His Excellency  
Mr. José Renato Casagrande  
Governor  
State of Espírito Santo  
Praça João Climaco, S/N - Cidade Alta  
29015110, Vitória, ES  
Brazil  
Fax: 27 3636-103

Excellency:

Grant No. TF-93210 (BR GEF Espírito Santo Biodiversity Project)  
Additional Instructions: AMENDED Disbursement Letter

I refer to the Grant Agreement (“Agreement”) between the International Bank for Reconstruction and Development/International Development Association (“World Bank”), acting as an implementing agency of the Global Environmental Facility, and the State of Espírito Santo (the “Recipient”) for the above-referenced project, dated December 11, 2008. The Agreement provides that the World Bank may issue additional instructions regarding the withdrawal of the proceeds of Grant TF-93210 (“Grant”). This letter (“Disbursement Letter”), as revised from time to time, constitutes the additional instructions and replaces the previous version date December 11, 2008.

The attached World Bank Disbursement Guidelines for Projects, dated May 1, 2006, (“Disbursement Guidelines”) (Attachment 1), are an integral part of the Disbursement Letter. The manner in which the provisions in the Disbursement Guidelines apply to the Grant is specified below. Sections and subsections in parentheses below refer to the relevant sections and subsections in the Disbursement Guidelines and, unless otherwise defined in this letter, the capitalized terms used have the meanings ascribed to them in the Disbursement Guidelines.

I. Disbursement Arrangements

(i) Disbursement Methods (section 2). The following Disbursement Methods may be used under the Grant:
• Direct Payment
• Reimbursement
• Advance

(ii) Disbursement Deadline Date (subsection 3.7). The Disbursement Deadline Date is four months after the Closing Date specified in the Grant Agreement. Any changes to this date will be notified by the World Bank.

(iii) Disbursement Conditions (subsection 3.8). Please refer to the Disbursement Condition(s) in Schedule 2, Section IV. B.1 (b) of the Grant Agreement.

II. Withdrawal of Grant Proceeds

(i) Authorized Signatures (subsection 3.1). An authorized signatory letter in the Form attached (Attachment 2) should be furnished to the Association at the address indicated below providing the name(s) and specimen signature(s) of the official(s) authorized to sign Applications:

The World Bank/ Banco Mundial
Setor Comercial Norte,
Quadra 02, Lote A
Edificio Corporate Finance Center
7º Andar
70712-900 Brasilia, D.F.
Brazil
Attention: Mrs. Deborah Wetzel, Country Director

(ii) Applications (subsections 3.2 - 3.3). Please provide completed and signed (a) applications for withdrawal, together with supporting documents, to the address indicated below:

The World Bank/ Banco Mundial
Setor Comercial Norte,
Quadra 02, Lote A
Edificio Corporate Finance Center
7º Andar
70712-900 Brasilia, D.F.
Brazil
Attention: Loan Department

(iii) Electronic Delivery (subsection 3.4) The World Bank may permit the Recipient to electronically deliver to the World Bank Applications (with supporting documents) through the World Bank’s Client Connection, web-based portal. The option to deliver Applications to the World Bank by electronic means may be effected if: (a) the Recipient
has designated in writing, pursuant to the terms of subparagraph (i) of this Section, its officials who are authorized to sign and deliver Applications and to receive secure identification credentials ("S IDC") from the World Bank for the purpose of delivering such Applications by electronic means; and (b) all such officials designated by the Recipient have registered as users of Client Connection. If the World Bank agrees, the World Bank will provide the Recipient with S IDC for the designated officials. Following which, the designated officials may deliver Applications electronically by completing Form 2380, which is accessible through Client Connection (https://clientconnection.worldbank.org). The Recipient may continue to exercise the option of preparing and delivering Applications in paper form. The World Bank reserves the right and may, in its sole discretion, temporarily or permanently disallow the electronic delivery of Applications by the Recipient.

