



Kosovo Business Finance (KBF) Project

Quarterly Report

USAID Contract No.
167-C-00-01-00106-00

Submitted by:
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Submitted to:
USAID

June 1 – August 31, 2003



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1.0 EXECUTIVE SUMMARY

The Kosovo Business Finance project has been in operation for nearly two and a half years. Since the initial start of the project, much progress has been made to realize the project goals and objectives. This report summarizes our activities and overall progress for the quarter of June 1 – August 31, 2003. It is provided in accordance with the Section C, Benchmarks, and Section F.4, Technical Reports, of the Contract for Services No. 167-C-00-01-00106-00 (“the Contract”).

1.1 Project Background

On 10 May, 2001 Deloitte Touche Tohmatsu Emerging Markets, Ltd. (DTTEM) and the United States Agency for International Development (USAID), through its Regional Contracting Office (RCO), signed contract 167-C-00-01-00106-00 for the implementation of the Kosovo Business Finance Project (“KBF” or “the Project”). The KBF is the second component of the Kosovo Employment Generation Program (“KEG”) under implementation by the USAID/Kosovo Mission.

The purpose of the KBF is to:

1. Support the recovery and revitalization of small and medium enterprises (SMEs) in Kosovo by providing a quick response SME credit facility (“the Loan Production Unit” or “LPU”);
2. Establish a full-service bank (“the Bank”) to mobilize deposits and provide other financial services to SMEs in Kosovo; and
3. Provide technical assistance to develop the financial analysis and management capability of bank professionals locally to assure post-Project sustainability.

The KBF will support USAID/Kosovo’s Strategic Objective 1.3 - Establishment of a Market-Oriented Economic Policy and Institutional Framework. The explicit focus of the program will be on stimulating employment and increasing private investment in the SME sector, thereby supporting the rapid and sustainable recovery of living standards for the Kosovar population.

1.2 Progress Summary

The following points summarize the progress achieved during this period for the Raiffeisen Bank Kosovo in the area of operations and in the SME loan program. Due to the sale of the remaining shares of the Raiffeisen Bank Kosovo, USAID/KBFF and Deloitte’s activities in the bank ceased as of July 10, 2003. Therefore, although this report period did not end until August 31, 2003, there are no figures on the lending and deposit targets for the month of August. Activities for the Kosovo Business Finance Fund and the Kosovo Business Finance project are also highlighted below.

Raiffeisen Bank Kosovo Activities

Deposits gathered: By July 31, 2003, RBKO’s deposit level has increased to approximately 70 million Euros. RBKO continued to hold strong with the second largest market share for deposits in Kosovo.

Loans approved: During this period (through July 10, 2003), the credit committee approved a total of 230 new loans. Since project inception, the credit committee has approved 2,405 loans for a total of Euro 64.6 million.

Loans disbursed: A total of 15.8 million Euros has been disbursed to borrowers during the period, for a total of 64.6 million Euros since project inception.

Loans in arrears: According to the credit administration team, as of July 31, 2003, 1.80% (Euro 0.67 million) of loans were in arrears (more than 60 days past due), which fell within the performance benchmark of 3.0% arrears. Of the total outstanding portfolio, 2.60% (Euro 1.0 million) of the loans were reported as being more than 30 days past due on all or a portion of their payments.

Jobs created: Since KBFF commenced lending through July 10, 2003, KBF project/ABK financing resulted in the direct creation of 5,348 new jobs or one job for every 12,069 Euro of loan volume.

Kosovo Business Finance Fund Activities

Finalized sale of shares to RIB: By the end of July, the team had finalized the sale of the remaining shares of the RBKO to RIB. As such, USAID/KBFF have fully divested of all banking and lending activities at RBKO.

Transferred delinquent loans: KBFF transferred ownership of its four delinquent loans to RBKO as part of the share sales transaction and has no more responsibility for collecting on these loans.

Kosovo Business Finance Project Activities

Potential change in scope of work: As a result of the decision to sell the remaining 24% shares of RBKO, USAID decided to change the scope of work under the project to encompass an educational endowment fund. The project management team has done some preliminary research on this. Further discussions on this proposed change in scope of work will take place over the next couple of months.

