



**USAID**  
NGA POPULLI AMERIKAN  
OD AMERIČKOG NARODA



Management  
& Technology  
Consultants

## United States Agency for International Development

### Economic Management for Stability and Growth

# Quarterly Report

March 2008

**BEARINGPOINT**

Matthew Smith

Chief of Party

Contract Number

GEG-I-00-04-00004-00

---

# Table of Contents

1. Chief of Party Report .....	2
Cross-cutting Themes .....	3
2. Team Reports .....	4
Objective 1: Strengthen the ability of three economic institutions, MFE, TAK, and CBAK.....	4
Objective 1.1: Ministry of Finance.....	4
Objective 1.2: Strengthen the Capacity of TAK .....	12
Objective 1.3: Central Banking Authority of Kosovo (CBAK).....	12
Objective 2: Stimulate Trade and Investment Through Modern and Well-Implemented Commercial Laws.....	16
Objective 3: Privatize or Commercialize POEs .....	19
Objective 4: Assist Kosovo’s Energy Sector to Become More Efficient, Transparent, and Modern.....	21
3. Problems Encountered, Status and Proposed Solutions .....	29
4. Success Stories.....	31
5. Major Upcoming Activities.....	31

---

## 1. Chief of Party Report

The new Government assumed office in the quarter. In the Ministry of Finance and Economy both the Minister and Deputy Minister have quickly settled into their new positions and are making great strides in working with the project to put in place the policies and procedures necessary to strengthen the institution. Another positive thing was that all staff were retained in their positions following the appointment of a new Minister who is from a different political party than his two predecessors.

Within the Central Banking Authority we have seen the transfer of the Managing Director position of CBAK to a Kosovar, Hashim Rexhepi. Further progress in building the CBAK institution can be assured under Rexhepi's leadership who was partly groomed by this project for the Managing Director position.

Within the Kosovo Trust Agency, the Privatization of socially owned enterprises is effectively stalled following a negative decision of the Special Chamber, coupled with the announcement that Pillar IV will cease to exist on 30 June. Progress in solving the legal issues surrounding the privatization process has been disappointingly slow, but there is light at the end of the tunnel with the project now providing legal support to the Republic of Kosovo in drafting amendments to a revised KTA Law.

In the energy sector, the 3 billion Euro foreign direct investment into new electricity generation and expansion of the lignite mine (Kosovo C) has been effectively stalled since the election in November 2007. Too many priorities were placed before the new Ministerial Team, outside the critical and single most important one of attracting a 3 billion Euro investment to finally solve the energy supply problem and breathe life into the broader economy. Subsequently, the energy sector has limped along for three months without major decision or action and the opportunity for a newly independent Kosovo to quickly signal their intent to establish an environment for a market economy and welcoming FDI, a critical component to reduce unemployment and provide security to the Balkans, was not taken.

### Ministry of Finance and Economy

- **Economic** – Focus has turned to the development of the MTEF and associated economic policy statement from the Government for the June donor conference. There is a concerted effort within the project to address 'first-best' policy options such as privatization of high profile public utilities such as telecommunications (PTK), energy (KEK), the railways, and the airport. The lessons, European-wide are clear. These policy actions attract FDI and publicize the fact that a market exists.
- **Budget** – the 2008 Budget was promulgated on 29 February. Major input to the amendment of the 'locked box' laws – law on public financial management and accountability and the new local finance law.
- **Treasury** – Financial statements delivered by 31 March. Reconciliation errors were minor and non-material. Statement quality continues to improve year on year.
- **Tax** – Acting Director remains in place. Major progress in business registry, risk-based audit selection and tax academy/anti-corruption training.
- **Property Tax** – Collections suffered in first quarter due to elections. RFP for a new Property Tax system (funded by SIDA) close to release following study tour to Sweden.

- 
- **Public Private Partnerships (including Airport Concession)** – Legal basis for PPP unit incorporated in Law on Public Financial Management and Accountability. Major presentations given to Minister of Health, Education, Transport and main municipal centers. Prime Minister to issue statement of support for PPP's early April.

**Central Banking Authority of Kosovo** – the Managing Director of CBAK has been officially transferred to a Kosovar, Hashim Raxhepi. Basel Core Principles assessment was very satisfactory with no surprises.

**Commercial Law** – One of the busiest quarters with a massive undertaking in drafting revised Law on Public Financial Management and Accountability; Local Finance Law, Law on Kosovo Trust Agency, and Law on Publicly Owned Enterprises. In addition, the Project Team undertook the rapid development of the first three legal trainings and the appointment of a project lawyer to the Office of the President.

**Kosovo Trust Agency** – Privatization remains stalled following an adverse decision of the Special Chamber; the (late) appointment of new non-government representatives to the KTA Board and the winding down of Pillar IV which will cease 30 June. Brezovica ski resort was re-launched.

**Mines and Energy** –Notwithstanding introductory comments, significant work was undertaken to have the Transaction, Legal and Environment advisor reports in a ready format for decision at a PSC meeting and the drafting of the key energy legislation is close to final.

**Energy Regulatory Office** – the decision on tariffs was made during the quarter and KEK received nearly all the revenue base it requested. The ERO has gone through the process in a professional and transparent manner.

