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EFFICIENT AND SUSTAINABLE TAX ADMINISTRATION OF KOSOVO (ESTAK)

YEAR 2 - QUARTERLY REPORT

OCTOBER 15, 2011 – JANUARY 14, 2012

Contract Number EEM-I-00-07-00005-00

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1. ESTAK QUARTERLY REPORT SUMMARY

ESTAK activities during the third quarter of Year 2 have continued to focus directly on specific tasks according to the workplan and to TAK priorities. The main achievements and the areas which dominated ESTAK input during the quarter are the following:

- implementation of the first phase of TAK's Call Center (with an initial focus on outcalls to delinquent debtors and non-filers) from 1 November 2011
- assisting TAK with the re-opening of its sub-office in North Mitrovica from mid-December 2011, albeit limited only to a reactive capacity at this stage
- assisting TAK with the development of a SIGTAS computer system replacement strategy – this was required to be completed by 31 December in line with commitments the Government of Kosovo/TAK had made to the IMF
- assisting TAK with the design of its 2012 Operational Plan (with ESTAK focus being on the taxpayer education/voluntary compliance aspects of TAK operations) - this was required to be completed by 31 December in line with commitments the Government of Kosovo/TAK had made to the IMF
- completion of a TAK Collections Handbook for TAK's Enforced Collection managers and staff
- commencement of ESTAK's management training program and the commencement of a range of technical courses designed and developed by TAK internal trainers following a standard methodology
- assisting the TAK DG with the design of a revised organization structure which it is expected will be progressively implemented during 2012
- assisting TAK with the adoption of a new logo and with a revision of its Taxpayer Charter
- completion of a report on the preconditions needed for merging TAK and Kosovo Customs into a single revenue agency and identifying areas where the two agencies can better work together

ESTAK also assisted TAK reach tax revenue collections for the 2011 tax/calendar year of 261.1m euro and thus meet the GoK/IMF agreed target and exceed 2010 collections by 18%.

In addition during the quarter, as ESTAK had reached its midpoint, ESTAK progress was reviewed by USAID in conjunction with the TAK DG, and as a consequence a number of changes in the future direction of the project were agreed to. These were subsequently incorporated into a revised ESTAK workplan covering the period from 1 January 2012 to the end of the project in April 2013.

As required by the Task Order, the balance of this report provides details on:

- Project progress (activities, benchmarks and performance standards achieved)
- Problems encountered and proposed solutions (progress has been made on resolving the problems identified in previous quarterly reports)
- Success stories and notable accomplishments
- List of upcoming events and activities to be carried out in the next quarter
- Updates to the Year 2 Work Plan
- Financial status of the contract

Although only required to be reported on annually, this report also details progress made in respect of the key performance indicators in ESTAK's Performance-based Management System.

2. PROJECT PROGRESS

OBJECTIVE 1 – STRENGTHEN THE CAPACITY OF TAK TO ADMINISTER ITS RESPONSIBILITIES

(A) SKILLS DEVELOPMENT/TRAINING:

In Year 1 the focus of ESTAK training effort was on the re-establishment of a functional Training Department and on the completion of a comprehensive training needs assessment (TNA), the first stage of the proposed introduction of ISD training methodology in TAK. These steps formed the base for a comprehensive ESTAK plan for a series of technical, soft skills and management training courses to be designed and delivered during Year 2.

In the third quarter it was envisaged that the following training activities would be undertaken:

- ESTAK's Train the Trainers program would continue with Test Writing and Presentation & Facilitation Skills courses being repeated for selected TAK internal trainers.

Both of these courses were repeated in October and again in November. Nominations have also been requested from staff for a repeat of the three Train the Trainer courses (including the two referred to above) in January/February 2012.

- ESTAK's management training program would continue with Managing Operations, Managing Finance and Managing Change courses being piloted and Managing for Results, Managing Performance and Managing Teams courses being repeated.

As noted in the previous quarterly report, delivery of management training courses was deferred for several months while ESTAK placed its training emphasis, at USAID and TAK request, on induction training for new hires. Progress on the above course delivery was consequently delayed. The Managing for Results and Managing Performance courses were piloted in November and December respectively and it is proposed that the Managing Change and Managing Teams courses will be piloted in January/February 2012 and the Managing Operations course will be piloted in March 2012. (The Managing Finance course was dropped since TAK currently doesn't have a standardized protocol for involving all departments in building and managing the annual budget). The Managing for Results and Managing Performance courses are also due to be repeated for a second group of managers in January and February 2012 respectively.

- ESTAK's technical training program would continue with a range of TAK developed courses.

The initial core team of 23 internal TAK trainers has continued to design and develop different technical training courses as part of their Train the Trainers program learning and each is at different stages of development. TAK internal trainers delivered technical courses focusing on Kosovo's tax laws, collection procedures, customer services and SIGTAS.

ESTAK also continued to assist the continued induction training program for the new inspector hires. Following the completion of the first period of classroom training in October, the new hires have been undertaking "on the job" training based on an ESTAK prepared OJT guide. Following a USAID review of ESTAK progress in November, ESTAK's role on the new hire training transitioned from one where ESTAK had ownership to one where TAK now has ownership (a TAK appointed induction training lead commenced in October) with ESTAK having an oversight role. Consequently, ESTAK has shifted its training focus back to the earlier deferred management training, as detailed above, and to the handover of responsibility of remaining training course development and delivery to TAK officers.

In total during 2011, ESTAK has piloted 3 "training of trainers" and 2 of 6 "management training" courses, and TAK internal trainers have conducted 5 different courses for audit inspectors, 5 different courses for taxpayer education staff and 1 course for enforced collection staff (with 3 other enforced collection courses having been prepared but not yet delivered). Together with training courses conducted by others, 115 training courses were conducted covering 1,514 participants during 2011.

During the quarter, in addition to the above, the following has also been achieved:

- Continued work on the Employee Opinion Survey which had been issued to all TAK staff in October. By mid-November responses had been received by 2/3 of TAK staff and analysis of the results is nearing completion and due to be reported in January/February 2012
- Developed, in conjunction with TAK IT, an automated personal development form for capturing training needs data from staff for 2012 based on 18 core competencies. This was presented to and signed off by TAK senior management and TAK intends to use this in place of the paper-based process that continues to be used by the Ministry of Public Administration throughout the rest of the civil service
- Continued work on the development of a Standard Operations Procedures Manual for Training. The Design and Development Policy & Forms section relating to TAK internal training was presented to the TAK DG for approval in November
- Continued work on development of a combined HR/Training Access database which would allow data on training to be entered for each TAK staff member
- Facilitated a meeting between the TAK, Customs and KIPA training departments to examine possibilities for co-operation in relation to soft skills training
- On-going facilitation of TAK Training Commission meetings with ESTAK focus now on assisting the chairperson of the Commission

ESTAK is also pleased to report that following the recent appointments of an induction program lead and an IT training and development support specialist, that TAK's Training Department now has the basic level of resources to manage internal (induction and non-induction), donor and vendor training.