Close out of banking and lending component: During the month of July, the project management team closed out the banking and lending components for the KBF project.

Demobilization of expatriates: As part of the component closeout, Deloitte demobilized all remaining consultants working at the RBKO by July 10, except Alan Pieper who will continue to provide some short term assistance.

1.3 Outstanding Issues and Concerns

We will continue to work with USAID on a daily basis to inform of important issues, concerns, and/or developments that arise in the course of our work. In addition to updates during the period, there are more general issues and developments that we would like to highlight in this report that may have a bearing on performance and/or give rise to new challenges in the future. These are summarized as follows and explained further in Section 6 of this report.

Contract modification: Deloitte has been working in coordination with USAID/Kosovo to review USAID's Concept Paper on the education trust presented and is prepared to respond to the potential change in the scope of work under the contract. However, we have still not received official notification via a contract modification from the contract officer addressing this issue. Once we receive this, we will be able to move forward.

Accountability to current targets and benchmarks under the project: As there has not yet been a contract amendment, Deloitte is still accountable to the benchmarks and targets for the KBF project as they were revised in May 2002. Since we no longer have staff at the RBKO, this is of great concern. Therefore, it is important that USAID determine new benchmarks based on the new scope of work and notify us of them, or explore options to revise the nature of the contract.

2.0 RAIFFEISEN BANK KOSOVO

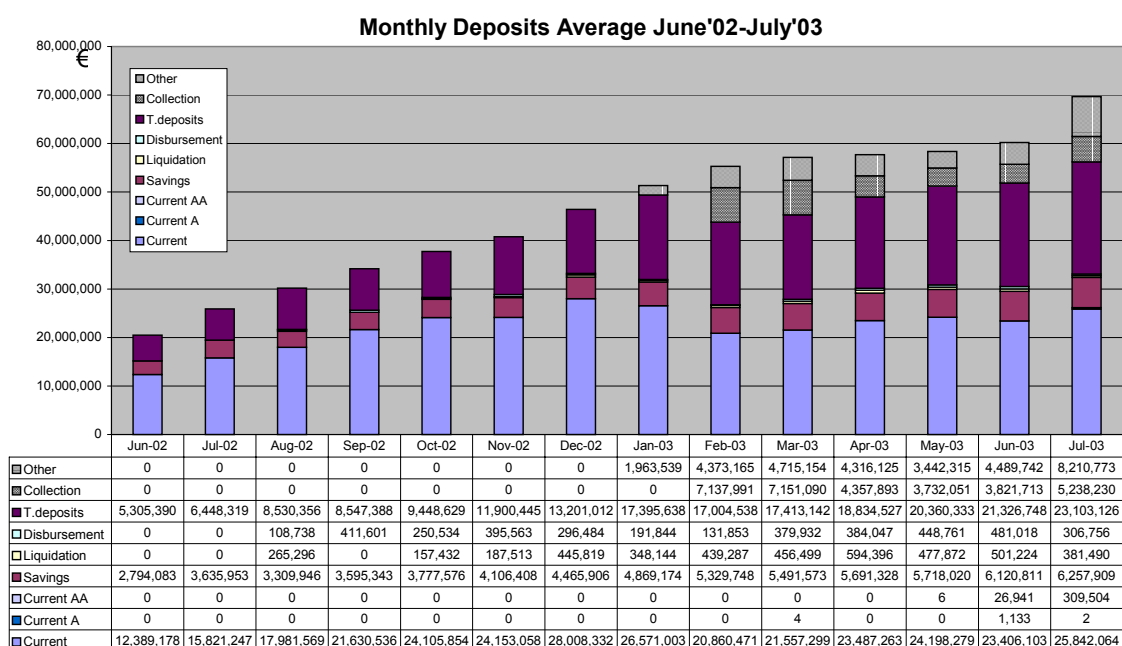
As part of the Kosovo Business Finance Project, the team established and effectively managed a full-service bank aimed at mobilizing deposits and providing other financial services throughout Kosovo. Once the bank was established, the team located a private investor to take over majority ownership from the Kosovo Business Finance Fund (KBFF), an NGO established under the KBF project representing USAID's interest in the bank. On December 10, 2002, the KBFF and Raiffeisen International Beteiligungs AG (RIB) signed the "Sales and Purchase Agreement" whereby RIB purchased 76 percent of the Raiffeisen Bank Kosovo's (RBKO) capital stock. USAID, through the KBFF, continued as a 24 percent shareholder. In July 2003, RIB purchased KBFF's remaining 24 percent interest in the Bank, divesting KBFF/USAID of any involvement in the bank and ensuring sustainability of RBKO in Kosovo. As a result, USAID no longer has any involvement in the operations or oversight of RBKO.