## **CROSS-CUTTING THEMES**

**Corruption** - The Anti-Corruption/Anti-Fraud training program continued during the quarter. The program is due to be completed in mid-June.

**Human Capacity Development**– Apart from the technical training identified within this report approximately one hundred and five (105) tax administration professionals continue to participate as learners in a long term training program that develops their professional public administration skills. An on-going Professional Development program with approximately 26 managerial students is also underway as is a Professional Leadership school.

**Gender** –A mid project assessment is planned to measure progress achieved.

**Administrative** - Ed Nolan left the project in the quarter and was replaced with Noble Franson in the CBAK. Mines and Energy resident advisor Amr Ibrahim arrived as did a short term legal advisor Vesa Lappalainen to complete the energy laws; Kris Kauffmann returned short term to assist the institutionalization process in the MFE; a short term IT advisor Josh Aslett, arrived to assist TAK; and, our new resident advisor for the Pristina Airport Concession, Chris Hanson will arrive April 7.

---

## 2. Team Reports

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

#### **Objective 1.1: Ministry of Finance**

##### **Economic**

A new democratically elected Government declared Independence on 17 February. The new Government has therefore a mandate to introduce and own policies that will take Kosovo forward to a new level of development and place the economy on a path in the direction of eventual EU accession. Underlying growth of about 3 per cent must be at least doubled if job creation is to occur and a serious inroad into reducing unemployment is to be made. The challenge is to help identify, develop and support those policies that will realize these objectives.

Over the past eight years, much has been achieved in fiscal policy and institution building which is well documented. By far the most important weakness however, has been the lack of serious initiatives that will contribute towards generating the growth process. There has been an observed failure to address 'first-best' policy options such as privatization of high profile public utilities such as telecommunications (PTK), energy (KEK), the railways, and the airport. Status bears only some responsibility. The lessons, European-wide are clear. These policy actions attract FDI, open and publicize the fact that a market exists. SME development follows with job creation.

The value to Kosovo at this point in time in opening up key sectors such as industry, mining, trade and agriculture cannot be underestimated. The latter currently employs either directly or indirectly up to 50 per cent of total employment. At the same time energy, encouraging private sector involvement in the POE's, extending where appropriate to full privatization will be continuing priorities. The same potential for private/public sector finance applies to other areas such as schools, hospitals and transport.

##### **Progress / Successes against the Work Plan**

As a first step in the Medium-Term Expenditure Framework (MTEF) process, a presentation on government priorities was prepared for the Finance Minister. The presentation to donors in Brussels was well received. Subsequently, a pared down version was given to donors in Prishtina, and the Government accepted those priorities.

A draft of the Macro-Fiscal Framework of the MTEF has been completed, but it is contingent on Government macroeconomic policies, which the Government should firmly decide on, and should be discussed with the IMF.

The 2007 Macroeconomic Bulletin has been completed. An innovation of this edition is that a number of leading businesses in Kosovo were interviewed.

---

A working paper describing the macroeconomic model of Kosovo that is in use by the Economic Policy Department is being completed.

The Ministry of Finance and Economy has started to restructure the old Macroeconomics Department into a larger Economic Policy Department, which will ultimately have significantly greater responsibilities and scope of work.

Other activities not included in the Work Plan

A working group has been set up in the Office of the Prime Minister (OPM) to provide advice on the Donors Conference to the Prime Minister and Finance Minister.

One element of the platform that the Government was elected on was change to tax policy so as to improve the competitiveness of Kosovo in the region. A short term BearingPoint tax policy expert produced a Report for the Minister that recommended the creation of a tax policy working group. This has been set up and has completed a first draft of a report that contains alternative options for policy change.

The Administrative Instruction governing the AUK scholarship program has been rewritten and signed, and the new program is being negotiated with AUK.

Issues / Obstacles

Nothing of significance in the capital Budget for 2008 has been implemented and at the time of reporting, the balance on Government account in the CBAK is well in excess of Euro 460 millions.

Central co-ordination in the OPM is unclear. The PM has adopted a remote style and unlike his predecessors has appointed hardly any formal advisers.

---

## **Budget / Intergovernmental**

### Progress / Successes against the Work Plan

As envisaged in the Annual Work Plan Budget Department commenced the development of updated MTEF document for the period 2009 – 2011. Advisors assisted the Central Budget Director in taking over from the Macroeconomic Department the responsibility for the MTEF development, preparing necessary procedures, and managing timetable. Timetable for setting priorities and ceilings was adjusted to meet the annual budget schedule.

The Central Budget Department was responsible for developing the Sectoral Strategies. The Central Budget Director has taken the lead on sending instructions to Budget Organizations and arranging and staffing meetings between the lead Ministries on the various sectors and the Minister of Finance, and was personally visiting Ministries with staff and the advisor to emphasize the importance of Kosovo ownership of the process and the product. Budget analysts have provided background material to the Minister and Deputy Minister (who headed the MFE working group on the MTEF), and the Department was providing periodic updates on the progress.

The Municipal Budget Department commenced its annual training program for municipal officials. During the reporting period, two regional training forums were organized in cooperation with the OSCE and USAID/EMI project, and were completed in February and March. Project advisors provided assistance to municipal representatives in the following areas: execution of the 2008 Budget, municipal budget development cycle and procedures, introduction to the MTEF, application of PIP procedures and system to the municipal capital projects and preparation to the donor conference, capital projects management cycle, application of PPP financing methods.