ESTAK advisors have also provided "on the job" training to selected TAK staff on:

- The penalty relief provisions of the Tax Administration and Procedures Law (for regional Enforced Collection team leaders and selected staff)
- Other technical aspects of the tax laws (as part of assisting TAK HQ and Large Taxpayer Unit staff with technical tax inquiries)
- Taxpayer education topics (e.g. the Taxpayer Charter, e-filing processes), and on Call Center operations
- Performance management issues, details of which are discussed later in this report.

(B) IMPROVING MANAGEMENT EFFECTIVENESS:

The only management effectiveness task identified for completion during the third quarter, relates to the review of staff workloads and budgetary allocations with a view to recommending changes that will achieve better results, which as necessary can feed into the 2012 Budget submission process. In this regard, early in the quarter ESTAK discussed with the DG a number of potential changes to TAK's organization structure, some of which the DG had himself mentioned previously, some which have been mentioned in previous IMF mission reports, and some which ESTAK felt would improve TAK performance (e.g. proposals for the creation of an international tax unit and to convert the Special Audit unit into an Intelligence unit). There have been on-going discussions with the DG regarding the proposed changes and ESTAK has prepared materials for him to assist him in briefing TAK management and staff (and ultimately TAK's stakeholders). While the details of such changes to the organization structure have yet to be announced, ESTAK understands this is due to happen during January and ESTAK expects this will have a resultant impact on ESTAK and TAK workload during the next quarter.

Although not part of the previously proposed organization structure changes, the DG has also decided to open a third TAK regional office in Pristina with division of workload between Pristina regional offices to continue to be on a geographic basis. While this change is contrary to earlier ESTAK recommendations (which recommended instead one large regional office for Pristina if there was to be a change), ESTAK acknowledges the right of the DG to make such decisions and has indicated it will assist him with its

implementation along with the other organizational structure changes. In addition, some changes to the IT department organization structure proposed by the Deputy Director IT have been agreed by the TAK DG.

ESTAK recognizes that the adoption of effective performance management principles and practices needs to be applied particularly to more clearly introduce accountability and delegated responsibility within TAK rather than the current tendency in which staff refer decisions for senior management approval. ESTAK has thus continued to work towards the progressive introduction of a proper performance management system. In particular, ESTAK's HR Advisor developed a comprehensive performance management material for 2011 end of year performance appraisals and provided training to TAK team leaders.

This performance management initiative was supplemented by (1) a process whereby all TAK managers rated their reports on a performance vs potential matrix designed to quickly identify TAK's best and worst performers, and to enable pre-calibration of year end annual performance ratings; and (2) ESTAK's piloting of a Managing Performance training course which will be progressively delivered to TAK's managers.

In order to ensure TAK's managers and team leaders give appropriate attention to performance management, it was decided during the USAID review of project progress in November to advise TAK that unless evidence of increased TAK commitment to performance management was forthcoming, ESTAK assistance in that area would cease. In order to demonstrate this ESTAK considers that, among other measures, the following steps will need to have been taken or substantially progressed:

- MoF approval for Administrative Instructions that ESTAK has previously drafted for TAK covering (1) recruitment and selection, (2) disciplinary procedure, (3) grievance procedure, (4) promotion procedure, and (5) performance improvement procedure (note that such procedures for TAK would differ from those applying in the rest of the civil service, as authorized by the Law of Tax Administration & Procedures)
- MoF's consideration of TAK's submission to be conduct a performance-based pay pilot in MoF during 2012 (e.g. within TAK's Large Taxpayer Unit)

TAK has taken initial actions in both of these areas. One area that ESTAK has been giving particular attention to (given the prospect that TAK will have no additional staff positions in 2012), has been the process for dealing with poor performers. For example, ESTAK envisaged that such staff would be warned that unless their performance improved that their employment contracts would not be renewed, thereby freeing up their positions for more productive use – however, plans for all TAK staff to convert to permanent employment contracts in early 2012 in line with the rest of the civil service will remove this possibility.

ESTAK also assisted TAK senior management with a review of taxpayer cases that meet the LTU criteria, but whose tax affairs are not being managed by the LTU. A transfer of taxpayer cases between TAK's offices is imminent.

ESTAK has also commenced high-level discussions with TAK Internal Audit management and staff on how the performance of that unit can be improved and better utilized by TAK senior management, anticipating a future discussion with the TAK DG on how Internal Audit can better assist him.

Throughout the quarter, the DG and TAK senior managers have continued to seek advice from ESTAK advisors. ESTAK advisors also continued to assist TAK management through their regular attendance at TAK HQ senior management meetings, TAK regional manager meetings, and TAK team leader meetings.

ESTAK is pleased to acknowledge that TAK senior management have continued with the ESTAK recommended practice of producing, minutes and action point lists at their weekly meetings, and that designated TAK HQ staff have now taken on the responsibility of preparing and distributing monthly information bulletins for distribution by the DG to all staff.

A further on-going management effectiveness task envisaged for completion during the year was the provision of support to TAK regarding proposals for a new IT system to replace SIGTAS. The need to replace SIGTAS has become more acute as there are signs that the level of support provided by the SIGTAS vendor has deteriorated as some of the vendor's experienced staff have left their employment. During the quarter ESTAK's IT Advisor completed a draft SIGTAS replacement strategy document which proposes a combination of commercial and internal TAK development of individual modules (collection, audit, etc.) to be integrated with a core system (registration, recordation, payment, accounts maintenance), allowing progressive implementation over a 3-year period (through 2014). Donor support during the period of development and implementation will be needed, from a perspective of both technical assistance (systems

architecture and development oversight) and funding assistance (on a shared basis with the Government of Kosovo). The strategy document was approved by TAK's IT Deputy Director and TAK's DG and referred to the IMF in line with a GoK commitment to the IMF that this would be completed by the end of 2011. In line with decisions made during a review of ESTAK progress in November, ESTAK's involvement with SIGTAS replacement is now complete and further work on this issue is now the direct responsibility of TAK and MoF.

An additional area of management effectiveness work that USAID asked ESTAK to undertake was in relation to conducting initial work on the GoK proposal to create a single revenue agency (merging TAK and Kosovo Customs) by 2014. An advisor was engaged for this purpose and following his research on the preconditions that should be met before making such a change and following his discussions with stakeholders, his initial conclusions were that although it was too early to make such a change in Kosovo, that there are a number of areas where both agencies could work more closely together in the interim. These initial conclusions were accepted by USAID and a final report documenting them was prepared. During the next quarter, ESTAK proposes to discuss the findings with MoF, TAK and Kosovo Customs management to encourage TAK and Kosovo Customs to work together in the areas identified in the report.

(C) DETERMINING RESOURCE NEEDS:

In the Year 2 workplan, resource need tasks mainly relate to the 2012 Budget cycle, covering the provision of assistance in identifying TAK resource needs to feed into 2012 Budget submissions and supporting TAK with the progress on those submissions and their eventual implementation.

As witnessed in 2010, TAK resourcing plans continue to be largely based on arbitrary decisions made during direct discussions between the TAK DG and the Minister of Finance. The 2012 Budget process continued in a similar vein with TAK initially requesting a significant funding increase, which has been reduced in subsequent budgetary hearings. While the final results of the Budget process are pending, it is understood that there will likely be funding increases, there will be no additional staffing increase for TAK for 2012 – it is accordingly now more important than ever that TAK's existing staff are fully employed in relevant work and that poor performance is appropriately dealt with.