2.1 Bank Operations

USAID/KBFF and Deloitte still owned a minority share of the ABK/RBKO through July 10, 2003. Therefore, this section will provide an overview of the progress made during this period on the deposit and lending benchmarks established for the bank under the KBF project. As USAID/KBFF and Deloitte's involvement in the RBKO ceased with the sale of the remaining shares of the bank, no figures are available for the month of August.

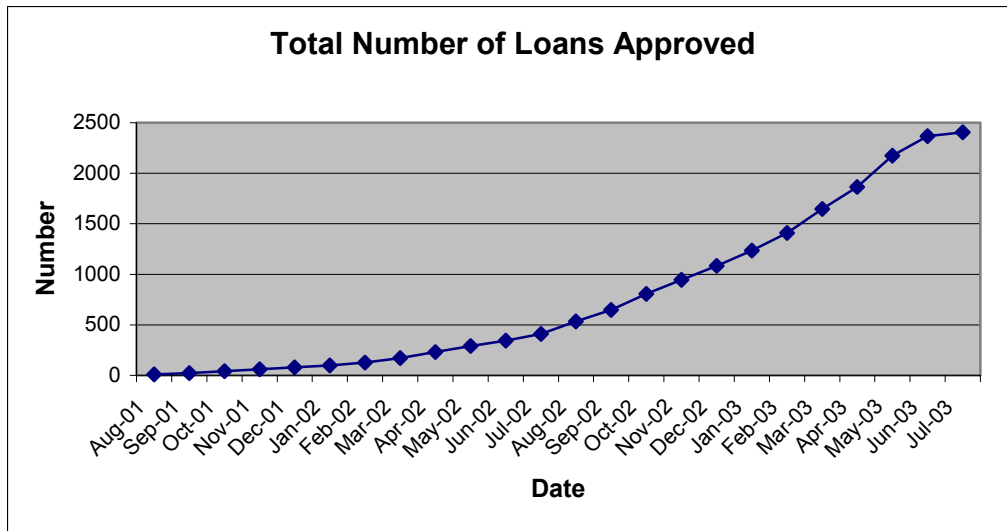
Level of Deposits

During the month of July, RBKO's deposit levels rose to approximately 70 million Euros. RBKO continued to hold the second largest market share in Kosovo and is expected to maintain this position throughout the year.



