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BEARINGPOINT

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Chief of Party

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1. Chief of Party Report

I am pleased to present the December 2007 Quarterly report. At the time of writing this report, a new government has been formed following the November elections. A number of initiatives the project has underway will be dependent on the support of the new Government, such as the Airport concession, Kosovo C and PPP unit – as will our general capacity building role in the Ministry of Finance and Economy. It is also hoped that the change in government and both central and many municipalities will not lead to a massive change of public sector personnel (not just in the supported institutions). A massive change across budget organization and municipalities would place a drain on the resources of the MFE (in particular), to meet training needs and will ultimately impact on the quality of the property tax and budget processes.

During the quarter, events outside of our control impacted on aspects of the project. For example, the Property Tax was hit by the election tsunami. Many Municipalities stopped collecting and issuing bills. While results for the first three quarters of the year were very positive, results for the last quarter show a drop of some 18% (on average) over the same period the year before. Another area to be effected by the elections was the 2008 Budget. Like last election we are in a period of continuous resolution. It is hoped that with the potential resolution of status that the election cycle will move from October/November period to spring. If not, serious consideration should be given by the Government to change the fiscal year. The impact every three years (now four) on economic development by 3-4 months of government paralysis due to an election and a 'temporary' budget is something the small economy of Kosovo could do without. In Privatization we face an unexpected threat to the process following a decision of the Special Chamber. The project, with the support of USAID, will submit (in January) amicus curiae brief to the Special Chamber to hopefully resolve this issue. In Kosovo C we are approaching the business end where the project will be defined and RFP released. Finally, the training academy has made great strides with eight ongoing training courses, including the anti-corruption/fraud program.

Central Banking Authority of Kosovo – One problematic bank was approved to merge during the quarter, leaving just two banks in need of stronger corporate governance and management. All banks are adequately capitalized and liquid.

Ministry of Finance and Economy

- **Economic** – the finalization of the medium term expenditure framework is the highlight of this quarter. The MTEF was endorsed by the PISG, EFC and International donor organizations.
- **Budget** – the 2008 budget was delivered to the Assembly on 7 November with a massive increase in capital funding. Unfortunately the election has meant we are in a 2 month period of continuous resolution.
- **Treasury** – 2006 Audit results continue to show good progress by the Treasury, however vast improvements in budget organizations are still required.
- **Tax** – the dismissal of the Director has hampered the normal progress in Tax, although the 2007 strategic plan outcomes remains on track.
- **Property Tax** – the municipal elections had a negative impact on revenue collection.

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- **Public Private Partnerships (including Airport Concession)** – Good progress was made in establishing the unit and advocating amongst stakeholders the role, functions and importance of the role.

Kosovo Trust Agency – In summary, a total of 312 SOEs have been spun off into 545 new companies. 343 contracts have been signed. Contractual investment commitments in the Special Spin off element of the program (20 Newcos) amount to over € 160.8 million with additional commitments to create over 7,441 new jobs.

Mines and Energy – extensive comments have been provided to the Project Office on the Transaction and Legal Advisors reports. The process has entered the final phase with the project design under development.

Energy Regulatory Office – a number of trainings delivered in the quarter in readiness for the ERO to undertake the KEK tariff review.

Commercial Law – the implementation of the training agenda is on track for March delivery. Significant work was undertaken on the rewrite of the LPFMA; the proposal for a resolution to Trepca and the development of an amicus curiae brief (and other briefing papers) for the Special Chamber to resolve the Privatization impasse.

Cross-cutting Themes

Corruption - The Anti-Corruption/Anti-Fraud program was initiated on October 18, 2007 and has approximately 30 members. The program is attended by Directors of Customs, Procurement, Assembly Procurement Board, ICO, CBAK, TAK, Budget, Treasury, Energy, KEK, SKAAK, Airport and multiple other organizations. The program is highly intensive with multiple practical and reasoning exercises designed to give members a full understanding of all aspects of anti-corruption, early detection, institutionalized prevention, and strengthened sustainable capacity through solid deterrence. Their goal is to complete the Association of Certified Fraud Examiners Exam in October of 2008 where they hope to become certified as fraud examiners.

Human Capacity Development– Apart from the technical training identified within this report, BearingPoint has initiated general training initiatives by establishing eight on-going training courses. Five of the training program classes are managed within a new Tax Academy. Approximately one hundred and five (105) tax administration professionals participate as learners in a long term training program that develops their professional public administration skills. The second initiative is to offer an on-going Professional Development program with approximately 26 managerial students. Members include Budget, Treasury, CBAK, Energy, IMF, and other government organizations. The third initiative is to continue to offer a Professional Leadership school. The Leadership school offers 26 executive managers representing most of the economic units in Kosovo. Participants work to use a high level process of risk assessment and problem solving skills through analysis. Student manager practitioners are offered an opportunity to engage in serious team building processes, and review real world problems.

Gender –Project's subcontractor DTS performed a gender assessment during the quarter, the results of which were incorporated into advisor work plans. It is planned to do a mid project assessment on progress achieved.

Administrative - a) our Mines and Energy Advisor Amr Ibrahim, was approved during the quarter and will relocate during the next quarter; our Mines and Energy attorney departed the project and a replacement, William James was approved and will relocate next quarter; New Resident advisors relocating during the quarter: Sarah Horrigan (Budget); Kelvin Power (Treasury),and; Jill Jamieson (PPP).

2. Team Reports

Objective 1: Strengthen the ability of three economic institutions, MFE, TAK, and CBAK

Objective 1.1: Ministry of Finance

Economic

Progress / Successes

The Prime Minister was briefed to introduce the important and successful Technical Donor Conference (2 October) hosted jointly by the World Bank and EU and held to discuss the policy priorities for Kosovo that would qualify for donor financial support. In this context, a major success was the production by the Macroeconomic Team and finalization of the Medium-Term Expenditure Framework (MTEF), including a comprehensive Matrix of public expenditure policy priorities. This exercise which provided the basis for the Conference was produced with full engagement of all Ministries and was endorsed by the government and the EFC.

The technical donor conference has led to Kosovo being able to have access, should it prove to be necessary, to up to € 50 millions of Budget support.

The two volume MTEF document serves as an excellent example of a high quality product that embodies full ownership by the Government of Kosovo as well as the support and approval of the wider international community. It compares more than favorably with any similar exercise in either Balkan or central European countries.

Budget 2008 - The MTEF also served as the basis for the Budget for 2008 and which has recently been approved by both EFC and the government. The economic background and analysis for this, again, has been a product of the Macro Team in the Ministry of Finance.

Pension Law - Advice from the Adviser to both the Prime Minister and the Minister of Finance was instrumental in securing a government decision to reject a highly inappropriate new draft Pensions Law that (a) would have compromised the good system that is in place already, (b) would have put at risk, the longer run sustainability of the public finances and (c) would have doubled the cost of taking on an additional employee.

USAID Growth Seminar - The OPM Adviser together with the Director of the MFE Treasury and the Head of the Macro Team attended a USAID Growth Officers Workshop in Washington DC. All three participants appeared on the Program as presenters. This was much appreciated by USAID as evidenced by the positive feedback. Details of the Workshop together with accounts of the presentations are available on the USAID website.