Based on analytical and technical works in the area of fiscal decentralization issues performed during the previous reporting period, project advisors worked with local counterparts on laws included in the Ahtisaari Proposal. In close cooperation with the USAID/EMI, the Project supported the Municipal Budget Department in the development and writing of the Law on Local Government Finances (LLGF). The Central Budget Department participated in the revision of the Law on Public Financial Management and Accountability (LPFMA).

The LLGF has been endorsed by the Government, main local stakeholders such as minority and opposition parties, and international stakeholders represented by the ICO, EC, WB, and IMF. Advisors provided their assistance to the MEF/MLGA working group in the area of policy and technical issues related to the comprehensive framework for municipal finances. The Law that resulted from the working group represents an important milestone on the road towards further fiscal decentralization in Kosovo. It is specifically important to emphasize that the LLGF complies with Section III Article 8 of Ahtisaari Proposal. As a result of the LLGF implementation, more resources will be transferred to all municipalities, which is in line with additional own competencies given municipalities in the Law on Local Self-Government. The LLGF sets a comprehensive legal framework for municipal own financial resources and provides municipalities with increased authority to autonomously regulate and manage their financial resources. The LLGF satisfies the main requirements of the Status provisions in several important areas.

---

### Other activities not included in the Work Plan

The appointment of the new Minister of Finance had a large impact on the work of the Central and Municipal Budget Departments during this reporting period. Advisors assisted the Budget Directors in preparing introductory briefs for the Minister focused on the main short-term issue – finalization of the 2008 Budget – and longer term strategic goals and challenges facing the Ministry in the area of budget processes and management of public finance (such as development of the MTEF and preparation for the donor conference for the Central Budget Department and development of the Law on Local Government Finances required by the Status Proposal for the Municipal Budget Department).

The 2008 Budget was promulgated by the SRSG on 29 February 2008 (when the continuing resolution that kept the Government operating at 2007 levels expired). Advisors provided support to both Budget Departments in managing efficient communication with budget organizations. The final revised budget showed a minimal increase to overall spending from the 2008 Draft budget. The Central Budget Department used four categories to classify submissions from Budget Organizations, which highlighted priorities and initiatives of the new Government and dispensed with resubmissions efficiently. Advisors provided Budget Directors with the reports on lessons learned from the 2008 Budget development process and recommendations on improvements in the future.

### Issues / Obstacles

During the development of the revised 2008 Budget, a number of projects and programs were added outside of the normal process. Some were added without adequate documentation, others without giving fair treatment to all Ministries or projects. In addition, the 35 M euro reserve for status implementation was used as something of a “slush fund.” There is a need for an enhanced effort to provide background information and education for the Minister and other political appointees concerning the budget process. Costs and implementation of status will be another important issue in the coming quarter. Advisors assistance in the management of the Status Settlement implementation (such as training of newly established budget organizations, incorporation of additional costs into the budget process) foreseen in the Work Plan for this reporting period has been postponed and closer aligned with status developments.

Preparation of the 2008 Budget Book has been postponed due to other workload issues, primarily the MTEF. The Budget Book will be prepared and printed later in the spring.

The 2008 Municipal Budget currently does not fully reflect changes in municipal administrative structure introduced by the UNMIK Regulation 2007/30, which entered into effect after municipal budget submissions were finalized. The budget structure is not fully aligned with a new organization structure of local governments, which is viewed by many municipalities as an obstacle in the execution of expenditures. To mitigate short term difficulties, the Budget Department in cooperation with Treasury established appropriate procedures based on cash management. Final alignment of budget structure is foreseen to be undertaken during the mid year budget review when all municipalities implement and comply with provisions of the UNMIK

---

Regulation 2007/30. This will be accounted for in the advisors' assistance scheduled for the next reporting period, when mid year budget review is going to be conducted.

The system of municipal financing, in particular with respect to grants from the central government, provided in the LLGF is foreseen to underpin the 2009 Municipal Budget. The implementation of new arrangements in the area of Specific Grants for Education and Health will very much depend on the respective Ministries assuming their role in the establishment of grants formulae. Further, the LLGF calls for much broader responsibilities of the Grants Commission. MEF will be required to strengthen efforts towards full institutionalization of the Grants Commission.

Following the promulgation of the LLGF by the Kosovo Assembly in March, information campaign introducing the new system of intergovernmental grants foreseen for this reporting period is now scheduled to take place during April and May. The MEF, assisted by the Project and USAID/EMI will present the main aspects of new legal framework to municipal officials, including Mayors and municipal administration.

## **Treasury**

### Progress / Successes against the Work Plan

The focus for the past three months has been on performing reconciliations for the preparation of Financial Statements (FS) for 2007, and cash flow/investment planning for the 2008 FY year.

The Financial Statements (FS) preparation has required a strong focus on resolving long standing reconciliation process issues. In support of the preparation of FS for 2007 extensive training has been delivered in January 2008 which was developed on the needs of the Budget Organizations (BOs).