2.4 Lending Activity

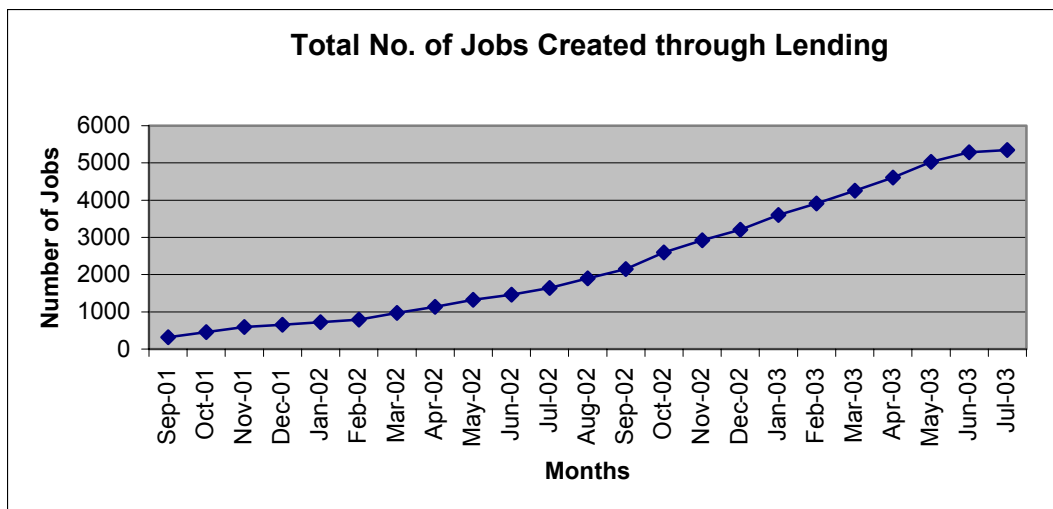
The Lending Unit approved 230 SME loans from June 1 through the first ten days of July, bringing the project-to-date loan approvals to 2,408 loans. As USAID/KBFF and Deloitte were no longer a part of the bank after July 10, no figures are available for the remainder of this period. The chart below details the number of loans approved since the KBF project began lending in August 2001 through USAID involvement in the RBKO.



The average loan size in the portfolio was approximately 28,000 Euros for a term of approximately 15 months. The average new loan amount and term slowly increased as the team continues to diversify the portfolio.

Employment Generation

The chart below shows the number of jobs created in Kosovo through the lending program since the start of the project. As of July 10, 2003, it is estimated through surveys conducted of loan



applicants, financing through the lending program will result in the direct creation of 5,348 new jobs or one job for approximately every 12,069 Euro of loan volume. If we use the figure of 5,000 DM (or approximately EURO 2,500), equates to one new job (as stated in the KBF RFP), then the number of jobs created is 25,800 (64.6 million EURO approved for disbursement as of July 10 divided by 2,500).

Targeted Lending

In accordance with the Project goals for employment generation and economic stimulation, the lending priority is to finance businesses engaged in labor-intensive manufacturing and production activities. Consistent with this objective, approximately 10% of the loans granted during the period were in the Agricultural sector. Of the 2,408 loan applications that were approved by the project to date, 52% are in the manufacturing/production industry sector, 15.8% are in the service industry sector and 32.2% are engaged in pure trade. A detailed breakdown of the loan portfolio by industry sector is shown on the following page.

Industry Concentration

As of July 10, 2003

Industry Sector	Amount		# of loans	
		%		%
1. Manufacturing+Production	34,327,852.68	53.2	1252	52.0
Manufacturing/ Wood	6,294,654.19	9.8	249	10.3
Metal Fabrication	1,633,093.03	2.5	61	2.5
Glass Production	228,600.00	0.4	15	0.6
Textile/ Aparent	1,521,233.41	2.4	75	3.1
Printing/paper products	1,242,122.54	1.9	41	1.7
Hygienic Production	814,680.87	1.3	19	0.8
Plastics	1,479,195.99	2.3	58	2.4
Pharmaceuticals	394,777.51	0.6	14	0.6
Soft Drinks products	433,867.95	0.7	17	0.7
Food	5,885,149.96	9.1	216	9.0
Milling Plant	1,317,266.41	2.0	32	1.3
Construction	8,473,325.39	13.1	284	11.8
Electrical	331,532.75	0.5	8	0.3
Farm/Fish, Eggs	2,382,630.00	3.7	113	4.7
Other	1,895,722.68	2.9	50	2.1
2.Trade	23,412,009.75	36.3	776	32.2
Fertilizer distribution	260,884.21	0.4	5	0.2
Food distribution	655,666.27	1.0	28	1.2
Retail	22,495,459.27	34.9	743	30.9
3.Services	6,806,933.58	10.5	380	15.8
Hotel/Restaurants	2,476,387.94	3.8	150	6.2
Professional services	4,330,545.64	6.7	230	9.6
Total	64,546,796.01	100.0	2408	100.0

The lending team focuses on visiting clients within Prishtina as well as throughout all of Kosovo, including the Serbian enclaves. Of the 2,408 loans approved, 16.6% are to borrowers within the Prishtina municipality, 14% in Prizren, 8.3% in Ferizaj and 4.5% in Mitrovica municipality. The

following chart shows a detailed breakdown of the geographic concentration for all loan clients throughout Kosovo.