(iv) Terms and Conditions of Use of S IDC to Process Applications. By designating officials to use S DIC and by choosing to deliver the Applications electronically, the Recipient confirms through the authorized signatory letter its agreement to: (a) abide by the Terms and Conditions of Use of Secure Identification Credentials in connection with Use of Electronic Means to Process Applications and Supporting Documentation ("Terms and Conditions of Use of S IDC") provided in Attachment 3; and (b) to cause such official to abide by those terms and conditions.

(v) Minimum Value of Applications (subsection 3.5). The Minimum Value of Applications for Reimbursement and Direct Payment, except for the Application submitted for the Capitalization of Fundágua, is USD 80,000 equivalent.

(vi) Advances (sections 5 and 6) to

- **Type of Designated Account (subsection 5.3):** Segregated

- **Currency of Designated Account (subsection 5.4):** United States Dollars

- **Financial Institution at which the Designated Account Will Be Opened (subsection 5.5):**
  - Banco do Brasil S/A

- **Ceiling (subsection 6.1):** USD 400,000

III. Reporting on Use of Grant Proceeds

(i) Supporting Documentation (section 4). Supporting documentation should be provided with each application for withdrawal as set out below:

- **For requests for Reimbursement:**
  - Records evidencing eligible expenditures (e.g., copies of receipts, supplier invoices) for payments against contracts that are subject to the World Bank's Prior Review;
- Statement of Expenditure in the form attached (Attachment 3) for all other expenditures / contracts; and
- List of payments against contracts that are subject to the World Bank's Prior Review, in the form attached (Attachment 4)

**For reporting eligible expenditures paid from the Designated Account:**

- Records evidencing eligible expenditures (e.g., copies of receipts, supplier invoices) for payments against contracts that are subject to the World Bank's Prior Review;
- Statement of Expenditure in the form attached (Attachment 3) for all other expenditures / contracts; and
- List of payments against contracts that are subject to the World Bank's Prior Review, in the form attached (Attachment 4)
- Designated Account Bank Statement(s); and
- Designated Account Reconciliation Statement

**For requests for Direct Payment:**

- Records evidencing eligible expenditures, (e.g. copies of receipts, supplier invoices)

(ii) Frequency of Reporting Eligible Expenditures Paid from the Designated Account (subsection 6.3): Monthly

IV. Other Disbursement Instructions

Disbursements under Category 3 (Capitalization of Fundágua) will be made using the Direct Payment method. An amount of USD 2,262,000 equivalent should be deposited into Fundágua's segregated account opened at Banco do Brasil for purpose of the Project. As supporting documentation, the Recipient should attach to the application evidence showing that the Recipient’s counterpart funds in the amount of USD 2,000,000 have been deposited in said account.

V. Other Important Information


From the Client Connection website, you will be able to download Applications, monitor the near real-time status of the Grant, and retrieve related policy, financial, and procurement information.
If you have any queries in relation to the above, please contact Tatiana de Abreu at tdeabreu@worldbank.org using the above reference.

Yours sincerely,

Deborah L. Wetzel

Attachments
1. *World Bank Disbursement Guidelines for Projects*, dated May 1, 2006 - Not included as there is no change from previous Disbursement Letter
2. Form for Authorized Signatures
4. Statement of Expenditure - Not included as there is no change from previous Disbursement Letter
5. Form of Payments Against Contracts Subject to the World Bank’s Prior Review - Not included as there is no change from previous Disbursement Letter

cc:  Mr. Antonio Henrique Pinheiro Silveira, Executive Director for Brazil, The World Bank
     Mr. Roberto B. Tan, Alternate Executive Director for Brazil, The World Bank
     Mr. João Guilherme Machado, Secretary of International Affairs, SEAIN/MP – Fax: 2020-5047, seain@planejamento.gov.br
     Mr. Paulo Caffarelli, Executive Secretary, MF – Fax: 3412-1824, gabinete.se.df@fazenda.gov.br
     Mr. Marcelo Estrela Fiche, Chief of Staff, MF - Fax: 3412-2525, sec.chgabin.gmf@fazenda.gov.br
     Ms. Adriana Queiroz de Carvalho, Attorney General, PGFN/MF – Fax: 3412-1740, adriana.carvalho@pgfn.gov.br
     Mr. Arno Augustin Filho, Secretary, National Treasury, STN/MF – Fax: 3412-1717, gab.df.stn@fazenda.gov.br
     Mr. Carlos Márcio Bicalho Cozendey, Secretary, SAIN/MF – Fax: 3412-1722 , gabinete.df.sain@fazenda.gov.br
     Ms. Eva Maria Cella Dal Chiavon, Executive Secretary, MP – Fax: 2020-5003, se@planejamento.gov.br
Cc with copies:  Secretaria Executiva Florestas para Vida
Secretaria de Estado de Desenvolvimento – SEDES
Avenida Nossa Senhora da Penha, 714, 3o andar
Edifício Trade Tower
Praia do Canto
Vitória, ES, 29055-130
Brazil