Significant resources have continued to be applied in support of the introduction of UNIREF and the application of Administration Instruction 2007/6. A number of problems associated with the UNIREF application by the commercial banks and printing of the UNIREF documents have been rectified. It is anticipated that UNIREF will greatly enhance the recording and reconciliation of revenues.

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. At the conclusion of March 2008 approx 430 million euros was invested for various periods at rates between 3.7% and 4.05%. Under the amended LPFMA investments no longer need to be terminated within the FY. This will provide greater flexibility for investment of public money, going forward.

The pilot stage of the decentralization of expenditure to Municipalities has concluded. Funding for the next stage is expected and is anticipated to begin later in 2008.

### Other Activities not Included in the Work Plan

The poor relationship between the Director Treasury and the Minister has now been resolved by the recent election result. The incoming Minister is very supportive of

---

the Director Treasury and has encouraged him to indicate where additional resources may be required in Treasury.

The Minister has also encouraged the Director Treasury to document a personal development plan which looks at the long term development needs of the Director. The documentation of a personal development plan has been initiated with support from the Treasury Advisor and other key advisors and will be completed in April for submission to the Minister.

#### Issues / Obstacles

The Ministry of Justice (MoJ) has now joined with Treasury to determine a way forward in terms of dealing with a number of outstanding Court Orders made against a number of BOs. It has been subsequently agreed that the court orders be sent to the MoJ which, in turn will send 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. Treasury will continue to engage with the MoJ to challenge the validity of the court orders on the grounds that appropriation from the assembly is required for Treasury to execute those orders. The Minister has represented this matter to the MoJ several times with a request that the process for dealing with Court Orders be reviewed and amended.

The new organization structure for Treasury requires the recruitment of suitably qualified and experienced staff to bolster the capacity of Treasury and to provide for succession planning. It is not anticipated that there will be a large number of suitably skilled applicants for these positions. The specification of new functions, particularly in the Revenue area will be required to reflect changed reconciliation and revenue processing requirements.

Lower levels within Treasury continue to submit relatively straight forward issues direct to the Director of Treasury. This practice slows down decision making, places too much strain on the Director Treasury and hinders the allocation of responsibility for decision making to the proper levels within Treasury.

The development of a new organization structure with three supporting Deputy Directors has been completed and discussed with the Deputy Minister. A briefing of the proposed structure for Treasury will be made to the review panel established by the Minister and a final decision will be made. The proposed organization structure, in part, is designed to alleviate the problem of too much access by Treasury staff to the Director but final resolution of this problem will require development of a process whereby the Director of Treasury is "protected" from routine decision making interruptions.

---

## **Property tax**

### Progress / Successes against the Work Plan

This quarter, the Project Advisor obtained approval from the Public Procurement Agency to outsource the printing and delivery of property tax bills and negotiated the contract with PTK on behalf of the MFE. The MFE Property Tax Office estimates that municipalities spend approximately €0.47 to print and deliver each property tax bill. PTK has offered to do it for €0.247 per bill. The total cost savings to the municipalities is €85,121. This is the first central contract any government ministry has negotiated on behalf of the municipalities that takes advantage of the volume discount. PTK began printing the bills in March and will complete delivery before the statutory deadline of March 31 – the first time this has been achieved. With property tax bills as an example, the Kosovo government should achieve some economy of scale by negotiating other central contracts for things like office supplies and equipment.

The collections manual has been updated to reflect the new procedures for levying individual bank accounts. Municipalities have been informed of the procedures in writing and during numerous seminars organized by the Municipal Budget Department. Local staff have met with large taxpayers in several municipalities, including PTK, KEK, Silcapor, Ferronikeli, and others, to inform them of their 2008 property tax liability and ensure that the assessment is accurate. The Project Advisor is continuing to work with the Kosovo Cadastre Agency to collect data on property sales. The data will be used in a sales-assessment ratio study for each municipality that is due to be completed in 2Q2008. Project local staff continue to assist the Pilot Municipal Units (PMU's). Project staff have assisted the PMU's in mapping property sales in order to draw valuation zones. USAID will sponsor the Property Tax Managers from each PMU to attend the Centre for Excellence in Finance Property Tax Workshop in Ljubljana in April.

### Other Activities Not Included in the Work Plan

A team from the Swedish Tax Authority (STA) visited Kosovo from February 4-8. The team consisted of a tax administration expert, who is an advisor to the STA's Executive Director, and a software developer from the STA's property taxation unit. As a result of their visit, the STA has decided to partner with the MEF to achieve the following four goals:

- Build a solid IT solution/platform for a property tax system
- Build a solid Collection system
- Advice and sharing of experience to create a reliable Property Register
- Advice and sharing of experience in the area of Taxpayer Education

The STA has proposed a three-year partnership with the MEF to design, develop (using commercially available, off-the-shelf software) and deliver an IT solution for property tax administration. The STA intends to program the system themselves after mapping the business process. It will also develop the necessary interfaces with other agencies such as the Kosovo Cadastre Agency, the Citizen Service Centers, and Treasury. In addition, the STA intends to look more broadly at the property tax system and develop solutions to improve the accuracy of appraisals, enable efficient collections, and strengthen taxpayer education. This approach has much less risk than an open tender. The STA has virtually limitless human resources at its disposal for this effort and the MEF can be assured that it will receive a custom-built software solution that will meet its needs for years to come. The 3 year

---

duration of the project will ensure that skills are transferred and staff are adequately trained to manage the new system and change in business processes. The Skatteverket will host a study visit to Ostersund, Sweden, from 31 March through 4 April to understand Sweden's property tax system and the IT solutions that Sweden has implemented. Participants will include seven counterpart staff from the MFE and 3 municipalities.