Other - further work has been undertaken by the Macro Team to update their macro-model system

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- additional briefing and analysis has been provided on the subject of rising world food and commodity prices and the appropriate response for Kosovo. This has been an agenda item at recent government meetings.
 - again, and due to the work load as indicated above, work on the Macro Bulletin although continuing, has had to be put back.

Issues / Concerns

In advance of the recent elections, the PM announced that he would not wish to be considered or to continue in his position. Through the reporting period however, he has played the leading local role in the status negotiations.

The protracted election process has diverted the attention of Ministers and Advisers and has meant that many policy issues and possible initiatives have been put to one side.

The October IMF Mission failed to negotiate successfully a new Memorandum of Economic and Financial Policies, the sticking point being the very large increase in planned capital spending through 2008. In fact, the inability of government to spend capital appropriations continues to be a serious problem. At the time of writing, the cash balance on government account in the CBAK is around € 430 millions, or 18 per cent of GDP and which is about 50 per cent greater than the opening balance as at 1 January 2007.

Much speculation concerns the issue of when and whether or not Kosovo will declare independence from Serbia. The Adviser in OPM produced a Report of some possible macroeconomic effects. Support was provided by the Macro Team and the Memo was sent to both USAID and the Prime Minister.

There will be new Ministers which will impact upon the allocation of support provided under the Kosovo VI Project. The macroeconomic side is now so important that it is clearly indispensable to the proper functioning of MFE.

Budget / Intergovernmental

Progress / Successes

During this reporting period, the MFE finalized the development of the 2008 Kosovo Consolidated Budget. The Central and Municipal departments worked jointly to formulate a budget proposal that meets Kosovo's many significant funding needs.

Following endorsement by the Government and the EFC, MFE submitted the 2008 Draft Budget to the Kosovo Assembly on November 9th. Completion of the Draft Budget occurred earlier this year, compared with the previous two years, bringing the budget development timetable closer to the statutory transmission deadline of October 31. In addition, the role of the Grants Commission in the municipal budget process was strengthened; for the first time, the Grants Commission reviewed and endorsed the municipal budget proposal.

This year, MFE staff took the lead in drafting the Budget Regulation and conducting necessary communication with the UNMIK Legal Office, with the Advisors playing mainly supportive roles. MFE staff demonstrated its capacity to produce required budget documents, with increasing focus on improving the quality of the budget presentation. Budgetary displays have been growing more robust over the past two years. Notably, the budget presentation includes:

- Multi-year proposals, consistent with the MTEF macro-fiscal framework, in the Budget Schedules. In 2007, the summary budget table (Schedule 1) showed only one year – 2007 itself. In the 2008 budget, the budget displays four years, 2007-2010.
- Multi-year funding streams for the list of capital projects (Schedule 4). In the 2006 Budget, there was no list of capital projects. In the 2007 Budget, there was a list of capital projects, but only for a single year. In the 2008 budget, there is a 2008-2010 funding stream for all capital projects, including the 2008 proposed budget appropriations and two out-years, showing funding in accordance with the analysis of the Public Investment Program (PIP).
- Municipal Budget Books from almost all Municipalities (i.e., 21 Municipalities as of mid-December) for the first time. Publication of budget information for citizens, produced by municipal budget organizations and supported by the OSCE project, showed considerable improvement.
- In addition, Advisors worked with Budget Departments towards including a standard functional classification in the 2008 Budget, as suggested in the PEFA report. However, due to tight deadlines and poor data quality (in particular for Municipalities), the functional information has not yet been provided to the Assembly.

The 2008 Draft Budget proposes spending of over 1 billion €. Operating spending is restrained, closely aligned with the levels agreed with IMF. The 2008 capital spending is consistent with the Government priorities envisaged in the Medium Term Expenditure Framework (MTEF) document, and is likely to exceed €400 million (versus € 200 million planned in 2007). This amount includes unexpended 2007 capital funding that is carried forward. In addition, the Draft Budget plans for the

post-status situation: it provides an initial € 35 million in 2008 for new ministries and activities, and also reserves € 45 million in 2008 for the servicing of debt with which an independent Kosovo is likely to be saddled.

If a budget is not enacted for a given fiscal year, the LPFMA includes a provision to provide an interim budget, or Continuing Resolution. Because the outgoing Kosovo Assembly did not review the 2008 Draft Budget and the new Assembly will not do so before the end of the year, the Budget Departments worked on such an Interim Budget for the first two months of next year. The Administrative Direction on the extension of the 2007 Budget, which was endorsed by the EFC, ensures the necessary financial means for the public administration to function and provide essential public sector services for January and February. In addition to making available statutory appropriations in the ratio of 2/12 of the 2007 mid-year review levels, MFE worked with UNMIK FAO to provide exceptional financing within the Administrative Direction for imports of electricity, increase in teachers' salaries, and carried forward capital projects with contracts signed in 2007.

The Advisors continued support of the Municipal Budget Director in fiscal decentralization area. A joint USAID/World Bank Technical Note on Selected Fiscal Decentralization Issues was finalized and officially transmitted to the local authorities. It is expected that findings of this study will prove helpful in policy discussions and policy decisions in drafting Law on Local Financial Resources (within the package of legislation required by the Comprehensive Proposal for the Kosovo Status Settlement Proposal). Further, support was provided to MFE to contribute to the Decentralization Road Map process. The Road Map workshop endorsed Issues Paper submitted by the MFE, which the Advisors helped to draft, and recommended to build on it a preliminary action plan matrix for the thematic area of municipal and intergovernmental finance.

Issues / Concerns

While the 2008 Draft Budget envisages a deficit, resulting from both increased capital spending and additional post-status costs, it will be financed from retained earnings with a pledge to maintain a minimum bank balance of no less than € 50 million by the end of 2008. The ambitious capital spending plan might create significant execution challenges for budget organizations, which have demonstrated low execution rates of capital projects over the recent years.

Current uncertainties surrounding the formulation of a coalition to establish a new Government may affect works and organization of Departments. Once the new Government is established, its decisions, including those at the local level, may call for Budget Departments to react swiftly to new priorities in revising the 2008 Draft Budget.

Due to delays in the promulgation of the 2008 Budget, many budget organizations may face complications in financial management at the beginning of next year. Further negative impact might be expected on the implementation of capital outlays, with the cycle effectively shortened by up to two months.

Treasury

Progress / Successes

The focus for the past three months was on developing and promulgating administration Instructions for the close of the financial year, the preparation of Financial Statements (FS) for 2007, preparations for the opening of the 2008 accounting data base and cash flow/investment planning until the end of the FY year. In support of the FS preparation an increased focus has also been directed to resolving outstanding reconciliation items.

Administration Instructions 2007/7 and 2007/8 were prepared covering the close of transactions for FY 2007 and the preparation of FS for 2007, respectively. In support of the preparation of FS for 2007 extensive training was scheduled for January 2008 focusing on the needs of the Budget Organizations (BOs).

The data base in Freebalance was developed for the 2008 financial year (FY), this provides the platform for the new financial year accounting record.

