to become a supplier of the State and how to register at the CRC is available for download at the procurement webportal.

58. *Economy and efficiency:* In terms of economy and efficiency, data provided to the Bank showed that in 2010, 85% of all contract expenditures done by the State followed open and competitive bidding processes, through *concorrência*, *pregão*, *tomada de preço* or *convite*. This result, which already is very good, would have been even better if the dataset allowed for segregation of non-procurable items, such as utility bills, which are paid through *dispensas*.

59. *Accountability:* The processes and procedures supporting implementation of procurement in Brazil assign very clear roles and responsibilities for all steps of the process. The *Ordenador de Despesa* is responsible for authorizing expenditures and he or she will perform this function with the advice of specialized teams in budget and planning, procurement, bid evaluation, legal issues, and financial management. Each of these specialized teams is individually accountable for their specific contribution. Oversight of this operation is performed by control agencies, such as CGE and TCE, which rely on different information systems to ensure compliance with legislation. For instance, the procurement system will only allow a bidding process to move forward if the required budget appropriation had been previously made at the budgetary information system. In the same vein, a payment can only be made within the financial management system if a contract had been duly awarded and recorded at the contract information system. The valuable

information collected by these systems allows the CGE and the TCE to play a very effective control role in the system and to ensure that implementing agencies comply with rules and procedures. The fact that only 3% of the number of contracts signed in 2011 were subject to amendments shows that the State of Ceará has effective controls to manage contract implementation and keep change order to a minimum of contracts.

60. *Fairness:* In terms of fairness, the procurement legal framework in Brazil is mature, solid and very well known to all stakeholders. This is a result of the constant evolvement of the regulatory framework since 1993, when the landmark procurement law was enacted. Also, there are three ways through which bidders and any citizen can voice complaints during a bidding process: directly to the implementing agency, to the Supreme Auditing institution or TCE, or to the judiciary. The first two channels are free of charge and TCE is independent from the implementing agency.

61. *Risks and mitigation measures:* the key risks on procurement result from the weaknesses identified under paragraph 2.2, which are (i) ineffective national procedures for selecting high qualified consultants, (ii) small value procurement and lack of a price data base for goods, (iii) weaknesses on contract management for works and (iv) insufficient information generated by the *Licitar* system used by the central procurement agency PGE.

Fraud and corruption risks:

62. The operation presents a number of fraud and corruption risks. Bank funds will be exposed to the same opportunities for rent-seeking behavior as other public funds. These are especially notable in the case of activities executed by municipalities, as are parts of all three components of the Program. The smaller municipalities in particular lack internal control mechanisms. Moreover, municipal election campaigns are often financed illegally by local business people in the expectation of paybacks once the beneficiaries are in office.¹⁰ In view of this, and given that the bulk of anti-corruption efforts are directed towards ex-post detection and restitution rather than ex-ante prevention, the overall risk of fraud and corruption is considered moderate.

63. *Ex-ante detection:* The Government's main tool for detecting fraud ex-ante is the Federal Cadaster of Debarred and Sanctioned Firms (CEIS) and the state-level *Sistema de Informações Gerenciais* (SIG). CEIS is maintained by the *Controladoria Geral da União* and consolidates all debarment and sanctions data on both firms and individuals at the state and federal level. Brazil's national procurement law stipulates that firms cannot be barred from entering a procurement process. Instead proposals are screened against the CEIS and SIG when initially received and any proposal from a firm or individual registered on CEIS immediately disqualified. A second screening takes place at the contract award phase. The selected firm or individual is once again checked against the debarment lists and if found, disqualified in favor of the next lowest bidder. If for some reason a firm on the Bank's debarment list is not on the CEIS or SIG and is not excluded at the beginning of the procurement process, it would be excluded at the later stage prior to award (Article 42, § 5^o of Lei 8.666). The CGE also has some capacity to monitor change orders on government contracts and monitors unit prices within contracts. It has

¹⁰ The Ministerio Publico has developed a program (*Operação Antes Desmonte*) to perform due diligence on the use of municipal funds six months before a mayor is due to leave office. Assets are frozen and reviewed, deterring incumbents from malfeasance.

undertaken a risk analysis of all 39 state agencies, assessing their procurement, financial management and payroll management capacity. It began to co-locate anti-fraud and corruption staff in those agencies deemed a high risk from October 2013.