The Project Advisor was key in negotiating this arrangement with the STA and designing the scope of work for the project. The Project Advisor will serve as the key team member who will advise the STA on existing business processes and identify areas for reform during the design and development phase. The Project Advisor together with Project local staff will lead the testing of the system components to ensure that the system that is implemented meets the needs of the MEF and municipalities.

The Project Advisor participated in the working group on the Law on Local Government Finance. He helped alter the section on the business registration tax and developed a Property Tax Incentive Grant formula that addressed the concerns of the World Bank and IMF. While the Incentive Grant was not included in the final draft of the law, the MFE will continue to monitor the progress of the municipalities and revisit the issue at the end of 2008. A ceremony with the Prime Minister, Minister of Finance and Minister of Local Government was held to distribute this year's Incentive Grant allocations where the municipalities were informed that the Government attaches a high priority to municipal own-source revenue.

#### Issues / Obstacles

A total of €1,376,247 has been collected during 1Q2008 which is a 16% decline compared to the previous year. Five small municipalities have seen a significant rise in property tax revenue, but 18 other municipalities have collected less than 2007 thus far. A number of events contributed to the fall in property tax revenue, not the least of which were the establishment of new municipal governments in January and the independence celebrations in February. Both of these events were tremendously disruptive to normal operations in the municipalities. However, it cannot be ignored that the stated aim of several new municipal administrations is to further decrease the already exceptionally low property tax assessments in their communities. The new local administrations have yet to demonstrate a commitment to collecting property taxes. In addition, the elimination of the Incentive Grant has removed the revenue targets that municipalities managed to achieve and the extra money that served as an incentive to collect. The table below shows the decrease in collections during the first three months of 2008.

**Table 1: Property Tax Revenue During 1Q2008**

	Jan 2008	Feb 2008	March 2008	1Q2008
<b>Total Property Tax Revenue</b>	€ 486,071	€ 333,785	€ 556,391	€ 1,376,247
<b>% Decrease from 2006</b>	- 6%	- 34%	- 11%	- 16%

The MFE Property Tax Office expects that collections will begin to increase in April after the 2008 property tax bills have been delivered. Nonetheless, municipalities have a significant amount of revenue to make up for in the remaining 3 quarters of 2008. In addition, municipalities that lowered the property tax levy through lower tax rates and/or municipal appraisals must significantly improve their collection rates to simply raise the same amount of property tax revenue.

---

## ***Objective 1.2: Strengthen the Capacity of TAK***

### Progress / Successes against the Work Plan

Strategic Plan: A complete review of the status of the strategic plan was conducted on 20 March 2008. Once the status report from that meeting has been finalized, it will be forwarded, so that this quarterly report will not address each goal area and current status. The Resource Audit has been completed and final report submitted to Director. It is expected that further discussions will be held with senior managers regarding the recommendations. As a result of delays in the resource audit, some of the staffing issues related to the strategic plan (staffing rulings unit, staffing gambling functions, etc.) have not yet been completed.

Director of TAK: With the removal of the Director of TAK, advisors have been heavily involved in many meetings, etc. with the Acting Director and senior staff to provide guidance and direction. TAK has operated with an Acting Director for this entire quarter.

Business Registration: The working group on business registration, including both advisors, has finalized the strategy and vision for business registration. A complete study of the current process of exchange of information between the business registration agency and TAK was completed. Meetings were held with the Minister of Trade and Industry, World Bank, and Business Registration Agency. A letter outlining the TAK needs and issues was prepared and sent to the Minister of Trade and Industry. A letter seeking World Bank assistance in ensuring the compatibility of TAK IT and IT being implemented in Business Registration through World Bank has been sent to World Bank. TAK is scheduled to provide to business registration agency IT contractors their specifications for the information they need by the end of March. TAK procedures for contacting new businesses and verifying registration information are to be developed.

Revenue: TAK revenue goal for 2008 has been set at 204 Million, a significant increase over 2007 goal and the total revenue realized. Full March figures are not yet available, however through 20 March revenue totaled €37.9 Million against 31 March target of €38.1 Million. The Government has established restriction on the use of telephones and vehicles in order to reduce costs, however, the restrictions are also imposed on TAK in the same degree as those restrictions imposed on other institutions. TAK inability to fully utilize the telephone and restrictions on travel could have a negative impact on its ability to deliver the revenue required.