Significant resources were applied to preparing for the introduction of UNIREF (Uniform Reference Number) from January 1, 2008. It is anticipated that UNIREF will greatly enhance the recording and reconciliation of revenues by providing bar code information on all invoices so as commercial banks (and in future other payment centers) can easily scan data to match payment. The pilots with Tax administration and the municipalities of Pristina and Shtimje were completed. Administration Instruction 2007/6 was issued in support of UNIREF.

Third quarter Interim Budget Report was prepared by the end of October with the assistance of the local Accounting Advisor. It was produced on time and there were no material differences in the reconciliation.

Consistent with the establishment of the Liquidity Committee a more active short term investment of public money focus continues. CBAK and Treasury meet on a regular basis and surplus cash is invested. As of the 17th of December a total of € 76.3 million was still invested with interest rates of in a range of 3.55% to 3.39%. Under the LPFMA investments are terminated within the FY. For the FY an aggregate € 590 million for various periods had been invested at an average rate of 3.45%. Interest earned amounted to € 1.9 million. Cash management procedures are in draft form and are currently being reviewed and edited.

The Commerzbank bank account was closed 5 December, 2007 in line with the Treasury Single Account concept and in anticipation for the resolution of status. The need for the 'off shore' account is no longer relevant. All funds under the control of the Government and for donor support reside within the CBAK.

The draft 2006 Audit Report was received by Treasury. Treasury has made initial responses to the Office of the Auditor General (OAG). While the OAG has been unable to express a positive opinion (Disclaimer of Opinion) on the 2006 FS there are positive signs of solid progress, especially by Treasury. Positive findings in relation to the enhancements to the Freebalance system controls were noted. The OAG observed that many issues raised in its 2005 Audit Report were resolved.

It is noteworthy that the OAG recognizes that the controls in the Freebalance system now provide reasonable assurance of the integrity of the data produced from the government's accounting and management system.

The report finds that Treasury processes are essentially sound but considerable work is required by the Budget Organizations to improve the accuracy of their record keeping. Procurement, revenue collections, key data bases (other than Freebalance) and reconciliations continue to be significant issues.

The pilot stage of the decentralization of expenditure to Municipalities has concluded. The timing of the pilot was not good due to the elections. However the level of accuracy of transactions was promising and the result confirmed that the plan for decentralization should continue, with strong controls put in place.

Issues / Concerns

By far the biggest concern is the continuing poor relationship between the Minister and the Director of Treasury. The current Minister continues to make ad hoc decisions on a number of things including the granting of selective bonuses to staff groups and other payments. The Director Treasury examines each such request on its merits and takes the appropriate action.

The CBAK has joined with Treasury to determine a way forward in terms of dealing with a number of outstanding court orders made against a number of Budget Organizations (BO's). It has been subsequently agreed that the CBAK will refer the court orders back to the respective courts stating that they cannot be executed as the bank accounts concerned are the property of the Treasury and not the BO's. The CBAK will copy Treasury with all correspondence. Treasury is engaging with the Justice department to challenge the validity of the court orders on the grounds that appropriation from the assembly is required for Treasury to execute those orders.

Property tax

Progress / Successes

Significant progress has been made this quarter in migrating the 30 Access-based property tax registers to an SQL database and housing them on a central server in the Ministry of Economy and Finance. The migration tool was developed and tested on 15 databases with no errors or loss of data. The redesigned user interface is now complete and testing began in Pristina and Lipjan municipalities. In December, 30 staff members from the municipal property tax offices of Lipjan, Pristina, Prizren, Shtime and Vushtrri were trained on the new system. Roll-out of the new system is now planned for January 30 when all of the operators in the municipalities will be trained and the additional modifications in the front-end of the software will be completed.

The USAID Property Tax Advisor and the MFE Property Tax Office continue to liaise with Sida for the tender of a commercially available, off-the-shelf solution for property tax administration. Sida has informed the MFE that it will fund this project through the Swedish tax authority which will send a mission to Kosovo during the first week of February and during the entire month of April to assist in finalizing the tender document.

With assistance from the USAID Property Tax Advisor, the MFE Property Tax Office produced a short assessment ratio study for each municipality. The assessment ratio study compares real estate appraisals by the municipality to actual sales of each type of property in each zone. When the findings were presented to each municipality, the MFE Property Tax Office demonstrated how the municipality could change its tax rates to maintain the overall assessment while redistributing the tax burden more fairly.

Issues/Concerns

There was a 16% decline in collections during 4Q2007 due to the parliamentary and municipal elections. The normal business of local governments in Kosovo essentially ground to a halt and virtually all municipal staff were engaged in campaign activities during working hours. The MFE Property Tax Office organized collection teams in five municipalities, but these teams did not work when not under the direct supervision of MFE staff. In several municipalities, the property tax office was instructed not to enforce collections, distribute bills or issue final notices. Normal operations resumed in December once the elections were over. The table below shows the decrease in collections during the last three months of 2008.

Table 1: Property Tax Revenue During 4Q2008

	October 2008	November 2008	December 2008
Total Property Tax Revenue	€ 514,618	€ 524,831	€ 1,041,334
% Decrease from 2006	- 28%	- 23%	- 3%

The significant fall in collections during 4Q2007 has resulted in lower than expected property tax revenue for the year. A total of just over €8.2 million was collected by Kosovo's municipalities during 2007 as opposed to €7.6 million collected during 2006. The euro collection rate will drop slightly from 54% to 53%. The poor revenue performance during 4Q2007, prompted by local elections, is a significant change from the end of 3Q2007, when property tax revenue was up by 20% compared to 2006 and a total of €9 million was projected for the year.

LDK's defeat during the elections means that most municipal employees expect to lose their jobs in the new year as PDK establishes control. The lame duck administrations at the local level as well as the civil service are simply not motivated to collect property taxes during their remaining weeks in office. Should they be removed from their jobs as is expected, a great deal of human capacity will be lost. The training of new staff members will dominate the activities of the MFE Property Tax Office during the first one or two months of the new year. Materials have been prepared to conduct training on property tax administration, property appraisal and rate-setting for the newly elected public officials.

Capacity also remains a problem within the MFE Property Tax Office. The MFE relies on USAID EMSG advisor to manage the migration of the property tax registers to SQL as well as the Sida process to secure a COTS solution through the upcoming tender. However, once installed, the new system will simplify property tax administration and greatly improve transparency, thereby making the job of our counterparts easier.

During 1Q2008, the Property Tax Incentive Grant will be distributed to the municipalities based on their performance during 2007. It is likely the some municipalities, such as Gjakove, Peje, Viti and Podujeve will fail to meet the threshold to qualify for funds, and the new Minister will face his first test in denying their allocations. At least 10 municipalities will meet or exceed their annual revenue targets while at least another 15 municipalities will cross the threshold to be eligible to receive a partial allocation of funds from the Incentive Grant.

In February, the tender for a COTS IT solution for property tax administration should be finalized with the assistance of the Swedish tax authority. The MFE Property Tax Office is conducting a needs assessment of the IT and communications infrastructure in each municipality in order to draft the technical specifications requirements. The format of the tender has been agreed upon with Sida and a draft will be circulated between the MFE and Sida for comment in January.

Finally, training of new municipal officials and local property tax staff will begin in January. Several executive seminars for the new mayors (20 of which are from PDK) will be held in Pristina and the regions as well as separate seminars for members of the local assemblies. The executive seminars will give political leaders a broader overview of property tax administration, the resources required, how to accurately establish property values and set realistic rates that meet the revenue needs of the municipality. Seminars for any new property tax office staff will be more intensive.