After a focus on assisting with recruitment of new staff in Quarter 1, ESTAK focus shifted to TAK's physical resources. In recent years, Ministry Budget hearings have usually disallowed TAK's vehicle and computer requests and have thus not allowed TAK to introduce asset replacement plans in relation to its vehicle fleet and its computers. The result has been that:

- TAK's vehicle fleet of around 90 vehicles is aging, with no new vehicles purchased for over 5 years, despite the need to visit taxpayers for tax compliance work and despite increases in staffing, and increasing maintenance costs. (Fortunately, arrangements have been made for EULEX to provide TAK with 20 of their surplus vehicles and although a formal agreement covering the transfer of these vehicles has been prepared, no vehicles have yet been transferred)
- Many of the computers used by TAK staff in its regional offices are very old requiring around 15 minutes to log on and very few laptops have been allocated at regional office level thereby denying staff the ability to take computers to taxpayer premises

During the quarter TAK completed a framework contract procurement process which identified a supplier for its furniture and equipment needs. An order was placed for 200 personal computers, 100 laptop computers and a smaller number of printers, all of which were expected to be delivered to TAK during December. All of the above has now been delivered to TAK except for the personal computers which are now expected to be delivered in January. As a result many of TAK's new hires who commenced in September 2011 still do not have computers in order to carry out their duties. In preparation for the arrival of the new computers, ESTAK has been monitoring the proposed allocation of additional equipment in TAK to ensure that distribution goes to those most in need and to try and eliminate the past practice of the best equipment going to TAK HQ and regional managers and then other staff getting used equipment.

(D) RETURNS PROCESSING AND TAXPAYER RE-REGISTRATION:

In the Year 2 workplan, the taxpayer registration task planned to be completed was to assist TAK counterparts in ensuring sustainable operation of an efficient and accurate system of taxpayer registration.

During the quarter, ESTAK has continued to liaise with other USAID projects to develop further improvements in relation to taxpayer registration, particularly for businesses. In particular, a joint MoF/MTI initiative supported by the ESTAK and BEEP projects, has facilitated regular TAK meetings to discuss the way forward to establish a one-stop shop for fiscal numbers, business registration, and similar items necessary for starting up a business. The initial concept developed by TAK, with ESTAK assistance, is for the TAK fiscal number to be the primary number issued so that TAK can ensure control over its database and prevent a return to the problems that were faced before starting to issue fiscal numbers. The TAK IT Deputy Director General has been charged with developing a proposal for integrating the MTI and TAK registration processes. USAID's YEP project has also taken an interest in registration processes and ESTAK is working with YEP and BEEP to prepare a "How to register a business" manual.

However, the trade advisor from USAID's GFSI project has recently advised that World Bank/IFC advisors assisting the Business Registration Agency have raised concerns about the MoF/MTI proposal and there is some indication that MTI are now no longer supporting the previous proposal and are looking at maintaining the separate use of business registration numbers. ESTAK has raised this issue with TAK's Deputy Director IT so that it can be addressed at the next meeting, but there is a potential that the USAID-funded projects are proposing change in a different direction than that being promoted by the World Bank/IFC.

In relation to returns processing ESTAK also continues to support tax form/processing reduction efforts to improve Kosovo's Doing Business ratings. TAK has agreed with ESTAK's suggested merging of employer monthly tax and pension forms and this is expected to be introduced from April 2012. This change will reduce the number of tax/pension forms required to be completed by an employer each year from 29 to 13. A further proposal for a reduction in VAT declaration filing frequency from monthly to quarterly for smaller VAT registrants (reducing the number of VAT declarations required to be filed from 12 to 4 for smaller businesses and reducing the total number of VAT declarations requiring to be completed and processed by 50% if ESTAK recommendations are agreed to) to tie in with a proposed reduction in the VAT registration threshold will be pursued with TAK once existing IT priorities have been addressed. During the quarter an update on TAK's progress in these and other "Doing Business" areas was provided to USAID/BEEP project and ESTAK was subsequently provided with templates to complete to assist with future Doing Business assessments.

(E) SIGTAS IT SYSTEM:

In the Year 2 workplan, four on-going tasks are expected to be progressed during each quarter. Those areas and the progress on each follow:

- Ongoing support for TAK in its efforts to sustain SIGTAS until a replacement system comes online - ESTAK assistance is continuing, with particular emphasis on the remaining issues from the Stage 1 upgrade (mainly individuals with multiple businesses where only "opening balances" were transferred from old to new SIGTAS), and to the proposed implementation of Stage 2 (the addition of various modules tailored to taxpayer audit activity, enforced collection activity and taxpayer objections/appeals). ESTAK has identified implementation of the "collections" module as the highest priority given the revenue implications arising from improved management of taxpayer debt cases. Concerns exist regarding the usability of this module as the process of assigning cases is not well-developed and work is under way of identifying desired changes to that module before a final decision is made on when it will be implemented. A further problem that emerged with the SIGTAS system, which ESTAK is also assisting to resolve, is its inability to correctly record the "closing" of a taxpayer account which is hampering TAK's ability to record the progress it has made on reducing the number of non/stop-filers
- Support the ongoing evolution of e-filing and online taxpayer service support - ESTAK actively supported the implementation of an e-filing pilot which commenced with August VAT declarations by large taxpayers that were due to be filed by 20 September. Since that time the number of monthly LTU e-filers has doubled to 135 which is now 1/3 of all LTU taxpayers. ESTAK considers that the next important step to encourage use of e-filing is the development of an e-payment facility so that taxpayers can both file and pay electronically at the same time – ESTAK understands that the TEB bank is ready to accept e-payments so further work is necessary with the Central Bank and that bank with the expectation that other banks will soon follow the TEB bank lead

- Support ongoing improvements in management information through SIGTAS - ESTAK assistance continuing. TAK has continued to review the reports in SharePoint (information derived from SIGTAS tables) to verify their need and accuracy and ESTAK monitors the KPI data that is displayed in SharePoint. ESTAK has used such information to identify for the TAK DG which were the best performing TAK regional offices in 2011, in order that the DG can recognize their efforts
- Ongoing improvements in the exchange of information among interested users - In addition to the data TAK already receives regularly from Customs, the Treasury and selected large organizations, TAK is now receiving data, as required by law, from taxpayers on all suppliers from whom they have had annual purchases over 500 euro and is receiving data electronically transmitted from most of the businesses that have installed fiscal cash registers. TAK also now has access to property tax and vehicle registration data. However ESTAK is concerned that the data being received is not being used effectively by TAK – for example none of the recently received data is currently being used to update TAK’s taxpayer audit risk model or to help in the identification of cases that could be referred to TAK’s Tax Investigation Unit. ESTAK intends to address this issue as its “intelligence” work proceeds, as detailed later in this report

OBJECTIVE 2 – INCREASE TAXPAYER COMPLIANCE

(A) IMPLEMENTATION OF TAX LEGISLATION (RULES AND REGULATIONS):

Following the revision of all of Kosovo's main tax laws during the last two years, and ESTAK's completion of associated Administrative Instructions during Year 1, most of ESTAK's legislative work has now been completed. Proposals for further legislative change have however emerged from three quarters, as follows:

- the EU-CTA project which finished in September 2011 identified a package of amendments to the VAT law. These changes, which have been forwarded to MoF for referral to the Assembly, are supported by ESTAK. The amendments included a proposal to reduce the VAT registration threshold from 50,000 to 30,000 euro of annual turnover, a change which, although supported by ESTAK, TAK and most of its stakeholders, has been withdrawn due to ongoing IMF concerns
- an October 2011 tax policy mission recommended numerous changes to the tax legislation, but after consideration by GoK/MoF only one change to the Personal and Corporate Income Tax laws (an increase in the presumptive tax rate for professional services providers from 5 to 9%) was agreed to be progressed and this has recently been enacted
- the MoF prepared a series of amendments to the Tax Administration & Procedures law related to the proposed replacement of the Independent Review Board by a division of the Courts from November 2012

During the quarter, ESTAK reviewed the proposed amendments and suggested a number of amendments, most of which appear to have been incorporated into the amendment laws. At this stage, the GoK has approved the income tax law and tax administration & procedures law amendments and has forwarded these to the Assembly, with the VAT amendments package waiting to be considered.