Facsimile:  
(55-27) 33 15 73 18

IEMA – Instituto Estadual de Meio Ambiente e Recursos Hídricos
BR 262 Km 0 S/N
Jardim América
Cariacica, ES 29140-130
Brazil
Facsimile:  (55-27) 31 36 34 44
Form of Authorized Signatory Letter

[Letterhead]
[Street address]
[City] [Country]

[DATE]

The World Bank
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Attention: [Country Director]

Dear [Country Director]:

Re: Grant No. ____-____ ([Project Name])

I refer to the Grant Agreement ("Agreement") between the [International Bank for Reconstruction and Development/International Development Association] ("World Bank"), acting as [an implementing agency of the Global Environmental Facility] [administrator of the Global Partnership on Output-based Aid] [administrator of name of the trust fund], and [name of recipient] (the "Recipient"), dated ______, providing the above Grant. For the purposes of Section 3.04 (b) of the Standard Conditions, as defined in the Agreement, any [one] of the persons whose authenticated specimen signatures appear below is authorized on behalf of the Recipient to sign applications for withdrawal [and applications for a special commitment] under this Grant.

For the purpose of delivering Applications to the World Bank, [each] of the persons whose authenticated specimen signatures appears below is authorized on behalf of the Recipient, acting [individually] [jointly], to deliver Applications, and evidence in support thereof on the terms and conditions specified by the World Bank.

This confirms that the Recipient is authorizing such persons to accept Secure Identification Credentials (SIDC) and to deliver the Applications and supporting documents to

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1 Instruction to the Recipient when sending this letter to the World Bank: Stipulate if more than one person needs to sign Applications, and how many or which positions, and if any thresholds apply. Please delete this footnote in final letter that is sent to the World Bank.

2 Instruction to the Recipient: Stipulate if more than one person needs to jointly sign Applications, if so, please indicate the actual number. Please delete this footnote in final letter that is sent to the World Bank.

3 Instruction to the Recipient: Use this bracket if any one of the authorized persons may sign; if this is not applicable, please delete. Please delete this footnote in final letter that is sent to the World Bank.

4 Instruction to the Recipient: Use this bracket only if several individuals must jointly sign each Application; if this is not applicable, please delete. Please delete this footnote in final letter that is sent to the World Bank.
the World Bank by electronic means. In full recognition that the World Bank shall rely upon such representations and warranties, including without limitation, the representations and warranties contained in the Terms and Conditions of Use of Secure Identification Credentials in connection with Use of Electronic Means to Process Applications and Supporting Documentation ("Terms and Conditions of Use of SIDC"), the Recipient represents and warrants to the World Bank that it will cause such persons to abide by those terms and conditions.

This Authorization replaces and supersedes any Authorization currently in the World Bank records with respect to this Agreement.

[Name], [position] 
Specimen Signature: ______________

[Name], [position] 
Specimen Signature: ______________

[Name], [position] 
Specimen Signature: ______________

Yours truly,

/ signed /

__________________
Governor

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1 Instruction to the Recipient: Add this paragraph if the Recipient wishes to authorize the listed persons to accept Secure Identification Credentials and to deliver Applications by electronic means; if this is not applicable, please delete the paragraph. Please delete this footnote in final letter that is sent to the World Bank.
Terms and Conditions of Use of Secure Identification Credentials
in connection with Use of Electronic Means
to Process Applications
and Supporting Documentation

March 1, 2013

The World Bank (Bank)\(^6\) will provide secure identification credentials (SIDC) to permit the Borrower\(^7\) to deliver applications for withdrawal and applications for special commitments under the Agreement(s) and supporting documentation (such applications and supporting documentation together referred to in these Terms and Conditions of Use as Applications) to the Bank electronically, on the terms and conditions of use specified herein.