64. *Ex-post treatment and restitution:* Although the Brazilian procurement legal framework is well developed, public agencies that oversee the execution of public contracts do not necessarily respond to instances of corruption with the necessary promptness and expediency. Fraud in construction contracts is frequently identified only after the fact and once payment has been made. The most common form of malfeasance involves the use of substandard materials and techniques by contractors or, even worse, the delivery of unfinished projects. Even after identification and investigation, itself a lengthy process in these cases, the inefficiency of the justice system can make it impossible to obtain reparations or punish perpetrators. An exception to this is the use of negotiated settlements or plea bargaining. Both the federal agency tasked with investigating and prosecuting economic crimes, CADE, and the *Ministério Público* can use plea bargaining to enforce compliance and extract restitution.

65. *Fiduciary risks and mitigation measures:* Table 1 provides the key risks and mitigation measures.

3. Conclusion on fiduciary performance and recent Bank experience

66. The conclusion of the assessment is that the fiduciary arrangements for the Program are in line with OP 9.00 and that the capacity and performance of the implementing agencies are adequate for the purposes of the Program. The performance rating for financial management arrangements under other Bank projects has been Moderately Satisfactory. Reviews by external auditors of the SWAP have revealed some lapses in internal controls, particularly in SEDUC, SESA and SECITECE. The implementing agency (IPECE) was effective in tracking activities under the technical assistance components of the SWAPs. However, TCE audit reports have pointed out some deficiencies in contract management on the part of sector agencies. Procurement performance has also been Satisfactory. The PGE is capable of carrying out its procurement responsibilities under the Program, the sector agencies are equipped with the qualified technical staff to provide inputs to PGE for competitive procurement and with the proposed mitigation measures the Government will have effective tools for improving the procurement and management of works contracts.

4: Improving fiduciary performance:

4.1 Financial management:

67. In addition to the technical assistance for budget preparation and execution, HR management including tightening of payroll controls and investment planning to be delivered through the public sector management umbrella, the Government and the Bank have identified a number of areas where ongoing medium/long-term reforms can be supported through technical assistance:

- *Support for the adoption of international public sector accounting standards (US\$ 0.2 mln) (SEFAZ/CGE):* The adoption of international public sector accounting standards (IPSAS) will improve the quality and relevance of financial information available for

decision making by public sector managers. The TA will supplement ongoing efforts to introduce IPSAS through: the provision of training and the dissemination of manuals; a staffing needs assessment to determine the most appropriate organizational structures; improvements in information systems and support for the implementation of a Chart of Accounts.

- *Strengthening risk and performance-based external auditing (US\$ 1.0 mln) (TCE)*: The TCE has been strengthening its audit capacity in recent years and is working on a strategy to modernize its audit methodology, putting more emphasis on performance and efficiency in the use of public resources. This activity will support the implementation of international accounting and auditing standards, including training and the preparation of guidance materials, and strengthen coordination with legislatures and citizen participation mechanisms.

68. Other actions to strengthen financial management performance include: the development of costing methodologies and investment planning tools that will contribute to enhance linkages between multi-year plans and annual budgets; and training for accounting staff on the new international accounting standards and their application in Ceará. The first of these will be supported through the technical assistance for cross-cutting technical assistance; the second is an item in the Program Action Plan.

4.2 Procurement:

69. Based on the weaknesses and opportunities for improvement identified in the risk assessment, the following technical assistance activities will enhance the performance of the procurement system:

- *Design and implementation of management information system and proposal for improving standard bidding documents (US\$ 1.2 mln) (SEPLAG)*: This activity will support three integrated information systems to support the execution of bidding processes: (i) a tool to enable procurement planning and the more timely implementation of procurement processes (\$ 0.5 mln); (ii) a platform to implement framework agreements for the procurement of low-value and high-volume items by consolidating demand across sectors (\$0.5 mln); and (iii) a database of all goods, works and services purchased by the Government to provide more reliable and accurate information for purchasing strategies (\$ 0.2 mln). These three information systems will be connected to S2GPR, allowing better disclosure of information and internal controls. The activity will also finance the preparation of a proposal for improving the Government's standard bidding documents.
- *System of preventive internal controls, management information system and social outreach (US\$ 1.5 mln) (CGE)*: This activity will help the Government improve its contract management system through the following activities: (i) introduction of preventive internal controls of works and other contracts; (ii) implementation of information system to collect and analyze data from all major Government databases and offer a user-friendly interface for officials to manipulate data relevant to their decision making; (iii) design of a social outreach program to raise awareness and train communities and civil society organizations to use data disclosed by the government to empower social oversight of public contracts.