The main remaining legislative work that ESTAK may need to cover is in relation to the VAT law amendments and completion of updated sub-legal acts, but this will be mitigated by the extent to which a 6-month EU/TAIEX funded VAT expert who is due to commence in March 2012 can cover this work.

Double tax treaties

ESTAK has continued to assist a MoF/Ministry of Foreign Affairs working group that has been arranging requests to other countries to enter into double tax treaties with Kosovo. During the quarter double tax treaty negotiations were conducted with Albania (a revision of the previous UNMIK supported treaty) and Hungary and a further set of negotiations with the United Kingdom is due to take place in early. In the meantime, Kosovo also awaits the formal signing of double tax treaties with Turkey and the Czech Republic (following negotiations in earlier quarters). Their signing would double the number of double tax treaties Kosovo has (agreements with Albania and with the Former Yugoslav Republic of Macedonia are already in place).

Legal barriers

The Minister of Finance agreed with previously submitted recommendations by ESTAK that the interest charged on late tax payments be reduced from 18% to 15% per annum (from 1.5% to 1.25% per month) and that increases in the interest rate paid by TAK on delayed refunds and repaid tax in dispute from 1.5% to 2.4% per annum. Since these changes did not require law change, they came into effect on 1 January 2012.

ESTAK has also continued to assist TAK with monitoring and identifying legal barriers to TAK collection and enforcement and on the continued development of a range of Memorandums of Understanding (MoUs) between TAK and third parties in order to remove or minimize such legal barriers. In addition discussions with the GFSI project property tax advisor indicated the possibility that TAK may be asked to take over property tax debt collection responsibilities given lack of capacity within the MoF Property Tax Unit to manage this aspect of their work.

(B) ROBUST AND FAIR AUDIT FUNCTION:

In the Year 2 workplan, one audit area requiring ongoing assistance is the support and development of TAK's risk-based audit selection system. During the quarter, ESTAK continued to support the model encouraging

TAK to use the information provided by it (rather than continuing to rely on their own methods) in their decisions on the tax audit cases being selected by HQ and working towards greater percentages of HQ selected cases for audit. Changes to the audit risk model to reflect changes to the data fields on VAT declarations made in 2010 have now been updated by TAK IT with ESTAK assisting in the testing process to ensure the changes had been made correctly. Next steps with the audit risk model are for (1) TAK IT to make the simplifications to the income tax formulae previously recommended by ESTAK and agreed by TAK management, and for (2) TAK HQ to train audit managers and staff on the recent changes and to look at simplifying the VAT formulae.

Another audit area requiring ongoing assistance is the support and development of TAK's audit quality measurement (AQM) program. During the quarter, ESTAK continued to assist this program by (1) assisting with an update of the audit quality standards so that they are consistent with TAK's Taxpayer Audit Manual, (2) assisting TAK with the introduction of three new templates covering audit time recording, taxpayer contact, and historical information for audit files, and (3) reviewing some of the cases reviewed by the AQM personnel and suggesting changes to Audit management.

A further audit area requiring ongoing assistance is the building of VAT administration capacity so that the turnover threshold for VAT taxpayer registration may be reduced. The EUCTA project assumed main responsibility for this task until their cessation in September 2011 and this will be continued by an EU/TAIEX funded advisor for 6 months but only from March 2012. In the interim, ESTAK provided assistance during the quarter in: (1) reviewing the latest draft of a proposed package of amendments to the VAT law (which unfortunately no longer includes a registration threshold reduction proposal due to on-going IMF concerns with this change despite ESTAK's attempts to show that those concerns are unfounded), (2) drafting an updated VAT Guide for taxpayers and (3) working towards the implementation of TAK recommended changes (consistent with US/Kosovo bilateral agreements) to the processes for VAT reimbursements in respect of VAT paid on local purchases by USAID contractors.

A final audit area requiring ongoing assistance during the quarter has been providing TAK with assistance with its operations in the enclaves. ESTAK has focused its enclave assistance on urging the reopening of TAK's sub-office in North Mitrovica. That sub-office was technically re-opened in December in ICO-provided premises but only one TAK employee is currently based there and their workload is totally reactive at this stage. Following confirmation that TAK's previously employed sub-office staff continue to be reluctant to return to work, TAK has advertised 3 new positions in that sub-office and appointments to these positions are expected to be made during January. The "co-ordinator" of TAK's Gracanica sub-office is also being reassigned to become the "co-ordinator/team leader" of the North Mitrovica sub-office. As the North Mitrovica premises are too small and not suited to tax collection purposes, TAK is continuing to work with Trepca North to see whether the sub-office can operate from the premises which it used from 2002 until the TAK staff walked out in 2008 following Kosovo's declaration of independence. Further work on re-establishing the sub-office will continue throughout the next quarter following the appointment of new staff including addressing their training/re-training needs and furnishing them with newer computers (and subsequently access to SIGTAS and SharePoint). It is envisaged that once this has been done, initial emphasis will be given to ensuring that North Mitrovica taxpayers are registered and are made aware of their tax obligations. It is also envisaged that discussions would later take place with the appointed TAK staff with a view to determine how best to proceed in dealing with non-compliance.

The Year 2 workplan also envisaged that following the earlier completion of a TAK Compliance Strategy, that TAK would complete a 2012 Operational Plan based on that strategy by the end of 2011. A TAK working team prepared a first draft of that plan and it has been submitted to the IMF as required. It will be reviewed in conjunction with the IMF expert who has been providing assistance in this area and who is due to return for a last visit in late January. ESTAK's focus in this process has been in working with TAK on the "taxpayer education/voluntary compliance" aspects of this plan, while playing a more limited oversight role in relation to the "non-compliance" aspects of the plan.

During the November review of ESTAK progress, it was noted that one area that TAK has not been giving sufficient attention to has been in relation to the identification of taxpayers who are "outside the system". Most non-compliance activities (audits, debt and return non-filing follow up) have focused on taxpayers who are already known to TAK and that while significant amounts of information are now being received from third parties, this information is not being used effectively. As a consequence, it was decided that ESTAK would give some attention to the development of "intelligence" capacity within TAK during the remainder of

the project. Late in the quarter, ESTAK commenced its initial scoping work in this area – meetings have commenced with a range of internal and external stakeholders (including the Financial Intelligence Center and international advisors who are assisting TAK's Tax Intelligence Unit) and it is proposed that an initial report recommending future work in this area will be available in early February.