SIDC can be either: (a) hardware-based (Physical Token), or (b) software-based (Soft Token). The Bank reserves the right to determine which type of SIDC is most appropriate.

A. Identification of Users.

1. The Borrower will be required to identify in a completed Authorized Signatory Letter (ASL) duly delivered to and received by the Bank each person who will be authorized to deliver Applications. The Bank will provide SIDC to each person identified in the ASL (Signatory), as provided below. The Borrower shall also immediately notify the Bank if a Signatory is no longer authorized by the Borrower to act as a Signatory.

2. Each Signatory must register as a user on the Bank’s Client Connection (CC) website (https://clientconnection.worldbank.org) prior to receipt of his/her SIDC. Registration on CC will require that the Signatory establish a CC password (CC Password). The Signatory shall not reveal his/her CC Password to anyone or store or record the CC Password in written or other form. Upon registration as a CC user, the Signatory will be assigned a unique identifying account name.

B. Initialization of SIDC.

1. Prior to initialization of SIDC by a Signatory, the Signatory will acknowledge having read, understood and agreed to be bound by these Terms and Conditions of Use.

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\(^6\) "Bank" includes IBRD and IDA.

\(^7\) "Borrower" includes the borrower of an IBRD loan, IDA credit, or Project Preparation Facility advance and the recipient of a grant.
2. Where a Physical Token is to be used, promptly upon receipt of the Physical Token, the Signatory will access CC using his/her account name and CC Password and register his/her Physical Token and set a personal identification number (PIN) to be used in connection with the use of his/her Physical Token, after which the Physical Token will be initialized for use by the Signatory exclusively for purposes of delivering Applications. Where a Soft Token is to be used, the Signatory will access CC using his/her account name and CC Password and set a personal identification number (PIN) to be used in connection with the use of his/her Soft Token, after which the Soft Token will be initialized for use by the Signatory exclusively for purposes of delivering Applications. Upon initialization of the SIDC, the Signatory will be a “SIDC User”. The Bank will maintain in its database a user account (Account) for each SIDC User for purposes of managing the SIDC of the SIDC User. Neither the Borrower nor the SIDC User will have any access to the Account.

3. Prior to first use of the SIDC by the SIDC User, the Borrower shall ensure that the SIDC User has received training materials provided by the Bank in use of the SIDC.

C. Use of SIDC.

1. Use of the SIDC is strictly limited to use in the delivery of Applications by the SIDC User in the manner prescribed by the Bank in the Agreement(s) and these Terms and Conditions. Any other use of the SIDC is prohibited.

2. The Bank assumes no responsibility or liability whatsoever for any misuse of the SIDC by the SIDC User, other representatives of the Borrower, or third parties.

3. The Borrower undertakes to ensure, and represents and warrants to the Bank (such representation and warranty being expressly relied upon by the Bank in granting SIDC) that each SIDC User understands and will abide by, these Terms and Conditions of Use, including without limitation the following:

4. Security

4.1. The SIDC User shall not reveal his/her PIN to anyone or store or record the PIN in written or other form.

4.2. The SIDC User shall not allow anyone else to utilize his/her SIDC to deliver an Application to the Bank.

4.3. The SIDC User shall always logout from CC when not using the system. Failure to logout properly can create a route into the system that is unprotected.

4.4. If the SIDC User believes a third party has learned his/her PIN or has lost his/her Physical Token he/she shall immediately notify clientconnection@worldbank.org.
4.5. The Borrower shall immediately notify the Bank at clientconnection@worldbank.org of any lost, stolen or compromised SIDC, and take other reasonable steps to ensure such SIDC are disabled immediately.