Risk-based Selection: Further progress has been made in developing systemic risk-based selection for VAT returns. Under the guidance and direction of USAID advisor, the working group within TAK has developed risk assessment formulae to score risk assessment indicators associated with the financial important indicator turnover. Formulae are now being developed for the other importance factors of payments, debt, credits, and losses. These formulae work in conjunction with the scoring factors associated with the financial importance factors of turnover, payments, debt, credits, and losses. A three-part report (Audit Model) has been developed for use by the LTU in its risk assessment and audit planning process; part 1 of the report is a compilation of data from returns filed for a specific year which allows a view of the return information for the full year at a glance and identification of items with wide variance during the year (primarily for VAT, but applicable to other taxes as well);

---

part 2 includes all third party data available (currently limited to Customs imports and exports) and other information regarding the taxpayer (audit history, payment history, etc.) for analyzing possible risk – part 2 will continue to expand as more data is available from internal and external sources; Part 3 includes the risk assessment scoring data that reflects the basis for the score assigned to that taxpayer. This Model represents a significant advance for TAK as it gives a good planning tool in addition to the risk assessment data. The tool has now been modified to be applicable to the large taxpayers in the regional offices (turnover of 500,000 to 2 Million). Senior management has agreed to begin the roll-out of the model to the regional offices for use by the large taxpayer teams there. Programming and IT support for that rollout should allow the roll-out to begin in late April. There is still significant further development work to be done.

**Tax Academy:** The tax academy is continuing with 80 managers in four classes receiving professional and managerial skills training. An additional 18 employees are receiving professional skills training. The employee course will end in early April. 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. All manager classes have just completed the module on total quality management and their presentations described quality improvement recommendations and concepts. Many of these recommendations and concepts will be implemented, such as improved VAT refund processing, improved sale of seized property procedures, etc.

**Anti-Corruption:** The anti-corruption training, with participants from a wide variety of Kosovo institutions, is continuing. The networking in the course has resulted in TAK picking up a well-qualified person for the Professional Standards Unit. The classroom contact has also allowed the Manager of PSU establish a dialogue with the head of the Kosovo Anti-Corruption Office regarding the use of their hotline to receive information regarding potential TAK corruption and pass that information on to PSU. Details of this cooperative effort are still to be worked out, but groundwork has been laid. Advisors continue to work with PSU on a variety of issues.

**Assistance in international issues:** Two half-day sessions with selected employees related to permanent establishment determination complemented the introductory sessions held in December. An additional two half-day sessions have been held regarding attribution of profits and taxation of those profits attributed to the permanent establishment, with accompanying text. SCAAK provided a four module program on construction project accounting and advisor has developed a guide on tax implications of construction project accounting. Advisors are regularly involved in assistance with cases involving international taxation issues.

**Payment and Declaration Processing:** A pilot proposal for declarations was prepared and submitted to IT. Main proposal is for TAK to test the feasibility of a limited number of taxpayers inputting their VAT declarations at Prishtina 1 or 2 using terminals set up in the regional office for that purpose. If that pilot is successful, it will pave the way for taxpayers to input their own returns from their computers at their place of business. Security and network issues are still to be settled before the pilot can start. Further work with Treasury and TAK has been done regarding payment processing and reconciliation. A flowchart has been developed and shared with Treasury, with some corrections to be done in the next week or 10 days.

---

Tax Reform/Laws: Advisors participated in finalizing the draft revisions to the Law on Tax Administration Procedures. Input has been provided on possible incentives to be included in the tax reform proposals currently being considered. Language to revise 2004/51 6d and 6e to exempt income from contracts issued by international donors was provided to Pillar IV.

IT: Josh Aslett, BearingPoint IT expert, arrived to begin a 90 work day assignment to assist TAK with a myriad of issues. He has developed a work plan which has been reviewed with the Deputy for IT. The initial purpose of his visit was to assist with migration of SIGTAS reports to web-based reports. However, there are a number of serious network and system issues that need to be resolved before that migration can start. Josh has the expertise to be able to assist TAK deal with these issues so that the migration can begin in mid-to-late May. There is a possibility that an additional short-term expert will be needed.

#### Other Activities not included in the Work Plan

Law on Tax Administration Procedures: Advisors spent significant time assisting in the drafting of the proposed amendments to the Law on Tax Administration and Procedures. The draft has been completed and is now pending in Government.

VAT Law: Advisor has been named as member of the working group to review and redraft the VAT Law to ensure it is in compliance with EU standards.

Assistance to TAK in a variety of technical and international issues has consumed substantial time – reorganizations, banking issues, drafting proposal for Corporate Income Tax Law to exempt foreign contractors of international donors from taxation in Kosovo, depreciation issues, etc.

Significant time has been spent in dealing with declaration and payment processing issues, as well as other IT issues.

A draft Audit Quality Measurement Program was developed in conjunction with Audit and position description developed.

IT expert was brought in primarily to assist with migration of SIGTAS to Oracle 10g, web-based reports. Significant time has been spent in working on system and network issues necessary to stabilize the system prior to implementing the migration. Migration to a web server is still possible, but the new capabilities will not be realized until the system and networking issues are resolved.

#### Issues / Obstacles

The proposed new Director of TAK proposed is of minimal tax and management experience. We aim to jointly establish a development plan and conduct a two-day team-building meeting to familiarize director with staff and issues, which is to be implemented when the new director is confirmed.

The IT system needs significant maintenance and updating. Assistance will be provided to Deputy IT to justify sole source contract for SIGTAS developer to send two employees to TAK for system analysis and determine best approach to making improvements and updating. Coordinate efforts with new TACTA IT expert to

---

determine if additional expert support is needed. Finalization of contract with SOGEMA is pending. IT expert has assisted in defining deliverables. IT expert has provided advice and assistance in implementing a new data back-up process and procedures for auditing the status of the system.