(C) ROBUST AND FAIR COLLECTIONS FUNCTION:

A key achievement during the quarter was the completion of TAK's Collection Handbook, which after TAK management approval, has been made available to all staff on TAK's SharePoint portal. This followed a series of meetings with Enforced Collection team leaders which progressively reviewed sections of the handbook. The Collections Handbook will provide a solid base for future staff training (selected TAK instructors have used the handbook as a basis for the training courses they are developing) and team leaders have been expected to go over chapters with their teams.

ESTAK also participated with HQ collection staff in training for the new SIGTAS Collections Module, scheduled to be implemented as part of Phase 2 of the SIGTAS upgrade. ESTAK has identified this module as being the one that has the highest priority for implementation due to the revenue implications from improved management of tax debt cases. However, ESTAK has also identified a number of deficiencies with the delivered module and these are in the process of being documented for the SIGTAS supplier. Pending how much further work is required and on how much time the supplier would need to complete such work, TAK will need to decide on when and how to implement the Collections Module. For example, it is likely that the "instalment arrangements" part of the module will be implemented before the rest of the module.

ESTAK also led two workshops for Enforced Collection team leaders and selected staff on the application of the penalty provisions of the Tax Administration & Procedures law. The emphasis of such workshops was on the circumstances in which penalties can be relieved based on legal requirements and where penalty relief must be considered by a commission based on written requests by the taxpayer and the relevant TAK regional office.

Systemic issues that ESTAK helped TAK address at HQ level during the quarter included:

- facilitating the introduction of a system fix to allow "closing" of taxpayer accounts for delinquent filers where TAK has successfully completed its action on non/stop-filers
- assisting with the resolution of lien recording issues after changes were made within the Pledge Registry meant that TAK staff then experienced difficulty in recording liens. ESTAK assisted in the resolution of this issue which now requires the involvement of TAK's IT administrator.

Another key ESTAK achievement, which for now has a collection function focus, has been the commencement from November 2011 of a Call Center within TAK. The Call Center has an initial staff level of 8 and is initially based in the TAK HQ building. At this stage the Call Center makes outcalls to taxpayers with aggregate debts of between 500 and 3,000 euro (cases above 3,000 euro are dealt with at regional office level), and in these cases follows up both the outstanding debt and any outstanding tax declarations.

In establishing the Call Center, ESTAK assisted with the following activities during the quarter:

- confirming the initial and future Call Center sites – while initially located in TAK HQ for operational support reasons, it is proposed it will be later shifted to the Germia building (where accommodation alterations have been identified ready for their completion during the next quarter)
- the fitout of the Call Center with purpose-built workstations and telephone equipment
- confirming the types of delinquent debt and delinquent declaration-filing taxpayers that will be managed by the Call Center in its early stages and working with TAK IT to ensure such information was available
- completing work on the procedures to be followed in the Call Center (including how long cases will be worked on by the Call Center, the number of call attempts to be made to each taxpayer, and the casework recording processes) with their inclusion in a Call Center procedural guide
- pre-implementation training for the 7 new Call Center employees, delivered by the Call Center manager with ESTAK advisor assistance, covering the mission and design of the Call Center, basic

tax laws, telephone techniques, inventory analysis and reporting, case related research utilizing SIGTAS and collection procedures

While the Call Center commenced with a manual inventory delivery and management system, ESTAK subsequently worked with TAK IT to develop an automated call center inventory management and workflow system, and with Call Center staff to test that system before its implementation. During its period of operation to date, ESTAK has also assisted with:

- arranging for TAK regional offices to provide details to the Call Center of taxpayer cases which are already paying off their debt under an instalment arrangement, so that the Call Center does not also follow up those cases (note the existing SIGTAS system does not have a capacity for recording this, but it is included in the yet to be implemented Collections Module)
- arranging for TAK to automatically close taxpayer debt accounts where the 6-year collection period has expired, so that those cases were not included in the inventory of taxpayers that the Call Center deals with
- assisting TAK's Call Center manager with improving the productivity of Call Center staff by emphasizing appropriate work practices and monitoring individual staff performance

As a result of Call Center activities during its first two months of operation, over 110,000 euro have been collected from the over 3,000 taxpayer outcall attempts.

The final stage of Call Center development (with in-calls) is proposed to take place during the next quarter and ESTAK progress towards this stage is detailed in the next section.

It was acknowledged during the USAID review of project progress in November that the future level of ESTAK assistance to TAK's enforced collection activities could be reduced given that appropriate laws and administrative actions have been completed, the Collections Handbook has been completed and training is being conducted by TAK staff. This also coincided with the completion of assistance from ESTAK's long-term Enforced Collection advisor.

(D) PUBLIC EDUCATION ON TAX COMPLIANCE:

During 2011 ESTAK has been focused on improving TAK's taxpayer education area. This assistance continued during the quarter, as detailed below. The need for continued focus in this area was confirmed by the TAK DG and USAID during the November review of ESTAK progress. As a consequence ESTAK has been directly assisting TAK with a taxpayer education/voluntary compliance section in its 2012 Operational Plan, while TAK has focused on the "non-compliance" aspects of that Plan. This proposed section of the Plan has been discussed and supported by TAK senior management and includes the following:

- an intention to shift some of the responsibility for responding to taxpayer enquiries from TAK HQ to the regional offices (but leaving the "rulings" area at HQ level), while also recognizing that telephone enquiries will go to the Call Center in the first instance in the near future
- an intention to remove or streamline the work that TAK regional taxpayer education staff currently perform on certificates for visa and Government procurement purposes, recognizing that regional taxpayer education staff will not be able to take on much additional work without such changes
- an intention to create a different approach with taxpayer education for LTU taxpayers, by giving tax auditors in LTU's specialized sector teams an educational as well as an audit responsibility
- clarification of responsibilities and expected timeframes for responding to taxpayer enquiries, particularly written enquiries, the timeliness of which has been subject to on-going criticism in taxpayer satisfaction survey responses

The ESTAK-developed TAK communications strategy envisaged the development of taxpayer education materials (where the focus would be on updating and improving materials for taxpayers that wanted to voluntarily comply) before increasing publicity efforts (where the focus would shift to those who had not complied).

In line with this strategy and following the development of income tax, VAT and e-filing guides and the simplification of tax forms in earlier quarters, focus this quarter has been on the completion of other tax

publicity material. In particular, ESTAK has (1) drafted separate flyers for VAT, corporate income tax, personal income tax, and on TAK and its role, (2) drafted a 2012 tax calendar for taxpayers, (3) assisted TAK with the compilation and publication of an updated Kosovo tax legislation book (which also incorporate sections from Administrative Instructions next to the relevant legal provisions), and (4) commenced work in conjunction with TAK and KPST on developing an Employer's Guide to include details on the proposed merged wage withholding tax/pension forms which employers will be required to complete from April 2012.