- *Modernization of 'Licitar' information system (US\$ 0.5 mln) (PGE):* This activity will revamp the 'Licitar' information system currently used by PGE in order to be able to produce actionable data and reports on bidding processes.

4.3 Application of anti-fraud and corruption guidelines for the Program:

70. The Government will be responsible for complying with the Bank's Anti-Corruption Guidelines for the Program (ACGs, dated February 2012). The Government agreed to implement the Program in accordance with the Anti-corruption Guidelines, applicable to PforR operations (ACGs). The ACGs will be implemented in accordance with the following arrangements as agreed:

(a) **Reporting:** the State of Ceará will provide the Bank with reports annually or more frequently as may be required or if requested by the Bank, detailing the status of complaints received and actions taken by the institutions of the State relating to the application of the Fraud and Corruption (F&C). Likewise, the Bank will report to the State on similar allegations or any relevant information it may receive and convey to the institutions of State. The main contacts for exchange of information are the Bank's Task Team Leader and IPECE. Recognizing the legal and regulatory framework, and judicial independence Brazil and the State of Ceará, the State agreed to inform the Bank if any situation arises that causes any inconsistency with the applicability of the ACGs, and resolve such situations on a case by case basis.

(b) **Investigations:** According to the Anti-corruption Guidelines, which are an integral part of the Loan Agreement, the Bank may, in collaboration with the institutions of the State, exercise the right to investigate allegations of fraud and corruption and will coordinate the modalities with the Borrower in accordance with its existing legal and regulatory framework. For fraud and corruption cases, the Bank can request an investigation by the State, and the State will respond under its legal and institutional framework, including actions by the PGE, consulting with the judicial branch (*Ministério Público*), and any other organ of government responsible for investigating fraud and corruption allegations. The State will share the findings of investigations with the Bank, as well as make public the results of the same upon conclusion in accordance with its legal and regulatory framework.

Table 1: Fiduciary Risk and Mitigation Measures

<i>Risk</i>	<i>Mitigation Measure</i>
There may be weak link between Government priorities and the annual budget, including allocations for the Program. In addition, the costs of sector plans may not properly be assessed due to a lack of cost accounting information.	The program will support the strengthening of results based management, including mechanisms for inter-sector coordination; design and implementation of investment planning and costing methodology; and the reform of budget preparation and execution procedures to strengthen linkages between sector plans and annual budgets.
The recent adoption of international accounting standards and the preparation of government financial statements on accruals accounting basis, and more sophisticated accounting knowledge and skills on the part of staff, and sensitization of government officials to ensure that information is properly understood and used.	The government has undertaken extensive training and sensitization programs. There is also a wide availability of guidance materials that were prepared and disseminated by the Federal Government. In addition, improvements in the information system architecture are likely to provide tools for the better application of the new accounting rules.
Implementing agencies may not fully comply with existing internal controls, as indicated in some of the recent internal and external audit reports.	Both the CGE and the TCE are developing their capacity to identify areas of key risks and support the government's focus on performance and results.
Delays and price amendments in the execution of work contracts	Setting up systems for improving contract management and setting preventive internal controls in work contracts (CGE) to permit better contract management and planning.
Apparent over use of <i>Dispensa</i> in the procurement of small value items	Setting up a procurement planning module to enable SEPLAG to consolidate data on procurement needs allowing the use of framework contracts and minimizing fragmentation of contracts through <i>Dispensa</i> .
Lack of information about PGE's performance and bidding response time	Improving the <i>Licitar</i> and PGE's IT bidding systems.
Lack of standard bidding documents	PGE with the assistance of a consultant will draft standard bidding documents for goods, e-procurement, non-consulting services and works.
Ineffective national procedures for selecting high qualified consultants.	High quality consultants will be selected following the Bank's procedures under the TA component.
Inappropriate purchasing strategies, Lack of reliable price estimates for goods	Setting up a price data base for goods.