TAK programming personnel are receiving favorable offers of positions providing better salary structure. Programmers are critical to the ability of the project to develop the risk assessment program required by the USAID Contract. We will determine if MEF will support salary increases for programmers; proposal made for project to assist with salary supplement for balance of 2008 pending government funding higher salaries. The Deputy Director of IT has been in contact with the Permanent Secretary and Deputy Minister who have indicated they will consider salary request at the mid-year budget.

Staff training in Oracle programs needed. IT expert will determine staff capabilities in various Oracle programs and provide some targeted training during the course of his assignment. To the extent that he is unable to provide all necessary training submit proposal to USAID for local training assistance. The IT expert has provided some Oracle reference material for staff. Further analysis of training that can be provided versus training needed to be done.

The network does not provide reliable connection between HQ and regions and significant effort to be made to stabilize network. Research has however, improved network connections and contact has been made with PTK to determine ability to use their existing fiber network. This resulted in conclusion that their service was too expensive for TAK. TAK are now concentrating on use of microwave technology using network of either Kosovo Police Service or Ministry of Public Services. There will be costs of around 100,000 euros for purchase of necessary antenna's which is currently beyond TAK budgetary capacity.

The System Administrator has resigned, and the replacement will take time to announce and select. The System Analyst is capable of filling in for System Administrator while the selection process is underway. If System Analyst is selected, it will then be necessary to select a new System Analyst, meaning a possible minimum of three months or more before both positions are occupied. The length of this delay is one basis for the probable need to bring in another short-term IT expert. A meeting with EU TACTA project which will determine their level of support is scheduled for April 1<sup>st</sup>. Further decisions will be made following that meeting.

SIGTAS is currently not capable of implementing payments process required by UNIREF. Reconciliation of revenue with Treasury adversely impacted until system is changed. TAK is seeking authority to let sole-source contract for the payments program.

TAK is not yet able to properly interpret laws or fully implement international taxation practices. Every day new cases come to light that demonstrate TAK's lack of familiarity with Permanent Establishment concepts, as well as other concepts of taxation of multi-national enterprises. It is encouraging, however, that a core part of the HQ staff is beginning to understand the concepts and are now taking a more active role in addressing the issues. Training has been given in PE issues and attribution of profits of PE. Additional courses are planned later in the year on transfer pricing issues.

---

MIS development is key to improving resource utilization and management oversight. As noted above, the IT staff is depleted and its ability to meet the demands of programming changes needed is in doubt. BearingPoint is providing an expert in Oracle to assist with the development and programming of reports, as well as migration of certain reports to web-based programs. The TACTA project includes an MIS and Governance expert who will assume a role in the MIS development effort.

### ***Objective 1.3: Central Banking Authority of Kosovo (CBAK)***

#### Progress / Successes against the Work Plan

An examination was completed of a newly created bank resulting from a merger of two local banks. Bank examiners from the Bank of Slovenia and an advisor from the International Monetary Fund (IMF) assisted with the examination. The on-site examination has been completed but the Report of Examination has not yet been finalized or issued. While improvements were noted at the bank, an Administrative Order will result from the examination recommending management to take immediate remedial actions.

The proposed amendments to UNMIK Regulation No. 1999/21 on Bank Licensing, Supervision and Regulation to establish the Deposit Insurance Agency of Kosovo (DIAK) were reviewed. Under the proposal, DIAK will have a small administrative staff and will be reliant on the CBAK Bank Supervision Department (BSD) to identify emerging problem banks. It was recommended that an MOU be established with the CBAK that would allow DIAK to request the CBAK BSD to conduct either a full scope or a target examination of a bank that DIAK is concerned with. The CBAK Managing Director vetoed the recommendation, citing concerns that the CBAK BSD would be overburdened with requests and only CBAK should be directing the BSD to conduct an examination. The proposed amended regulation has been sent to OLA for their review and approval.

The micro-finance regulation remains with OLA. The CBAK Managing Director has followed up on the regulation to no avail.

Debate continues with an existing micro-finance institution and its application to obtain a full banking license from the CBAK. The CBAK is standing firm that until the MFI can provide a satisfactory ownership structure, a banking license will not be issued.

#### Other activities not included in the Work Plan

The Serbian bank, which was brought under CBAK control during 2007, is providing the CBAK with financial and regulatory reports on a timely basis; however, no examination of the institution is scheduled at this time. The CBAK is waiting until the situation stabilizes before sending in an examination team to review the bank and its operations.

The IMF funded CBAK Managing Director has been replaced by the Deputy Managing Director of Financial Supervision, following his approval by the Government. Prior to his departure, the IMF funded CBAK Managing Director indicated that the IMF would provide a general central bank advisor to the CBAK to assist the newly appointed

---

Managing Director with his duties and responsibilities; however, no names or credentials have yet been presented to the CBAK.

There was a Strategic Planning Retreat that resulted in an identification of SWOT and produced a new organization structure that is in the process of being implemented. A third supervision directorate for policy and methodology development will be created. It also will house the combine licensing and corporate activities for all supervision (banks, insurance, pension, intermediaries, etc). Ms. Suzana Dervari, the current Director for Banking Supervision has been offered the position as head of the new unit. She is still considering whether to accept the position.