Following the commencement of the e-filing pilot in the previous quarter, ESTAK has continued to promote the use of e-filing by LTU taxpayers and has worked with TAK LTU management and staff to ensure their taxpayers have received the necessary tokens, contracts and guides to enable them to e-file. Over 90% of LTU taxpayers can now e-file their VAT declarations but only around a 1/3 of these taxpayers are doing so on a regular basis. ESTAK considers that the next stages of e-filing development are (1) to introduce e-payment ability in conjunction with the banking system, (2) to allow e-filing (this time without the need for tokens) for employers for the new merged tax/pension forms, particularly since the processes for the new form will replace existing e-filing arrangements between employers and KPST, and (3) to expand the amount of information that e-filers will be able to access from the TAK computer system regarding their tax position.

ESTAK has also continued to oversee progress on plans to modify TAK's "front office" accommodation in the Germia building to ensure that the facilities provided to taxpayers are expanded so that they can be improved to the standards of a commercial bank and that are being provided by other TAK regional offices. Following delays due to TAK budgetary constraints, ESTAK is overseeing the tender process where 11 contractors have made bids to complete the necessary renovations. It is envisaged that once these alterations are completed, Taxpayer Education/Pensions staff from TAK's Pristina 2 office will shift back to the Germia building so as to provide a centralized taxpayer education service (which will also now cover TAK's new Pristina 3 regional office) from a central location with ground floor access. The TAK DG has also asked ESTAK to assist with ensuring that the taxpayer entrances to TAK's other buildings are improved to a common standard and this work will be progressed during the next quarter.

The alterations to the Germia building also cater for an expanded Call Center which will then have the capacity to respond to taxpayer in-calls, and where the existing outcall work will only continue during periods where staff are not taking in-calls. In preparation for this development, ESTAK has been assisting TAK with the acquisition of Automatic Call Distributor (ACD) equipment (ESTAK prepared technical specifications, served as a technical advisor to the tender evaluation panel and participated in clarification meetings with the two bidders), with the result that the selected vendor is currently in the process of installing the ACD equipment at TAK's HQ site. Linked in with this development, ESTAK have also documented the additional training requirements (particularly on standard answers that should be provided to a wide range of expected questions) that new and additional Call Center staff will need in order to deal with taxpayer in-calls.

ESTAK also continued to support TAK's efforts to develop a new logo in conjunction with a public relations firm and as a result a new logo has been selected. ESTAK assistance has included working with TAK to obtain Minister of Finance approval for TAK to have its own identity and participating in discussions with the public relations firm on identifying the promotional opportunities that a new logo introduces.

In accordance with the ESTAK work plan, ESTAK has also facilitated a process of TAK updating its Taxpayer Charter. ESTAK developed a plan for its update which included:

- distribution of a questionnaire to staff to ascertain their awareness of the charter and identification of any areas where they felt change was necessary – surprisingly many staff were not aware of the existence of the previously prepared Taxpayer Charter, but this has now significantly improved with over 300 TAK employees responding to the questionnaire
- visits to TAK's regional offices to discuss the Charter with selected staff – ESTAK participated in the earlier Pristina office visits with TAK HQ staff taking on this responsibility in other regional offices
- drafting an updated Charter for TAK management consideration, taking into account the questionnaire responses and other feedback from staff

It is expected that the new logo will be launched along with an updated taxpayer charter in January 2012, and that following this the new Charter and logo will be prominently displayed in TAK offices and placed on TAK's website. The logo will also progressively appear on TAK reports, letters and publications.

An important factor in the revision of the Charter and incorporated in the “taxpayer education” part of TAK’s 2012 Operational Plan has been the specification of the timeframe in which responses to taxpayer enquiries should be made. Adoption of these standards should see a reduction in the poor ratings TAK has received in its taxpayer satisfaction surveys (which ESTAK has continued to assist in with their analysis) in relation to delays in the receipt of responses to written enquiries. (The other area of taxpayer concern has been the poor taxpayer education facilities in TAK’s Pristina regional offices, an area which is expected to improve once forthcoming building alterations are made).

OBJECTIVE 3 – DONOR COORDINATION

The only donor co-ordination task to be completed is the ongoing active participation of ESTAK in a donor co-ordination forum. Various attempts to establish such a forum in the past have been unsuccessful and they have been replaced by TAK-run workshops at key times when the need for TAK stakeholder input is considered appropriate. The first such workshop was held in July 2011 and was held at the time that TAK was commencing its work on developing an IMF-recommended Compliance Strategy. While no workshops were held during this quarter, consideration is being given to a workshop being held in early 2012 to not only allow TAK to report back on the results of the Compliance Strategy work but also to discuss TAK's plans to establish an intelligence capacity as ESTAK commences its support of TAK in that area (to coincide with the final visit of the IMF compliance strategy expert in late January 2012).

Between such workshops, ESTAK continues its successful cooperation at an operating level with other donor projects assisting TAK. During this quarter ESTAK liaison has continued with the IMF (with regular contact with visiting missions, the IMF representative office in Kosovo, and the IMF expert who has been assisting TAK with its compliance strategy work), with DFID (in relation to a tax gap measurement study), with GIZ (in relation to continued training assistance in EU-CTA project work areas being provided with the assistance of the Bavarian Government), with EULEX and EU/TAIEX (in relation to support for TAK's Tax Investigation Unit), and with a EU/TAIEX advisor (in relation to a review of Independent Review Board operations).

3. PROBLEMS ENCOUNTERED AND PROPOSED SOLUTIONS

The previous ESTAK progress report highlighted two problem areas – the management of staff performance (which is repeated below) and funding limitations (which was subsequently successfully resolved).

ESTAK considers that the current largest barriers to its objectives of improved TAK capacity and increased taxpayer compliance are:

- (1) Not adequately managing the performance of TAK staff

ESTAK continues to believe that one of the most significant issues which is impeding reform progress and improved revenue collection performance is the reluctance by TAK managers to effectively and robustly manage the performance of their direct reports.

The problem - As TAK has largely resolved its main salary level and working condition complaints, attention has shifted to the more difficult issue of getting TAK staff to work more productively. This requires a cultural change for both management and staff and highlights the immediate importance of applying proper standards of performance management. This is proving to be a challenge, as TAK senior management has been reluctant to move away from the previous practice of performance management being largely a paper exercise and with managers rarely discussing personal staff performance with their staff, let alone taking corrective actions where there has been clear under-performance. The ability to address these issues hinges on strong and visible support from the DG and his immediate staff. While progress is being made at the regional office management level, HQ management continues to show a lack of seriousness about and commitment to the management of staff performance.

In turn, the lack of attention to managing direct reports, results in other problems at the middle management level. In particular,

- some managers are largely reactive, simply doing what they are told – effectively bureaucrats rather than managers in the true sense
- some managers try to do everything themselves and rarely delegate tasks to their staff, who as a consequence are under-utilized, under-developed and bored
- job protectionism and key person dependencies are widespread with little evidence of managers developing their own staff and this compounds the delegation cycle referred to previously. This also leads to considerable succession gaps and limits scope for lateral as well as vertical career mobility

The absence of any meritocracy within the organization inhibits any movement on performance management and as a result there is little consideration of staff performance when it comes to internal appointments and promotions.

Proposed solution - In this climate, ESTAK's current Year 2 workplan emphasis on performance management and management training is vital, but, as previously noted, it also needs the observed commitment of TAK senior management to support such initiatives rather than taking the easier path of dealing with performance issues by simply rotating staff – a protocol that ESTAK has consistently made known its objections to.