5. **Reservation of Right to Disable SIDC**

5.1. The Borrower shall reserve the right to revoke the authorization of a SIDC User to use a SIDC for any reason.

5.2. The Bank reserves the right, in its sole discretion, to temporarily or permanently disable a SIDC, de-activate a SIDC User’s Account or both.

6. **Care of Physical Tokens**

6.1. Physical Tokens will remain the property of the Bank.

6.2. The Bank will physically deliver a Physical Token to each Signatory designated to receive one in a manner to be determined by and satisfactory to the Bank.

6.3. Physical Tokens contain delicate and sophisticated instrumentation and therefore should be handled with due care, and should not be immersed in liquids, exposed to extreme temperatures, crushed or bent. Also, Physical Tokens should be kept more than five (5) cm from devices that generate electromagnetic radiation (EMR), such as mobile phones, phone-enabled PDAs, smart phones and other similar devices. Physical Tokens should be carried and stored separate from any EMR device. At close range (less than 5 cm), these devices can output high levels of EMR that can interfere with the proper operation of electronic equipment, including the Physical Token.

6.4. Without derogating from these Terms and Conditions of Use, other technical instructions on the proper use and care of Physical Tokens are available at http://www.rsa.com.

7. **Replacement**

7.1. Lost, damaged, compromised (in terms of 4.5, above) or destroyed Physical Tokens will be replaced at the expense of the Borrower.

7.2. The Bank reserves the right, in its sole discretion, not to replace any Physical Token in the case of misuse, or not to reactivate a SIDC User’s Account.
DATA SHEET

Brazil

Espírito Santo Biodiversity and Watershed Conservation and Restoration Project (P094233)

LATIN AMERICA AND CARIBBEAN

0000009061

Basic Information

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<th>Project ID:</th>
<th>P094233</th>
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<th>Specific Investment Loan</th>
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<td>Regional Vice President:</td>
<td>Jorge Familiar Calderon</td>
<td>Original EA Category:</td>
<td>Partial Assessment (B)</td>
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<td>Country Director:</td>
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<td>Current EA Category:</td>
<td>Partial Assessment (B)</td>
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<td>Senior Global Practice Director:</td>
<td>Paula Caballero</td>
<td>Original Approval Date:</td>
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<td>Practice Manager/Manager:</td>
<td>Emilia Battaglini</td>
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<td>Team Leader(s):</td>
<td>Gunars H. Platais</td>
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Borrower: 

Responsible Agency: 

Restructuring Type

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Financing (as of 13-Nov-2014)

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Disbursements (in Millions)

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Policy Waivers

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<td>Does the project require any policy waiver(s)?</td>
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<td>No [ X ]</td>
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A. Summary of Proposed Changes

This restructuring entails the inclusion of the capitalization of the Water Resources Fund (FUNDÁGUA) as an activity under Component 3 and as a disbursement category of the withdrawal schedule in the legal documents. As a result of this change, it also seeks to reallocate US$100,000 in grant funds under "Category 2b (Operating Costs – Espírito Santo Water Utility - CESAN) and 2c (Operating Costs – State Rural Research, Technical Assistance and Extension Institute - INCAPER) and US$ 2,162,000 under Category 1 - Goods, works, non-consultants' services and consultants' services under the Project" to the new Categorogy 3 (Capitalization of FUNDÁGUA).

In order to facilitate the carrying out of Component 3(a) and 3(b) the original project design called for the cooperation of INCAPER and CESAN, respectively. In practice this has not transpired given the technical difficulties of designing and implementing PES payment schemes. As a result the implementation arrangement of Component 3 has been changed with State Secretariat for the Environment and Hydrological Resources (SEAMA) taking on full responsibility for its implementation which it has done through the hiring of specialized firms to provide the needed technical expertise.