Objective 1.2: Strengthen the Capacity of TAK

Progress / Successes

Strategic Plan: Reviews confirm that nearly all the scheduled activities for 2007 will be completed by the end of the year. A change in direction with regard to business registration will focus more on improving use of the business registration data, rather than establishing a separate registration process in the tax administration, which would require establishing a new unit and finding resources. The new plan calls for combining new business visits with verification of registration data and then issuing a unique taxpayer identification number, which will utilize the business registration number with added digits for TAK.

Director's Advisory Group: Two meetings during the quarter; participants have included representatives from AmCham, Alliance of Kosovo Business, MEF Tax Policy, and SCAAK. The Kosovo Chamber has been invited, but has not participated to date. The December meeting was postponed until January due to the holidays. It is anticipated that the January meeting will finalize arrangements for a series of tax seminars sponsored by AKB for its membership.

Revenue: TAK revenue performance continues to exceed projections. Through 17 December 2007, a total of €177.3 Million had been deposited in CBAK against a target for calendar year 2007 of €142.6 Million.

Risk-based Selection: Further progress has been made in developing systemic risk-based selection for VAT returns. A working group within TAK has been established to identify risk assessment indicators associated with five financial importance indicators that have been identified (turnover, payments, debt, credits, losses). When fully developed, a mathematical score will be assigned based on the total of the scores assigned for financial importance indicators and the risk assessment indicators. Once the risk assessment indicators have been developed, it will be necessary to program the system with the appropriate formulas and the information source to be searched for data on which the formulas can be computed.

Tax Academy: The tax academy under Bill Campbell is continuing with 80 managers in four classes receiving professional and managerial skills training. An additional 18 employees are receiving professional skills training. Advisors are continuing to work with two of the managerial groups to ensure that skills developed are implemented in the workplace, thus ensuring that they are increasing their professional capacities.

Anti-Corruption: Bill Campbell began a course in anti-corruption in mid-October, with participants from a wide variety of Kosovo institutions. At the end of the course, students will be qualified to take the examination to become Certified Fraud Examiners. An advisor accompanied Manager of Professional Standards on a visit to the KPS Professional Standards Office to begin dialogue on establishing a mutual assistance MOU. The Manager of Professional Standards frequently consults with advisors on a range of issues.

Assistance in international issues: Two one-day sessions were held, each attended by approximately 170 employees, to train staff in the concepts of Permanent Establishments (PE). Etienne Cosyns prepared and presented the training. Other work to increase TAK capacity in dealing with international taxation includes assistance with a major corporate reorganization case, assistance with the audit of a large company which involves application of the PE principles, advice on warranty

application with respect to VAT, advice on application of the laws with respect to UNMIK entities which have transitioned into PISG entities, advice on the application of bad debt provisions of the VAT law, advice and assistance to Appeals on a major case – including assistance in drafting decisions, etc.

Payment and Declaration Processing: Advisors have assisted with developing concepts for payment and declaration processing. As a result of efforts, TAK is entering into a new MOU with CBAK, assisted by Treasury, for revisions to the payment information TAK is currently receiving. It is expected that these revisions will ultimately allow taxpayer payments to post directly to their accounts without waiting for reconciliation with a return - significantly improving customer satisfaction and reconciliation with Treasury. Further work on declaration processing is needed, but preliminary plans are being made to pilot some revised procedures in the LTU during the next 6 months.

Collection Manual: Advisors assisted CAFAO in drafting a collection procedures manual. The manual is currently in translation and will then need to be finalized with TAK staff. Administrative Instruction prepared relative to bank levies is pending Minister's signature.

Issues / Concerns

Director of TAK: Following recommendation of the Minister, the SRSG has terminated the Director. The turmoil leading up to this point has created a certain amount of stagnation and concern in the tax administration, although the work is going forward.

KTA MOU: The existing MOU with KTA regarding VAT liabilities of POE's expires at the end of December. A draft MOU has been prepared and discussed with KTA (and KEK, the POE most affected), but agreement has not yet been reached. The MOU contemplates the use of modified bad debt provisions for the POE's in order to put them on the same basis as other VAT filers, except for the relaxed bad debt provisions. KTA and KEK are resisting based on their position that KEK does not have the IT and accounting system to allow its implementation.

TAK IT: New IT personnel with increased salary have been selected and are in place. However, prior to their arrival, all staff with knowledge of the SIGTAS system departed and the new staff, capable as it is, is struggling to learn the system.

Budget: The FY 2008 budget as initially approved by the Minister was somewhat over €7 Million. This has been reduced to €5.2 Million. Included in the TAK proposal was the ability to adjust coefficients in order to provide some salary increases for staff in professional positions – provide a two-tier compensation process for inspectors. Renovation work scheduled for 2007 could not be awarded and that work must now be funded by the 2008 budget. Staffing is frozen at 654, impacting the ability to staff the gambling department and other units as well.

Objective 1.3: Central Banking Authority of Kosovo (CBAK)

Progress / Successes

There have been mixed results from the efforts to resolve three banks. After an onsite examination, CBAK lifted the Administrative Order on the larger of the two banks that will be merging. The CBAK Governing Board approved the application to merge. In the two other banks, examinations also were performed; in one, technical weaknesses and a lack of management systems persisted and these became the subject of a Memorandum of Understanding entered into between CBAK and its Board. The new management in that bank has yet to take hold. In a separate AML examination of the same bank, serious issues were disclosed relative to transfers through an unlicensed affiliated money transfer agency for benefit of the major shareholder. CBAK is coordinating with FIC on action to be taken. In the other bank, the issues are even more problematic. The general manager was conditionally approved subject to achievement of specified objectives; a new internal auditor and operations manager were approved, but a proposed credit risk manager was not. Core earnings weaknesses still must be addressed. As of quarter end, an onsite examination was nearing completion with preliminary findings indicating continued unsatisfactory condition and performance. A revised Administrative Order will be imposed to incorporate treatment of deficiencies. Ownership and governance are matters of concern. All banks are adequately capitalized and liquid.

The Serbian bank that was brought under CBAK's supervision in the previous quarter is struggling to meet administrative and operational requirements. That bank's Kosovo-based staff are not very competent and receive all instructions from Belgrade. Operating systems are weak. A CBAK team has been established to work with the bank in a consultative role to bring it into compliance. The other two "parallel institutions" operating in Serb enclaves were not dealt with this quarter.

A Turkish-French bank, given preliminary license in the preceding quarter was given the final approval by the CBAK Governing Board late this quarter. The new Albanian-Turkish bank began deposit taking.

One application to enable an existing micro-finance institution to obtain a full banking license has been put on hold due to inability of the applicant to provide a satisfactory ownership structure to CBAK.

The micro-finance legislation finally passed all bureaucratic hurdles but remains with OLA. If enacted, it will open the door, first, for a re-licensing exercise over the next six months, and then for applications by eligible MFIs to become deposit-taking institutions. Extensive technical support has been promised for this transformation process by World Bank, EFSE and EBRD, but initially, CBAK envisions few that would qualify, based upon recent onsite examination results.