Recent discussions with the DG have focused on meaningful revisions to the organization structure which are expected to be implemented from January 2012. These proposed revisions are designed to bring more accountability for those senior managers responsible for audit, collection, and taxpayer services. With a strengthened organizational structure increasing accountability and responsibility, meaningful and specific performance expectations can be established at the senior management level. ESTAK has also drafted an administrative instruction outlining a performance improvement procedure which, if adopted by TAK and the Minister of Finance, could give additional impetus to proper performance management in TAK if sufficient vocal executive support is provided to its application in practice.

To give added support to the resolution of this issue, following the November review of ESTAK progress, the TAK DG was advised that unless future actions by TAK management to improve performance management were not evident by the time of the USAID reviewer's next visit in February 2012, then future USAID assistance with performance management would cease.

(2) Constant HQ-driven changes by a largely invisible senior management

The problem – Related to the above issue, in recent times performance issues have been dealt with by a continuation of staff rotational and organization structure changes, many of which are dictated directly from the TAK DG with limited (and often, no) input from his intermediate managers. Exacerbating the demotivational impact of these changes, has been the normal lack of any explanation for the changes. Two recent examples highlight this:

- decisions to increase the remuneration of selected taxpayer audit staff were made jointly by the TAK DG and HR Manager and distributed to staff by e-mail late on a Friday. No consultation was undertaken with HQ or regional office managers with the DG subsequently verbally stating the reasons for his decisions at the following week's senior management meeting. Not surprisingly this generated a number of additional suggestions of other areas in the organization where remuneration increases could be warranted. Worse still was that while the decisions made by the DG took into account the performance appraisal ratings of staff by their team leaders, ESTAK noted that in some instances staff rated as good by their team leaders were rated as poor by their regional managers (in the separate performance vs. potential matrix exercise), and vice versa
- the TAK DG's decision to open a third regional office in Pristina the reasons for which have not been communicated and despite the reservations of TAK's Pristina regional managers who feel that they were not consulted about the change to any meaningful extent

In both cases, decisions were announced with inadequate consultation with TAK management stakeholders, and of course once they have been announced, it is rare for such decisions to be changed. Taken together with the almost complete lack of visits by TAK senior managers to regional offices, let alone around HQ, TAK staff feel that they are not treated as stakeholders.

While it is acknowledged that TAK senior management have made major positive changes for staff in the area of remuneration and in some other areas, the fact that such changes are not adequately explained, limits the support top management could expect from such changes from TAK managers and employees. As a result, many staff continue to feel themselves passive recipients of centralized messages, disregarded, and disengaged. This has negative performance consequences.

Proposed solution – There is a need to educate TAK senior managers in change management as this is conspicuously absent across TAK and represents a significant inhibitor to modernization. The ESTAK management training program includes a "managing change" course which is due to be piloted in the coming month. There is a need to ensure that this course, and the other management training courses (particularly managing performance and managing teams) are delivered to and attended by TAK senior management as soon as can be practically done.

4. SUCCESS STORIES AND ACHIEVEMENTS

The main success stories of the quarter have been:

- **TAK Call Center opened.** TAK opened a purpose-built Call Center on 1 November 2011. The Call Center is located in TAK's Pristina HQ office (for initial operational support reasons) and comprises 7 staff and a manager. Since its opening, Call Center work has been limited to staff making outcalls to taxpayers with aggregate tax/pension debts of between 500 and 3,000 euro (those with larger debts are followed by TAK regional office staff) to prompt taxpayers to pay off those debts and at the same time file any outstanding tax declarations they may have. In its initial phase, the Call Center has thus complemented the work of TAK's Enforced Collection staff. In its first two months of operation, over 3,000 outcall attempts were made and over 110,000 euro of debt was collected as a direct result of those efforts. Plans are under way for the Call Center to be expanded to also provide taxpayers with an incall option for their tax enquiries from the second quarter of 2012, at which stage the outcall work will only be undertaken when there are gaps in incall demand. The initial phase of operations has provided an opportunity for TAK and taxpayers to get used to greater TAK/taxpayer contact via telephone, while at the same time allowing TAK to prepare for the more comprehensive incall work that will follow. The opening of the Call Center is in line with other tax administration operations worldwide and has followed earlier visits by TAK management and staff to Call Centers in USA (an ESTAK facilitated USAID funded study tour to Seattle) and Macedonian tax administrations.
- **TAK presence in North Mitrovica re-established.** TAK has re-opened its sub-office in North Mitrovica to complement its sub-offices in Gracanica and Shterpce. TAK had operated a sub-office in North Mitrovica of up to 10 staff for many years until the staff there walked out in early 2008 following Kosovo's declaration of independence. Since that time, while TAK has continued to collect some taxes from taxpayers based in North Mitrovica, TAK's ability to provide personal service to those taxpayers and to follow up on taxpayer non-compliance has been extremely limited. The sub-office has re-opened in ICO-provided premises in the Bosniak Mahala area of Mitrovica but for now is confined to one staff member. Advertisements to a further 3 positions are expected to be filled during the next month and all of the staff in the sub-office will be managed and trained by the former manager of the Gracanica sub-office who is relocating to the North Mitrovica site. The initial focus of the sub-office will be on ensuring taxpayers in North Mitrovica are properly registered and aware of their tax obligations.

ESTAK also notes that TAK tax revenue collections for the 2011 tax/calendar year reached 261.1m euro and met the previously agreed GoK/IMF target. This result also represented an 18% increase over the level of tax collections recorded for 2010. As a result of this achievement, and similar strong revenue collections by Kosovo Customs, the GoK was successful in obtaining additional funding from the World Bank to supplement its Budget.

Significant progress has also been made with a range of "taxpayer education" initiatives, which are expected to be announced by TAK during the next quarter and which are expected over time to lead to an improvement of the image of TAK by taxpayers. These initially include the publication of TAK's new logo and of TAK's revised Taxpayer Charter and will be followed soon after by the opening of renovated taxpayer service premises in Pristina and the introduction of incall facilities at TAK's Call Center. While most of the preparation for these achievements has taken place during the current quarter, these are expected to be "success stories" in ESTAK's next progress report.