B. Project Status

On December 26, 2013 this Grant project was restructured to extend the closing date from June 2012 to December 31, 2014, to enable the implementation of two delayed large contracts. The 2013 Restructuring Paper called for and the State has finalized arrangements to operationalize the transfer of funds to the FUNDÁGUA “SEAMA-Florestas para Vida” sub-account for Payments for Environmental Services (PES). Despite slow disbursement of Global Environment Fund monies the Espírito Santo Biodiversity and Watershed Conservation and Restoration Project (Florestas para Vida - FpV) has had an impact on conservation beyond that expected at the outset of the project. The passing of the first State level Payment for Environmental Services law in Brazil was a direct result from project supported consultations and technical assistance. The restructuring of FUNDÁGUA, which directs 2.5% of royalties originating from oil and gas exploration to PES payments has also benefited from this support. Through the FpV project the State has committed to scaling up the effort initiated under the project and has committed to doubling the natural forest cover of the state through the launch of the Reforestar Program which essentially scales up the current FpV project's objectives with the ambitious goal of reforesting 30,000 has with native species in water critical areas. Recently the State was invited to join the World Resources Institute (WRI) and the International Union for the Conservation of Nature (IUCN) in their drive to respond to the 2020 Bonn Challenge of restoring 150 million hectares of degraded forests and landscapes.

Those two large contracts are coming to a close. The first is finalizing the Watershed Management Plans for the Basin Committees of the two target watersheds of the project: Jucu and Santa Maria. The state is extending their contract through January 2015. 75% of the contract has been finalized. The remainder of the contract will be paid through State Institute for Environment and Hydrological Resources (IEMA) funds. The second contract with the University of Washington (UW) has been concluded. This contract started the hydrodynamic modeling of these watersheds and of the broader areas of influence (including the Doce river basin) and has delivered preliminary results which are now an integral part of the Dynamic Information Framework and can be found in the Portal Capixaba da Gestão da Água e da Paisagem (PCGAP portal) at http://pangaea.ocean.washington.edu/. A student from the Federal University of Espírito Santo spent three months in training at UW and subsequently finalized his PhD focusing on one of the models used, data collection has continued throughout the year with state agencies (INCAPER,
Espírito Santo Integrated System of Geospatial Databases - GeoBases, IEMA) and the water utility CESAN participating. Recently the University of Espírito Santo has taken on the leadership of the modeling in the state and is coordinating a group of interested parties. A final report is imminent. The state is extending the UW's contract with the intent of exploring future directions of this analytical work including how this relates to land use, land use change and disaster risk management.

The FpV project has launched PES schemes and currently 120 land holders are participating. After the first payments were officially launched by Governor Renato Casagrande an increasing number of farmers are benefiting from the program. Another 280 farmers have signed on. Their properties are scheduled to be visited and prepared in January. Preliminary spatial land use analysis is ongoing. The identification of critical areas for biodiversity conservation and the establishment of private nature reserves (RPPN) inside and in neighboring municipalities are not only contributing to the achievement of the Global Environmental Objective (GEO) but demonstrating an important multiplier effect.

The Espírito Santo PES Program has been noticed nationally and internationally. Just in this past year it has been invited to share its experience in pulling together a PES scheme internally in several states in Brazil and internationally in the US, Panama and China. The program has also been noticed by several key international NGOs and Think Tanks through invites to participate in events in international venues: WRI, IUCN and The Nature Conservancy (TNC).

The GEF confirmed, through correspondence dated September 2, 2014 (attached) that they do not need to approve the transfer of funds to the endowment fund as there is no change in the objectives of the project and the monies are for the same purpose: namely PES payments. The Bank should follow its own procedures and later inform in the Project Implementation Review (PIR) these changes.

Given that half the grant will be deposited into a forest specific sub-account of the State’s FUNDÁGUA the task team reviewed the FpV project's Financial Management arrangements and verified that FUNDÁGUA had the capacity to manage and control the resources to be disbursed against payment for environmental services. The October 2014 FM mission (Aide Memoire attached) verified that SEAMA staff, who are now managing the follow-on Reflorestar Program, are experienced in working with World Bank projects, that the FpV project has appropriate systems of control to approve transfers/budgetary allocations and make the proper execution of the procurement plan. Moderate shortcomings in financial management exist but do not prevent the timely and reliable provision of information required to manage and monitor the implementation of the FpV project and its continuation through the Reflorestar Program. Information can be easily accessed as a result of good documentation/record keeping and the auditors issued a clean opinion.