The CBAK Governing Board deferred proposed legislation for a deposit insurance regulation until January; the legislation necessitates further revisions to the Banking Regulation (UNMIK 1999/21). Issues with the industry were discussed and resolved, not entirely to the industry's satisfaction. A new Rule on Loan Disbursements was issued. A proposed amendment to the Disclosure Rule was drafted to require banks' fees for products and services to be disclosed in a consistent manner. The previously mentioned Rules regarding External Auditors and Internal Controls are undergoing further review. Most legislation submitted to OLA and the Government received little

attention in the run-up and aftermath to elections, attention being given to “transition” legislation.

Onsite and offsite banking supervision are progressing well. In addition to the examinations mentioned above, resulting in enforcement actions, several MFIs were examined and found to be in need of technical skills on the liability management side. Two will be insolvent if their liabilities are not rescheduled/converted. Emphasis during the quarter also has been on AML-CFT examinations. Administrative Orders and MOUs are being prepared.

The CBAK Governing Board revoked the license of Atlantic Capital Partners as a pension fund provider for reasons of false and misleading representations to PTK pension fund participants and for noncompliance with conditions for granting the license. All remaining defined benefit pension funds still are in process of liquidation.

A project management team was established and a procurement officer hired to support the World Bank’s USD \$2 million technical assistance project for the financial sector. The bulk of the assistance will be dedicated to upgrading the CBAK’s insurance and pension supervision capability.

Issues / Concerns

The SRSG and Government did not act on a proposal to replace the current CBAK Managing Director with the present Deputy Managing Director for Financial Supervision. It now appears that IMF may fund another international for 1-2 years in the MD position; the Government seems to support this, but it still is not certain. If a new version of the CBAK Regulation is adopted, subsequent appointments would be by the President upon nomination by the CBAK Governing Board. CBAK is at a difficult juncture in its evolution, and much will depend upon the final CBAK Regulation, the Constitution, and who is sitting on the Board and in the CEO seat. Ability to withstand threats against independence, from whatever source, may prove difficult, and much could depend upon the IMF-funded advisor/MD.

Previously internally institutionalized systems, or those thought to be well underway have begun to deteriorate, as has transparency of internal decision-making. The internal budgeting process is one good example where ill-considered cost cutting and funds re-allocations are at the sacrifice of longer-term goals and plans. Staffing, already short, will become an increasing problem as more work is loaded onto an already pressed group. Retention could again become a problem.

Objective 2: Stimulate Trade and Investment Through Modern and Well-Implemented Commercial Laws

Commercial Law

Progress / Successes

In the fourth quarter of 2007, BearingPoint legal advisors continued to assist several PISG institutions with the development of a basic modern legislative framework governing commercial, economic and public administration activities. In particular, BearingPoint legal advisors provided key assistance on the development of several key pieces of legislation required for the implementation of the Ahtisaari settlement agreement, including, a new law on Civil Aviation and substantial proposed revisions to the Law on Public Financial Management and Accountability, the KTA Regulation and the SOE Reorganization Regulation. With respect to proposed revisions to the SOE Reorganization Regulation, these were the central component of a plan that had, with substantial legal team assistance, been developed by USAID - and successfully advocated to the PISG and UNMIK - for the resolution of the impasse over Trepca's reorganization. The legal team also initiated the preparation of an amicus curiae brief for a case before the Special Chamber that has the potential to substantially and negatively affect the privatization activities of the KTA.

In the Assembly, the legal team provided assistance with respect to the finalization of the draft laws on Obligations (Contracts and Torts), Real Rights, and Business Organizations.

Notwithstanding the residual legislative development activities described above, during the fourth quarter of 2007 the legal team continued to take substantial measures to implement the shift in its principal focus away from legislative development activities and toward building institutional capacity among the judicial and legal community to improve the implementation of Kosovo's legal framework, especially with respect to economic and commercial laws. The legal team spent considerable time with USAID finalizing (i) a general plan that defines our overall activities and implementation objectives throughout the life of the project and (ii) a detailed work plan for the legal team's activities during the first year of the project.

These principal element of these plans calls for the legal team to develop and deliver, over the course of the project, a comprehensive training program for judges, public and private sector lawyers and law students covering 11 specific legal subject areas. Training is to be provided on Arbitration, Contracts and Trademarks during year one; Foreign Trade, Business Organizations, Foreign Investment and Secured Transactions during year two; and Competition, Real Property Rights, Bankruptcy and Copyright during year three.

In order to implement these trainings, in the fourth quarter of 2007 the legal team began, as required by the work plans, (i) to develop the training methodology that will be used; (ii) to organize the timing and conduct of the specific training courses with the Chamber of Advocates, the Kosovo Judicial Institute, and the University of Pristina, (iii) to identify, interview and hire quality local lawyers who will be responsible for delivering – under legal team supervision - the training, and (iv) to prepare detailed explanatory material for the first three courses, which will cover Business Organizations, Contracts and Trademarks.

The training program will cover 3-4 subject areas per year and will be aimed at significantly increasing the understanding of judges and lawyers with respect to both the substantive provisions and the policy bases and objectives of each concerned piece of legislation. The engagement of local lawyers to deliver the training is intended to promote the achievement of the sustainable local institutionalization of this training.

Issues / Concerns

The project undertook substantial efforts in the quarter to identify and engage a training professional to take the lead on this and we expect to have the training professional join the project in January 2008. Despite the delay in identifying and engaging a training specialist, the legal team has moved forward with all other preparatory work needed to ensure that the training program is implemented in accordance with the schedule specified in the work plans.

Objective 3: Privatize or Commercialize POEs

Kosovo Trust Agency

Progress / Successes

By December 31, 2007, the KTA will have tendered 312 SOEs spinning them off into 545 new companies. From these sales, KTA to date has signed 343 contracts with the new owners and generated EUR 388,469,662. Contractual investment commitments in the Special Spin off element of the program (20 Newcos) amount to over 160.8 million €s with additional commitments to create over 7,441 new jobs in Kosovo. A total of greater than 9,300 investors, both local and foreign investors have expressed formal interest and have been logged in the process of privatization so far.

An independent survey of 55 New companies undertaken by the EAR confirmed the KTAs own survey which illustrated paid employment up by 23% in the newly privatized companies, revenues up by more than 700%, with year on year growth of 26%, and investments of around 420,000 per new company had occurred in the last 2 year period. Furthermore, the significant growth in exports is testament to the economic growth that has been stimulated by the privatization program, and it is notable that the 3 largest exporters are recently privatized companies.

From the total 550 SOEs in the SOE spectrum, it is estimated that around 200 are not viable. Non-viable SOEs are being liquidated, and in these context asset auctions commenced this year and have been rapidly increasing in frequency. In this regard, some 106 SOEs have been placed in liquidation, and asset sales of € 12,118,130 have been achieved to date.

The new local Director of the Privatization program has been identified by broad advertisement and a full competitive interview process. The new head, Shkumbin Bicaj, took leave for the whole of December, but is expected to take up his leadership role in early January 2008.

Trepca policy development has moved on to the extent that a reorganization strategy was adopted by all of the main actors by consensus. However, the recent elections and change in government mean that full implementation will need to await consultations with the incoming administration. We hope that the new minister will be equally positive in the adoptions of the consensus strategy band that 2008 will be the year that the Trepca conundrum starts along the road to full resolution.