5. UPCOMING EVENTS AND ACTIVITIES FOR THE NEXT QUARTER

Following on from the work completed to date, the next quarter is expected to see the following developments:

- finalization of TAK's 2012 Operational Plan in conjunction with a visiting IMF expert
- review of changes necessary to allow for the commencement of the SIGTAS phase 2 modules (with emphasis on the Collections module)
- assisting TAK and KPST with the introduction of proposed merged wage withholding tax/pension forms for employers, including the completion of an Employer's guide covering the new process
- assistance with the further development of e-filing covering plans to introduce e-payment facilities and to allow e-filing of the new merged tax/pensions forms
- implementation of the second phase of TAK's Call Center (starting to take inward calls)
- completion of accommodation changes in TAK's Germia building which will improve staff and taxpayer working conditions in Pristina and cater for an expanded Call Center, and reviewing entrance facilities in other TAK buildings
- assistance with the implementation of a revised TAK organization structure including the establishment of a third TAK regional office in Pristina
- assistance with the expansion of TAK's sub-office in North Mitrovica
- completion of initial work on proposals to develop "intelligence" capacity within TAK
- continuation of ESTAK's management training program
- assistance with continued implementation of performance management practices

6. CHANGES TO THE YEAR 2 WORK PLAN

The ESTAK project reached the midpoint of its three-year timeframe in October 2011. Accordingly, it was an appropriate time to review the progress of ESTAK in November in conjunction with the TAK DG. As a result, several changes in direction were envisaged as follows:

- it was decided that the then focus on delivering comprehensive induction training for TAK's new hires should be transferred to TAK with ESTAK's role reducing to an advisory/oversight one. A similar change was envisaged with other planned training, except for management training where ESTAK would need to play the lead role for the time being
- following the completion of laws, administrative instructions and a Collections Handbook, and with TAK staff having taken on the responsibility of conducting collections training, it was felt that the that the future level of ESTAK assistance to TAK's enforced collection activities could be reduced in the future. This also coincided with the completion of assistance from ESTAK's long-term Enforced Collection advisor.
- it was decided that ESTAK work on working towards a replacement for SIGTAS would conclude with TAK's approval of a SIGTAS replacement strategy document. This was in recognition of the fact that TAK would need to find another donor to continue this long-term work (which would extend beyond the ESTAK timeframe) and that it was likely that any additional work carried out by ESTAK in this area would likely be repeated for the new donor
- following a report on interim findings regarding the GoK proposal to work towards a merged TAK/Customs single revenue agency in Kosovo, it was decided that it was too early to progress this issue and that instead a report should be prepared based on the interim findings
- in view of concerns about the lack of action being taken by TAK to identify taxpayers "outside the system" and the ineffective use that was being made of a wide range of third party information now being received, it was felt that ESTAK should consider these issues as part of new work to assist TAK with the development of an "intelligence" capacity
- it was confirmed that ESTAK should continue a focus on improving taxpayer education capacity

It was also noted that despite extensive assistance provided to TAK in relation to performance management, that there continued to be a lack of commitment by TAK management to adopt ESTAK's proposals in practice. As a result, it was decided that progress in this area would be reviewed during the next visit of the USAID reviewer in February 2012. If at that time it was felt that TAK was not making significant progress in relation to ESTAK proposals, then future ESTAK assistance in the performance management area would then cease.

Given these changes, it was also decided to prepare a revised ESTAK workplan to cover the period from 1 January 2012 to the end of ESTAK in April 2013. This quarterly report records progress made against the previous ESTAK workplan but the next quarterly report will record progress against the new workplan.

7. FINANCIAL STATUS OF CONTRACT

The table below summarizes the financial status of the ESTAK project as of the end of Year 2 Quarter 3, and includes: (1) budgeted amounts by line item, (2) amounts committed, disbursed and expended (with disbursements plus accrued amounts shown separately) and (3) estimated costs to complete the contract).

Budget Cost Elements	Budgeted Amounts	Disbursed Amount	Accrual Amount	Expended Amount (Disbursed + Accrual)	Remaining Budget to Complete
Fixed Daily Rate - Labor	\$2,462,680.12	\$1,349,788.57	\$134,827.94	\$1,484,616.51	\$978,063.61
TCN - Labor	\$1,090,881.00	\$696,979.10	\$163,310.22	\$860,289.32	\$230,591.68
CCN - Labor	\$593,652.00	\$333,618.61	\$65,224.90	\$398,843.51	\$194,808.49
Other Direct Costs	\$1,173,541.00	\$646,957.82	\$108,218.32	\$755,176.14	\$418,364.86
Subcontractors-ODC	\$27,271.81	\$0.00	\$0.00	\$0.00	\$27,271.81
G&A	\$349,166.00	\$146,755.01	\$22,141.20	\$168,896.21	\$180,269.79
Total	\$5,697,191.93	\$3,174,099.11	\$493,722.58	\$3,667,821.69	\$2,029,370.24

**Accrual amounts include invoice #80015664707 (dated 12/15/11), invoice for period 7 (11/13/11-12/10/11) and period 8 (12/11/11-01/07/12)

8. PERFORMANCE-BASED MANAGEMENT SYSTEM PROGRESS

The ESTAK Year 1 Annual Report included a Performance-Based Management System (PBMS) which lists a series of performance indicators against which ESTAK program progress can be measured. Although these indicators are annual ones and are not required to be formally reported on in quarterly ESTAK reports, it is however appropriate to present progress against the general high-level result indicators that were included in the PBMS.

(A) TAK TAX REVENUE COLLECTIONS:

A key outcome of the ESTAK program is to increase TAK tax revenue collections by at least 50% over the program's 3-year timeframe. Compared with a base of 206.5m euro collected in 2009, the PBMS thus requires revenues to reach 310m euro in 2012.

After collecting 221.2m euro in 2010, the 2011 tax revenue collection target agreed by the GoK/IMF had been set at 261m euro. Total tax revenue collections for 2011 reached 261.1m euro thus meeting the target set and exceeding 2010 collections by 18%.

The GoK has set the TAK revenue collection for 2012 at 287.8m euro. Achievement of this target would fall short of the original ESTAK revenue target of 310m. ESTAK will be encouraging TAK to not only reach but also to exceed that target to get as close to the 310m level as possible.

(B) ACTIVE INDIVIDUAL ACCOUNTS AT KPST:

A second key outcome of ESTAK is to increase the number of active individual accounts at KPST. To a large extent as tax compliance increases, KPST compliance is also expected to increase as some tax declaration forms double as pension contribution collection forms.

Compared with the 31 December 2009 baseline of 218,000 active individual accounts at KPST, that number has now risen to 274,000 exceeding the expected 2011 annual target of 240,000 active individual accounts. Achievements to date have been due to a combination of better compliance and pension contributor follow-up (by TAK and KPST) where some past contributions had not been able to be allocated to specific individuals.

(C) ANNUAL COST OF TAK:

Taken together with revenue collection information, the cost of collection per 100 units of revenue in respect of 2010 dropped from the 2009 baseline of 3.73 to 2.94 marginally above the expected annual 2010 result of 2.87.

For 2011, TAK spent 6.723m euro (comprising 4.689m on personnel costs, 1.366m on goods and services costs, 0.187m on utility costs and 0.48m on capital costs). Compared with tax revenues received, the cost of collection has fallen further to 2.57 euro per 100 euro of revenue.

It should be noted that the above measures compare the full costs of running TAK with gross tax revenue collections. If pension contribution collections are also included the cost of collection per 100 units of revenue reduces further but the positive on-going trend of reductions in the ratio of cost to revenue collection continues.

(D) TAK STAFFING:

By the end of 2011, TAK staff numbers had increased from their 2009 base of 679 to 747 marginally below its authorized maximum 2011 staffing level of 760.

Gender balance has remained relatively constant at around 70% male/ 30% female from a 2009 base of 468 male and 211 female to a position of 519 male and 228 female as at the end of December 2011.

The ethnic mix of TAK staff as at 31 December 2011 was 726 Albanian, 11 Serbian, 2 Turkish and 8 from other ethnic minorities.

For 2012, no change in staffing level is expected from the 2011 maximum of 760.