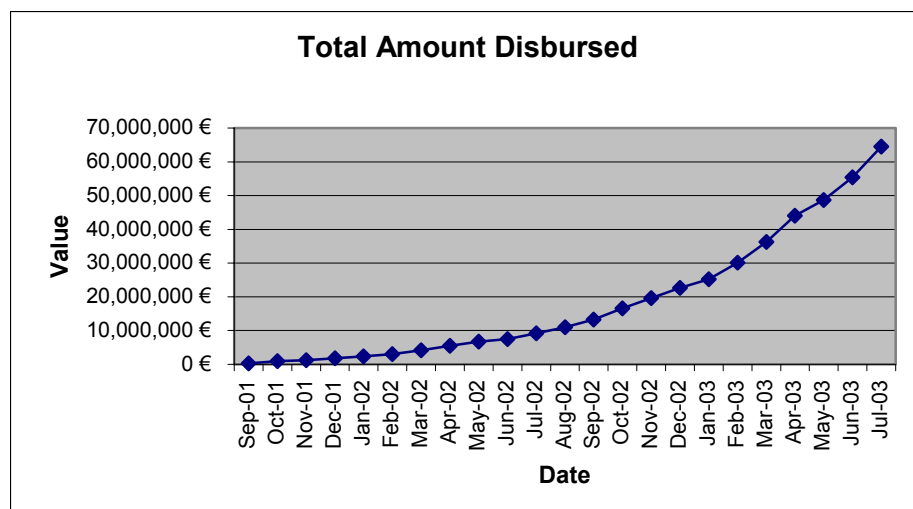
Geographic Concentration

As of July 10, 2003

Municipality	Amount		# of loans	
		%		%
Decan	719,580.99	1.1	31	1.3
Dragash	69,500.00	0.1	5	0.2
Drenas	699,364.59	1.1	37	1.5
Ferizaj	5,769,671.83	8.9	199	8.3
Fushe Kosove	651,413.79	1.0	24	1.0
Gjakove	4,436,948.11	6.9	241	10.0
Gjilan	7,081,510.05	11.0	235	9.8
Istog	1,085,022.53	1.7	50	2.1
Kacanik	498,600.00	0.8	16	0.7
Klina	256,550.00	0.4	16	0.7
Kamenice	912,400.00	1.4	48	2.0
Leposaviq	293,314.00	0.5	34	1.4
Lipjan	1,129,232.54	1.7	38	1.6
Malisheve	707,022.63	1.1	29	1.2
Mitrovica	1,823,093.55	2.8	109	4.5
Peje	6,032,876.95	9.3	249	10.3
Podujeve	825,462.88	1.3	38	1.6
Pristine	17,600,287.63	27.3	399	16.6
Prizren	9,398,550.70	14.6	337	14.0
Rahovec	612,625.84	0.9	32	1.3
Shtime	457,784.21	0.7	10	0.4
Skenderaj	193,448.13	0.3	15	0.6
Strpce	263,610.00	0.4	26	1.1
Suhareke	819,450.84	1.3	34	1.4
Viti	702,495.00	1.1	32	1.3
Vushtri	476,495.22	0.7	29	1.2
Zvecan	860,704.00	1.3	77	3.2
Zubin Potok	169,780.00	0.3	18	0.7
Total	64,546,796.01	100.0	2,408	100.0

2.5 Disbursements

As noted in the following chart, a total of 64.5 million Euros has been disbursed to RBKO borrowers since the beginning of the KBF project. During the quarter, the team disbursed a total of 15.8 million Euros.



2.6 Portfolio Performance

According to the credit administration team, by July 31, 2003, 1.80% (Euro 0.67 million) of loans were in arrears (more than 60 days past due), which fell within the performance benchmark of 3.0%. Of the total outstanding portfolio, 2.60% (Euro 1.0 million) of the loans were reported as being more than 30 days past due on all or a portion of their payments.