The Brezovica Ski resort tender was re-launched. There has been considerable nervousness within the leadership of Pillar IV concerning this politically complex privatization. We have managed to keep the tender open despite this nervousness, and have been in contact with four significant interested parties. We also arranged a commercial bank loan for the SOE in order to facilitate its operations during the tendering process, however, the SOE management declined to take advantage of this facility. Currently, the resort is not operating, though they have applied with safety certificates, through us, to the MTI for operational licenses. This positive step shows that the SOE accepts the authority of Kosovo government institutions for the first time.

The MD and Head of Legal at the KTA are at best, luke warm on the privatization initiatives for Sharrcem. Indeed, the MD has issued instructions to the regional offices that no further privatization of commercialized companies should commence due to concerns on provisioning. We therefore believe that the initiative to launch this tender is effectively frozen.

Significant progress was made on the development of the strategy for dealing with the Dragash Sharprodhimi high alpine area. A two day workshop with all of the actors enabled the building of a broad consensus on the strategy of creating a development agency to manage the high alpine areas. Furthermore, a recent court case in favor of KTA, has enabled the lowland agricultural land to be made available for privatization.

The privatization program which we led in this quarter had 2 bid days (for waves 28, and 29) and launched a further 2 waves of tenders (waves 30 and 31).

Issues / Concerns

It is notable that there has been a considerable slowing of the privatization process and this has been due to Pillar IV's desire to clear up all contracts prior to status and a potential hand over. Indeed, there was a strong desire at Pillar IV to halt privatization altogether. To date we have resisted this policy, since we strongly believe that the inertia created by a complete halt would severely impact public moral, and would cost a great deal of time and effort in the inevitable restart program.

Liquidation and winding up of the company's remains far too slow. This area is supported by the EAR Maxwell Stamp program. Furthermore, distribution of the workers 20% has become increasingly difficult as the KTA has been given greater analytical and preparatory responsibility.

A recent Special Chamber decision has potentially far reaching consequences to the continuance of the privatization program since it questions the validity of the eminent domain element of the KTA regulation in the light of the ECHR directives of the EU. A full and detailed analysis of this decision is currently being undertaken, however, it has effectively halted the signing of any further contracts by the chairman of the KTA at this present time.

Public Private Partnerships / Airport Concession

Progress / Successes

In an effort to centralize and coordinate multi-sector activities relating to Public-Private-Partnerships, a new policy department, the PPP Unit, was created within the Ministry of Finance and Economy. The organizational chart, job descriptions and reporting structure for the PPP Unit have been established, while proposed amendments to the Law on Public Financial Management and Accountability (LPFMA) set forth the Unit's general legal mandate.

Due to the need to confirm incoming government support for PPP, as well as the need to define funding sources for staffing, the PPP Unit is not yet fully consolidated; nevertheless, it has begun operating and working within the scope of its mandate.

Amongst other advances, the nascent PPP unit has begun capacity building across multiple sectors, preparing materials and imparting basic PPP training to line ministries, POEs, and ad hoc project teams. The PPP Unit has also engaged in stakeholder consultations with an eye towards generating broad-based consensus regarding public-private-partnerships. Thus far, these consultations have included policy and project discussions with other donor agencies (World Bank, IMF, EU, etc.), private sector representatives, and public sector officials.

The PPP Unit has also initiated a preliminary framework review to identify legal, regulatory, and institutional barriers to PPP investments. In this regard, it is clear that as a first step, a strongly articulated policy statement in support of PPP should be issued by the highest levels of government in order to help foster investor confidence in public-private-partnerships.

The PPP Unit has also worked to develop specific procedural recommendations designed to standardize and institutionalize the review and vetting of potential PPP projects. Nevertheless, these procedures have not yet been formally adopted by the MFE or included in the capital expenditure analysis process.

Finally, in an effort to create a pipeline of projects, the PPP Unit has begun identifying and reviewing possible PPP projects for future implementation, i.e. educational programs at the municipal level. It has likewise commenced a review of existing project initiatives, specifically the Pristina International Airport (PIA) concession and the Kosovo C energy project, in order to provide technical assistance and support to ensure that each transaction is successful and complies with international best practices.

With regard to the Pristina International Airport, on the heels of the September 12 PISG Steering Committee decision to proceed towards a master concession, work continued towards setting the legal, institutional and regulatory groundwork necessary for an eventual PPP transaction. In this regard, significant progress was made towards developing broad-based consensus for a comprehensive civil aviation law.

The Civil Aviation law, which sets forth the institutional and regulatory framework for all aspects of the aviation sector, has been drafted to the satisfaction of international aviation law experts; nevertheless, the proposed legislation is pending approval by multiple working groups, prior to its formal submittal to the Assembly. Approval of this law is a necessary prerequisite to tendering the airport concession.

Issues / Concerns

In light of recent elections, there is some uncertainty as to whether or not the incoming government will commit to a multi-sector PPP program. There is also concern as to whether or not they will support specific components of the existing PPP initiative, including the establishment of a centralized PPP Unit in the Ministry of Finance and Economy and the Pristina International Airport master concession. Clearly articulated policy directives in support of PPP and in favor of proceeding with the PIA airport concession are imperative.

Indeed, given opposition to the Airport concession by PIA management and some members of the PIA Board, there is also growing concern that actions will be

undertaken to effectively preclude the possibility of a future airport master concession. Asset stripping is one concern; but additionally, PIA has begun to tender medium and long term contracts for non-aeronautical commercial concessions, such as restaurants, parking, retail, fuel supply, etc. Obviously, these legal encumbrances will effectively impede the ability of any future concessionaire to implement its own commercial program the airport, thereby making the PIA master concession less attractive, deterring potential investors and minimizing the concession's potential benefits for Kosovo. Despite efforts to convince the PIA and its leadership to take measures to ensure that these contracts do not have an adverse effect on an eventual master concession; to date, both the EU and PIA have refused to accept the incorporation suggested "safeguard" clauses into these commercial contracts.

The Civil Aviation Law also remains an issue. From the perspective of the PIA master concession, is imperative that this law is passed in the near future; however, there is uncertainty as to how the incoming Minister of Transport might view this piece of legislation. Likewise, the implementation of the law and its regulation are issues which must be addressed in the near future.

Finally, the lack of funding for salaries in the PPP Unit is a major concern. Given the need to staff the Unit with western educated professionals of the highest caliber, current public sector salaries (even if available) are insufficient.

Objective 4: To assist Kosovo's Energy Sector to Become More Efficient, Transparent, and Modern

Ministry of Mines and Energy

Progress / Successes

During this quarter the Advisors continued their support of MEM, the PSC and the Project Office (PO) with particular focus on the continuing work of the Transaction, Legal and Environmental and Social LPTAP Advisors (TA, LA and EA, respectively), who have provided a number of reports to the LPTAP Project Office. Reports from the LA include: Interim Diagnostic Report, draft and revised Inception Report, a Legal Analysis of the IFC/SENCAP Issue and a legal opinion resolving this issue, a draft Expropriation Law, a draft Resettlement Policy Framework, and draft SEA Legislation. The TA submissions include: draft Interim Process Letter, draft Early Diagnostic Report, Draft Phase I Report with separate major appendices (Working Framework, Financial Model, Decision Support and final Early Diagnostic Report). We continue to review and provide our comments on these documents to enhance the understanding of important transaction issues by the PSC and to facilitate its communications and interactions with the LPTAP advisors.