In light of the FpV project closing, special attention was placed on an analysis of FUNDÁGUA in order to assess its capacity to manage and control the GEF funds that will be disbursed for the payment of environmental services (PES). This is similar and consistent with previous World Bank projects where endowment funds were capitalized (e.g. Costa Rica's Sustainable Biodiversity Fund established through the Ecomarkets Project). Through close scrutiny it was possible to determine that FUNDÁGUA was created by a legal instrument (Law 9866/2012), has an organized institutional structure (it has a Fiscal Number, an advisory board and management board), rulings that define models, manuals and operational standards for eligibility of projects by the Fund (eg. Ruling 51-R / 2013 making the call for producers to present projects to the program Reflorestar) and has a team that, although reduced, is able to meet the demands of the program. It was agreed that a chapter in the Operational Manual that aggregates all of this information, would be developed, and would include: laws; structure; institutional arrangements; chart of accounts; document workflow and staff responsibilities; computer systems (SIGEFES and PES Management System); Annual Reports; and, Audit / Review of Accounts. This information has been
created and inserted in the Operational Manual to the satisfaction of FM, Legal and of a technical review. It was also agreed that the Annual Report of FUNDÁGUA will detail the use of funds from the bank account of the Project (the segregated account opened at the Bank of Brazil under the Nr. 72884-5) and that this note will be audited by SECONT (the internal audit entity of the State) which will validate the information and issue an opinion on the proper use of funds. This information has been added to the Operational Manual of the project and satisfies the requirements of good financial management and control stipulated by the operational policies of the Bank and of the GEF.

It should be noted that reallocating the US$50,000 originally allocated to both category 2(b) and 2(c), to cover the operational costs of INCAPER and CESAN, to Category 1 does not mean that these institutions are not participating in the project. The funds were not used in the case of CESAN as it covered its own expenses and INCAPER's needs were for vehicles. Those were eligible expenditures and purchased under Category 1 in lieu of the operating costs. The two institutions are instrumental to the work in the field and will continue to collaborate.

With this in place, the FMS considers that the requirements of OP 10.20 will be met and the Bank may disburse the GEF funds to capitalize FUNDÁGUA.

C. Proposed Changes

Financing

Reallocations

Explanation

Disbursement Arrangements and Reallocations
This restructuring entails the inclusion of the capitalization of FUNDÁGUA as an activity under component 3 and as a disbursement category of the withdrawal schedule in the legal documents. This new category will allow for the transfer of US$2,262 million to the SEAMA-FpV sub-account of FUNDÁGUA. This Sub-account was specifically set up, by law, for Payment of Environmental Services. During the course of the project it was determined that the funds allocated to the operating costs of the Implementing Entity and the collaborating agencies (INCAPER and CESAN) was better used for the purchase of equipment which allowed them to better operate in the field. For example, in lieu of operating costs for INCAPER, vehicles were purchased which were eligible expenditures under Category 1. Thus the funds are being transferred to Category 1.

The Disbursement Letter was revised to include specific procedures for disbursements for Capitalization of FUNDÁGUA. Disbursements will be made using the Direct Payment method. An equivalent amount of USD 2,262,000.00 should be deposited into FUNDÁGUA's segregated account opened at Banco do Brasil for the purposes of the Project. As supporting documentation, the Recipient should attach to the application evidence showing that the Recipient’s counterpart funds in the amount of USD 2,000,000.00 have been deposited in said account. The provision of an Amended Project Operational Manual, in a manner satisfactory to the World Bank, to incorporate the necessary provisions for the carrying out of Component 3 of the Project was established as a condition for disbursement and has been met.

The project’s Development Objective continues to be achievable, which is namely to support the adoption of environmentally friendly land-use practices on 3,400 hectares in two key Atlantic Forest watersheds in Espírito Santo, thereby contributing to biodiversity conservation.

The FpV Project’s Overall Implementation Progress has been rated MS. The FpV Project Operating Manual has been updated to ensure that the funds are managed and audited in accordance with operational
and financial procedures acceptable by the Bank. The project has no outstanding audit reports or audit reports not satisfactory to the Bank.

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