3.0 KOSOVO BUSINESS FINANCE FUND

The Kosovo Business Finance Fund (KBFF) was established under USAID funding as a non-profit organization to aid in the reconstruction and economic development in Kosovo by encouraging lending activities, particularly to borrowers that are small or medium size businesses. In November 2001, the KBFF, along with RIAS, established the American Bank of Kosovo (ABK), later changed to Raiffeisen Bank Kosovo, to further its lending objectives. With the sale of the remaining 24% of shares of the Bank to RIB in July 2003, KBFF no longer maintains any ownership in the ABK/RBKO. Therefore, KBFF, at the direction of USAID, is considering changing its mandate to be able to provide funding for an educational trust to bring Kosovars to the US to pursue business/financial related masters degrees. Currently, Deloitte is still in discussions with USAID/Kosovo to determine next steps to make this happen.

3.1 Sale of Interest in RBKO

While owner of 24% of the shares of Raiffeisen Bank Kosovo (RBKO), KBFF served as the representative of USAID to ensure that the goals of the KBF project were met through the lending activities conducted at the bank. As the structure and demands of the RBKO have changed since the closing of the initial sale of 76% shares to RIB, USAID determined that it would be best for KBFF to become involved in other initiatives. Therefore, in May, KBFF submitted notification to RIB detailing the intent to sell its 24% interest in the RBKO. USAID, RIB, KBFF, Deloitte and RBKO began discussing the logistics of the sale in June. The sale was finalized in July 2003, divesting KBFF/USAID of any interest in the RBKO.

3.2 Indemnity Account

As part of the initial efforts to integrate the KBFF lending activities into the RBKO to create a fully functioning bank, most of the loans initially granted through the KBFF were transferred over to the RBKO. After the sale of shares to RIB, an indemnity fund of USD 1 million was created to cover the existing loan portfolio for any loan losses over 0.75% per annum. Once the sale of the remaining 24% shares of RBKO was finalized, the funds maintained in the indemnity account were transferred to KBFF.

3.3 Portfolio

All four of the loans owned and managed by KBFF were transferred over to the RBKO as part of the sale of shares.

4.0 PROJECT MANAGEMENT

Project management staff continued to support the Kosovo Business Finance project from Washington DC as needed. During the month of June, the focus was on demobilizing the expatriate staff, closing out the banking and lending components of the project, and commenting on the new scope of work being proposed under the project. During the months of July and August, the focus was on responding to the concept paper presented outlining the new scope of work being proposed under the project. The team has researched several different options for advertising an RFA and has also presented another means for which the project objectives could be met. We understand the Mission's current preference for an RFA and how this would work, but we would also like the Mission to consider that Deloitte be allowed to implement this revised scope of work through the Kosovo Business Finance Fund (KBFF). However, we are fully prepared to issue the RFA, should USAID/Kosovo maintain that this is the way they would like to pursue implementation of the stated objectives. Further discussions on this will take place over the next few months, once we receive a revised scope of work on the project from the Contracts Officer.

The following sections provide a summary of some of these major project management issues that were addressed during the quarter.

4.1 Staffing

Project management staff finalized the demobilization of 7 expatriate staff members from the project by July 10, as requested by USAID, to facilitate the sale and transfer of the remaining 24% shares of RBKO owned by KBFF, USAID's representative. Discussions were held with each of the seven staff members in July to determine their needs and terms for their dismissal. USAID agreed to provide compensation for demobilization and transition costs, as needed for each consultant. Most of the consultants will continue to work in their current positions with RBKO, contracted through RZB, for a short duration, until local staff can be trained to take on their responsibilities. This allowed USAID and KBFF to completely divest of any involvement in the RBKO.

Alan Pieper, former COP, remains on the project payroll as short-term technical assistance to assist in any outstanding issues that need to be addressed in the closeout of the banking and lending components of the project. In July, Mr. Pieper assisted USAID in negotiating the final sale of shares to RIB. He also worked with the team to closeout the banking and lending components of the project. During the month of August, he was not in Kosovo. However, Mr. Pieper plans to return in September to continue to address some project close out activities for the banking and lending components. Veronica Gilbert will continue to act as Chief of Party when Mr. Pieper is not in Kosovo.