The milestone report from the Transaction Advisor, its Draft Phase I Report, was presented to the Project Steering Committee at its 24th meeting held on December 11, 2007. The Report presented some of the major issues / proposals which will shape the structure of the Kosovo C Project and, therefore, will need to be thoroughly analyzed by the PSC. The Draft Phase I Report also included a Decision Support Document which aims to provide the PSC with a structured basis on which it can make decisions and move the project to the next stage. The Report also provides a new provisional timetable for issuance of the RFP (May 2008) and a revised due date for bids of September, 2008, taking into consideration both the current stage of the project and overall political developments in Kosovo.

The EA provided a First Draft of the Strategic Environmental and Social Assessment Report which presents a preliminary examination of different alternatives associated with lignite and energy development scenarios; analysis of the existing environmental and social situation and identification of key strategic issues associated with lignite development in the framework of the proposed Sibovc Development Plan.

Specific activities during the quarter included:

- Closing of WB/IFC/SENCAP conflict of interest issue. Subsequent to the initial request by the PSC to the LA to provide a formal legal opinion on this issue, the response from the LA was not responsive either in substance or form. Subsequently, we provided assistance to the PSC to instruct the LA to provide a legal opinion on which the PSC could rely, as provided under its consulting agreement. Upon receipt of the requested legal opinion, we provided assistance to the PO to prepare letters to the World Bank for confirmation of the resolution of the COI issue and a letter to Transaction Advisor instruction the TA to inform bidders of the closure of the COI issue.

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- Assisted in the preparation of the "Process Letter" issued by the TA to short-listed bidders setting out the next steps of the project and requiring certain confirmations from the bidders. All four bidding consortia responded affirmatively in the set timeframe with a letter to the PSC in the required format.
 - Reviewed and provided comments and suggestions for improvement of: Draft Expropriation Legislation, Draft Resettlement Policy Document and Draft Strategic Environmental Legislation.
 - Reviewed the PO process for administering project deliverables and tracking of agreed submission schedules of the LPTAP advisors. Provided suggestions to the PO for improvements in tracking and managing the receipt, and distribution of deliverables, the subsequent preparation and circulation of comments on these documents and efficient resolution of issues emerging from these reports.
 - Provided feedback to the PO for improvement of project data management and documenting. Following the suggestions, PO is creating electronic system of shared folders with all the relevant information to be stored there. Also suggested to the PO to secure files storage outside of the Project Office for increased data security.
 - Supported PO in preparations for the 24th PSC meeting and meetings with LA, TA and EA.

Organized presentation for the PO on general concepts of PPPs with emphasis on infrastructure / energy projects. This will increase awareness of the PO staff about critical issues in structuring the Kosovo C project and the importance of proper management of the implementation process.

Accompanied Minister Ceku and key staff from MEM and the LPTAP Project Office to the Vienna Economic Forum held on November 6, 2007 in Vienna. The purpose of the trip was to present key projects of Kosovo that have regional significance for the SE Europe energy market with presentation of the Kosovo C project.

Assisted MEM, ICMM and KEK to bring to a successful conclusion the final approval and execution of the Mine Development Agreement for the Sibovc SW mine, critical both for KEK's near-term lignite supplies and the coal supply that is the essential resource underpinning the Kosovo C project.

Issues / Concerns

This complicated Kosovo C transaction requires careful review of the documents that define the deal structure and ultimately will determine the value that Kosovo will obtain for the transaction. With the change in government now going through a transition stage and the uncertainty surrounding the status issue, it becomes difficult to secure the needed attention of decision makers and keep the project moving forward.

Energy Regulatory Office

Progress / Successes

The Training Needs Analysis identified a list of principal topics and means to deliver those topics. The delivery is now well underway, though varied means. A principal component was to assist USAID and ERRA design and deliver a general training course on basics of regulation. That course was given in Prishtina in early November 2007, and attracted the desired audiences. On the first day, which was designed as a presentation of the rationale for regulation and the necessity for an independent regulator, key people from the press and Assembly, as well as wide representation of the industry attended. On the following days, the technical sessions on tariff methods, rate design issues (especially targeted tariffs for mitigating cost impacts), and market issues, were very well attended by technical professionals and senior managements from all parts of the electricity industry and government. The course delivery also specifically includes detail presentation of tariff methods that had been a specific subject of the TNA.

Also in filling the TNA, BearingPoint has begun working closely with the AUK Center for Energy and Natural Resources. The Energy Center appointed the BearingPoint ERO resident regulatory advisor to be a member also of the AUK energy center advisory board. In that capacity he is assisting the Energy Center to arrange courses on competition law (generally, and as applied to energy specifically) from a leading US anti-trust attorney, James Calderwood. That course, expected as a two-day intense competition law program, followed by a half day specifically on competition issues in energy law, is now expected for late April 2008. The Advisor is also assisting the AUK Energy Center to present courses in administrative law and procedures, by a senior United States Federal Energy Regulatory Commission attorney, also expected for spring 2008. The ERO advisor also gave an open lecture at AUK on the history and purposes of energy regulation.

Within ERO, the advisor has now developed regular dialogues with the board members and staff on principal issues of policy. On those topics where ERO has advisors sponsored by other Donors (principally, the EAR funded task assisting the ERO on tariffs and licensing policies), the advisor has developed a cooperative working arrangement with those consultants, and also, directly with the cognizant ERO staff on similar topics. This has led to encouraging conceptual development of the ERO staff and Board, by conscious education on areas where policy judgments may differ. For example, on December 18, 2007 the EAR consultancy scheduled with ERO, a special seminar on tariff issues. At that seminar, the BearingPoint advisor presented a discussion of the theoretical reasons for and practical measurement of, effects of setting tariffs below the cost of energy and of capacity. The EAR consultants, as well as ERO staff and Board, then discussed the issues openly.

The BearingPoint advisor has also established good working relationships with the USAID funded advisors assisting the KEK, and in cooperation with USAID, seeks to assure common policy positions among USAID funded advisors, especially, on tariff issues. Though the ERO is aware that USAID may have positions on technical issues related to tariffs, none the less they remain open to considering those issues, and clearly (as demonstrated by the above seminar example) engage the BearingPoint advisor in seriously considering those positions.

ERO holds a mandatory seat on the Kosovo C Project Steering Committee. The advisor has developed a working relationship with the ERO Board members responsible for Kosovo C issues, engaging in regular discussions, and developing analysis based on those discussions. With the delivery in December of the Draft Phase 1 Reports of the Kosovo C Transaction Advisor (TA), Legal Advisor (LA) and Environmental Advisor (EA), the ERO has asked the BearingPoint advisor to assess the findings and recommendations of those reports. More specifically, they have also asked the advisor to analyze the proposed transaction structure, and advise the ERO on options for maximizing the benefits to Kosovo from the transaction.

This was a critical request, since the ERO viewed the TA report, especially, as asserting the interests of the investors, not specifically those of Kosovo. While that is arguably a proper perspective for a TA contracted to assure a financial close, the fact that they have taken that position means that the representatives of Kosovo on the Project Steering Committee need a clear analytical foundation within which to assess the interests of Kosovo, and on which they can then negotiate productively in the PSC process.

Separately, BearingPoint prepared and provided to USAID an analysis of Kosovo System loads, and how those relate to system planning especially for KEK, and for KEK's possible contract with Kosovo C. USAID scheduled a meeting with the USAID advisors to KEK, on their views of the strategies assumed in that analysis. In that meeting, the KEK advisors presented an additional possible strategy, and the BearingPoint advisor revised the loads analysis to include consideration of that strategy as well. BearingPoint is now using the results of that analysis as the background for development of comment to ERO on the Kosovo C TA, LA and EA Reports.

Finally, as part of the conduct of the above tasks, Bearing Point develops Excel models of aspects of the power sector. A key model of that sort which we are developing is a model capable of assessing scenarios of dispatch of the South East Europe regional wholesale power supply market, and of the role of Kosovo (and Kosovo C) in that market. We have now developed a working version of the model, and are starting to generate different scenarios, to understand practical implications of specific possible actions. The concept of the model is somewhat similar to, and uses some of the same data as, the "GIS" capacity expansion model used for the Athens Forum. But while that model concentrates on addition of units and time horizons, the BearingPoint model much more easily allows to compare the overall results of particular market structures or specific change in market operations. We expect to be able to begin making practical use of that model for supporting the ERO, starting in the first quarter of 2008.

It is expected that the next Kosovo C PSC meeting will occur in January, at which meeting the ERO may take a more active part in discussing the interests of Kosovo as affect the contracting structure for the Kosovo C project.

Issues/Concerns

In the first Quarter of 2008 the ERO will review a retail distribution and supply tariff application by the public electricity supplier, KEK. In the past, the ERO has been reluctant to allow full cost recovery, for fear of public and other political reaction. The BE advisor, by involvement in the ERO review of the tariff application will raise awareness by ERO of the necessity for allowing full cost recovery (and the

consequences if ERO should not do so). The advisor BearingPoint will also help educate the public (and other political authority) on the necessity of proper cost recovery, by assisting ERO to write comments explaining its actions when it issues the next tariff order, and assisting USAID to prepare materials for public distribution via the media. Establishing ERO credibility as a proper agent for cost review also supports the Kosovo C process, by encouraging investors that their eventual supply-sales contracts to KEK could be paid.

3. Problems Encountered, Status and Proposed Solutions

Objective	Problem/Issue	Mitigation Plan	Status
All	Uncertainty with new incoming government regarding their support for a number of initiatives, such as the future role of an Adviser in OPM, Airport Concession, Kosovo C, PPP unit, Property tax..	Developed a detailed set of incoming government briefs to educate on policy initiatives, their benefits and status. Use in conjunction with verbal presentations	Await new Government to be formed
1.1 Economic	Disagreement with the IMF on Capital spending Budget	Continue to produce coherent MTEF	Informed debate to continue next IMF Mission
1.1 Economic	Draft Pensions Law unaffordable, economically poor	Advise PM and Minister of MFE against its adoption	Resolved
1.1 Budget	Delayed enactment of 2008 Budget due to elections	Continuous Resolution in force, advice new government to quickly pass Budget	Await new government to be formed
1.1 Budget	Budget organizations have routinely under spent available funds for capital projects	Encourage Budget Organizations to begin preparing for capital projects, even prior to enactment of Budget. Establish working groups to understand problem of under spending.	In progress
1.1 Treasury	Minister of Finance relationship with Treasurer is problematic	Consistent advice to Minister on the legal authority of Treasury. Continue to try and develop working relationship through business meetings	Close to resolution with change of Government
1.1 Budget, Property Tax, Intergovernmental and Budget	Skills in municipal property tax, budget at the local and central level with the change in government with potential turnover of civil service	Open dialogue with the newly elected officials, explain the importance of where we have come from and encourage retention of skills. Develop training program for potential change	Await new Government to be formed
1.1 Tax Administration	Removal of Director will result in an individual being appointed requiring substantial mentoring and development.	When new director appointed, jointly establish an individual development plan	To be implemented when new director appointed
1.1 Tax Administration	MIS development is the key to improving resource utilization and management oversight. IT staff are depleted and lack ability to	Provide an expert in Oracle to assist with the development and programming of reports, as well as	Assistance scheduled in February

	meet the demands of programming changes	migration of certain reports to web-based programs	
1.1 Tax Administration	Accounting skills are weak and instructions need to be more client friendly.	An MOU with SCAAK, which provides for increased cooperation between SCAAK and TAK in developing forms, instructions, and procedures, in addition to partnering with TAK on training programs	In place
1.1 Tax Administration	Tax compliance with some international organizations is impeded by the sometimes hasty departure of individuals from Kosovo.	An MOU with Border Police to assist in preventing the departure from Kosovo of individuals who have not satisfied their tax obligations, which should have a significant impact on compliance.	In place
3.0 Airport Concession	Concerns about legal encumbrances over airport commercial activities that will preclude a master concession	Seek agreement from the PIA and Government to approve "safeguard clauses" for all commercial contracts	In progress
3.0 KTA	Special chamber decision threatening privatization program	Submit amicus curiae brief to Special Chamber	Under development

4. Success Stories

Economic 1.1: Development and passage of Medium Term Expenditure Framework (MTEF). This was a major achievement during the quarter and has met with approval from the World Bank, European Commission, Donors and importantly the PISG. The two volume MTEF document serves as an excellent example of a high quality product that embodies full ownership by the Government of Kosovo as well as the support and approval of the wider international community. It compares more than favorably with any similar exercise in either Balkan or central European countries.

Energy 4.0: The final resolution of complicated issues related to the Sibovc SW mine through the execution of a Mine Development Agreement between KEK and ICMM represents the successful accomplishment of two important goals for the Kosovo energy sector: 1) assurance of an uninterrupted fuel supply for Kovovo A and B generating stations, and 2) the avoidance of any obstacles to the Kosovo C investor's need to a secure lignite supply for the proposed new 2000 MW power plant. Open communication and persistent dialog among the parties proved to be the winning combination that produced a win-win outcome for Kosovo's future.

5. Major Upcoming Activities

Objective	Upcoming Activity	Counterpart(s)	Planned Dates
1.1. Economic	Donor coordination meeting	Prime Minister / Minister of Finance and Economy	Second quarter 2008
1.1.Economic	Release 2008 Budget Book	Budget Departments and organizations	March 2008
1.1 Budget	Release revised 2009-2011 Medium Term Expenditure Framework (MTEF)	Budget Department, Macro Department	April 2008
1.1.Treasury	Release of Financial Statements for 2007	Treasury / Budget Organizations	31 March 2008
1.1 Treasury	Launch the new UNIREF system for revenue collection	Treasury	2 January 2008
1.1 Property Tax	Launch tender for the COTS property tax system.	SIDA and MFE Property Tax Office	4-18 February 2008
4.0 Energy Regulatory	KEK Retail Tariffs and KOSTT Transmission Tariff filing, review and approval	ERO	End of March 2008