As of July 10, Deloitte no longer employs anyone working at RBKO under the KBF project.

4.2 Budget

A budgeting system has been developed that tracks the budget across various cost categories for the project. In the table below, the actual expenses incurred to date are outlined.

Estimated Kosovo Business Finance TA (CLIN 1)

	Year 3		Estimated		Estimated	
	Budget (5/10/2003- 5/10/2004)	Year 3 Quarter 1 (5/10/03-7/26/03)	August (through 8/23)	September (through 9/20)	Cumulative Amount - Year 3	Burn Rate
Salaries	\$ 1,052,657.03	\$ 200,287.16	\$ 7,974.21	\$ 8,000.00	\$ 216,261.37	20.5%
Fringe	\$ 95,673.98	\$ 24,030.97	\$ 615.51	\$ 1,000.00	\$ 25,646.48	26.8%
Overhead	\$ 871,290.12	\$ 170,374.37	\$ 6,709.01	\$ 6,750.00	\$ 183,833.38	21.1%
Travel	\$ 190,411.03	\$ 14,716.15	\$ -	\$ 1,000.00	\$ 15,716.15	8.3%
Allowances	\$ 353,138.35	\$ 111,828.16	\$ 515.00	\$ 1,000.00	\$ 113,343.16	32.1%
Other Direct Costs	\$ 119,854.82	\$ 12,006.08	\$ 85.94	\$ 500.00	\$ 12,592.02	10.5%
Subcontractors	\$ 250,000.00	\$ 149,131.94	\$ 33,563.59	\$ -	\$ 182,695.53	73.1%
General & Administration	\$ 230,509.14	\$ 54,589.99	\$ 3,957.06	\$ 1,460.00	\$ 60,007.05	26.0%
Base Fee	\$ 62,238.50	\$ 14,739.30	\$ 1,068.41	\$ 394.20	\$ 16,201.91	26.0%
Totals	\$ 3,225,772.97	\$ 751,704.11	\$ 54,488.73	\$ 20,104.20	\$ 826,297.04	25.6%
Award Fee	\$ 500,616.00	\$ 323,096.00			\$ 323,096.00	64.5%
Total Value for Clin 1	\$ 3,726,388.97	\$ 1,074,800.11			\$ 1,149,393.04	30.8%

The chart also presents a projection of project costs through September 2003 as compared to the Year 3 budget for the project. As is noted, through September 20, 2003, the burn rate is expected to be at approximately 30.8% of total budgeted costs for Year 3, which is below original projections. Given the change in scope of work proposed under the project, it is expected that the original budget will change. Therefore, once an official contract modification is received, the budget may need to be realigned to more accurately reflect projected costs for the implementation of the new tasks outlined in the revised scope of work.

Obligated Funding

During the month of August, USAID obligated \$150,000 more to the project to cover the costs incurred under the project. Since we have not yet received a contract modification, it is expected that we will need to request additional funds during the month of September to be in compliance with FAR 52.232-22 (Limitation of Funds) and until the new scope of work is finalized.

The burn rate through September 20, 2003 in relation to the total contract budget for each of the three CLINS under the contract is highlighted in the following chart. Currently, we have burned 78% of the budget for CLIN 1: Technical Assistance, 41% of the budget for CLIN 2: Loan Funds, and 100% of the budget for CLIN 3: Bank Startup Costs. As mentioned above, once the contract modification is issued, these figures may change, with the realignment of the budget.

	RE-ALIGNED	EXPENDITURES		OBLIGATED**		CONTRACT
	Total Contract Value (Yr 1 - Yr 3) As per Mod #9 8/15/02*	Total Expended Year 1, 2 and 3 (thru 9/20/03)	Burn Rate	Total Obligated (thru 8/23/03)	Burn Rate	Total Remaining (thru 5/10/04)
CLIN 1	\$ 12,859,173.00	\$ 9,969,799.07	78%	\$ 8,419,310.00	100%	\$ 2,889,373.93
CLIN 2	\$ 12,060,887.00	\$ 5,000,000.00	41%	\$ 5,000,000.00	100%	\$ 7,060,887.00
CLIN 3	\$ 4,098,690.00	\$ 4,098,690.00	100%	\$ 4,098,690.00	100%	\$ -
	\$ 29,018,750.00	\$ 19,068,489.07	66%	\$ 17,518,000.00	100%	\$ 9,950,260.93

*Listed CLIN 1 total does NOT include award fee not obtained in prior award fee periods

**This amount includes only funds obligated from USAID and does not include any funds from the proceeds of the sale of ABK shares. Per agreement with USAID Budapest, approved project costs after all obligated funds are expended will be paid using the sales proceeds, until additional project funds are obligated to CLIN 1.

Total Estimated Costs Paid through Bank Sales Proceeds (11/17/02 - 3/8/03) \$ 1,551,096.02

With regards to obligated funds for the KBF project, as discussed with USAID during the budget modification period, Deloitte expended the initial total amount obligated for CLIN 1 by December 2002. In coordination with USAID, Deloitte set up a system to have the proceeds from the sale of ABK shares cover any project related costs, until more funds were obligated by USAID. The amount charged to the bank sales proceeds for the periods from November 17 through March 8, 2003 is also listed above.

4.3 Contract Administration

Three contract modifications were issued during the quarter. During the month of June, Contract Modification #13 was issued, granting \$750,000 more in obligated funding to the project. Contract Modification #14 followed during the month of July, granting \$250,000 more in obligated funding to the project and Contract Modification #15 was issued during the month of August, granting \$150,000 more in obligated funding to the project.

4.4 Proposed Revision to Scope of Work

On May 29, 2003, project management staff had a conference call with USAID to discuss the future of the KBF project. It was proposed by USAID to change the scope of work under the contract to encompass an Educational Endowment Fund to send Kosovars to the US to study. This would involve closing out the banking and lending component and focusing on the development of this Fund. The reasons given for changing the scope were so that USAID could try to mitigate risk, maintain value under the contract, and minimize the management requirements for the project, as it was intensive for the amount of shares owned by KBFF. Deloitte Touche Tohmatsu Emerging Markets has reviewed the initial concept paper for the Kosovo Education Trust and is fully prepared to implement the program by issuing an RFA, should this be the preferred method of implementation.

During the month of July, Deloitte Touche Tohmatsu Emerging Markets reviewed the initial concept paper for the Kosovo Education Trust. Our team has conducted substantial research and planning regarding the implementation of such an activity. We have laid out proposed steps, put together a timeline, contacted individuals who could provide the necessary expertise, gathered information on entities in the US that would be instrumental to an education exchange program, and discussed contractual matters that would have to be taken into consideration for

implementation. We realize that the Education Trust is a priority of USAID/Kosovo and we look forward to working with the mission on it over the course of the next few months so that we can make the concept a reality.

5.0 OUTSTANDING ISSUES AND CONCERNS

We will continue to work with USAID on a daily basis to inform of important issues, concerns, and/or developments that arise in the course of our work. In addition to updates during the period, there are more general issues and developments that we would like to highlight in this report that may have a bearing on performance and/or give rise to new challenges in the future. Below is a short discussion of some of the major issues and concerns during the quarter.

Contract modification: Although Deloitte has been working in coordination with USAID/Kosovo to change the scope of work under the contract, we have still not received official notification from the contract officer addressing these issues. In order to be in compliance with regulations, it is crucial that we receive this written notification/approval to proceed from the contract officer before the transition is completed.

Accountability to current targets and benchmarks under the project: As there has not yet been a contract amendment issued, Deloitte is still accountable to the benchmarks and targets for the KBF project as they were revised in May 2002. Since we no longer have staff at the RBKO, this is of great concern because we do not have control over performance. Therefore, it is imperative that we discuss this issue with USAID as soon as possible to determine new benchmarks, based on the new scope of work, or explore options to revise the nature of the contract so that it is not award fee based.

6.0 WORK PLAN FOR NEXT QUARTER

During the next quarter, the team will focus on gathering further information on the implementation on the proposed new scope of work that is expected under the KBF project.