The Basel Core Principles assessment was completed and the results were quite satisfactory. Several of the Materially Noncompliant ratings are easily curable with issuance of a paper or policy (one of the reasons the new Methodologies Directorate was/will be established). The former MD objected to some of the noncompliant ratings on the basis that they were hypothetical because the activity does not yet exist in Kosovo. The weaknesses disclosed by the BCP assessment already had been identified by the CBAK.

---

## **Objective 2: Stimulate Trade and Investment through Modern and Well-Implemented Commercial Laws**

### **Commercial Law**

#### Progress / Successes against the Work Plan

In the first quarter of 2008, BearingPoint legal advisors continued to assist several institutions with the development of a basic modern legislative framework governing commercial, economic and public administration activities. In particular, BearingPoint legal advisors provided intense assistance on the development and finalization of several key pieces of legislation required for the implementation of the Status Settlement, including the new law on Civil Aviation, the new Law on Public Financial Management and Accountability, and the new Law on Local Government Finance (all adopted in the first quarter). Substantial work was also done in connection with a draft new KTA Law and a draft new POE Law.

The work that the legal team had done in the last quarter of 2007 with respect to proposed revisions to the SOE Reorganization Regulation (Regulation 2005/48) was put on hold during the first quarter of 2008 as higher priority legislation (needed to implement the Status Proposal) took precedence.

In the Assembly, the legal team continued to provide assistance in reviewing a number of laws, including "lock box" laws, which were adopted in the first quarter.

Notwithstanding the residual legislative development activities described above, the legal team continued to take substantial measures to implement its new principal focus 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. After considerable debate about a wide variety of training methodologies, the legal team and USAID agreed to implement the Instructional Systems Design model, which has been used by BearingPoint projects in the region and successfully implemented by other USAID contractors as well.

The principal components of the ISD methodology include seminar design, course development, and course presentation. To better address each component, a short-term training advisor held a workshop on seminar design as well as a workshop on course development to the three trainers. Following these workshops, the trainers worked efficiently and effectively to complete their course design worksheets, which contain seminar objectives, sub-presentation objectives, a sequence of activities, as well as a list of resources necessary. The seminar design worksheets for each course are approximately 25 pages in length and can be easily used by subsequent trainers selected by BearingPoint, KJI, the Chamber of Advocates and others.

Beginning in March, our 3 trainers turned their attention to the most difficult component, course development or the preparation of the participant's guide. The participant's guide can have different functions depending on the subject matter and audience of a course. Given our task of building the capacity of the judges and lawyers in order to improve the implementation of Kosovo's legal framework, the legal teams has made our participant's guides a handbook or go-to guide for each particular commercial law. While it is certainly not as comprehensive as a commentary we expect that the judges and lawyers will use them as a reference document when they have a question on a particular commercial law case.

---

To date, the participant's guide for Trademarks is 100 percent complete, the participant's guide for Business Organizations is 50 percent complete, and the participants guide for Arbitration is 33 percent complete. All work is on schedule for the delivery of 3 courses this Spring at KJI as follows: April 23. 24-- Trademarks; May 8, 9-- Arbitration, June 11, 12, 13-- Business Organizations. Our regional training expert will return on April 14 to 25 to present a final workshop on course delivery, which will include a component on exercises and slide.

The commercial law 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.

#### Other activities not included in the Work Plan

At the request of the President of Kosovo, our third legal team member was moved from the Assembly and placed in the Office of the President. He is currently working on constitutional issues and the restructuring of the judiciary.

#### Issues / Obstacles

The loss of the senior legal advisor from the Assembly position has left a void in the Assembly, which continues to adopt economic legislation and amendments at a very fast pace. We were unable to give adequate attention to much of this legislation including the Law on Notaries, Law on Small and Medium Enterprises, and Law on the Kosovo Pension Savings and Trust. This issue will persist until this critical position in the Assembly position is filled. There are a number of similarities between this period now, immediately post status and 2002/03 when a number of complex pieces of legislation were written and the Assembly was in need of advice and assistance to ensure intentional or unintentional damage to the economy was avoided. The final backstop of the Office of Legal Advisor will no longer be there with the passing of the Constitution in early April.

---

### **Objective 3: Privatize or Commercialize POEs**

#### **Kosovo Trust Agency**

##### Progress / Successes against the Work Plan

The new local Director of the Kosovo Privatization program was identified by broad advertisement and a full competitive interview process. However, the new head, Shkumbin Bicaj was immediately elevated to acting DMD SOE division when Ahmet Shala was appointed as the Minister for Finance and Economy in the new government, which has again left the Head of Privatization position vacant.

Furthermore, the KTA privatization program has been hit by a treble of road blocks. At the legislative level, decisions at the Special Chamber have thrown the KTA legal team into disarray and many of the assumptions upon which we had confidently moved forward, had to be reexamined in the light of the chambers new legal interpretations. The second major blockage has been caused by the new government's determination to replace ministerial KTA board members with industry specialist board members, and the lack of board meetings that have resulted. The third challenge has been the EU pillar IVs determination to close down its operations by mid year. The results of these events have been a brake on the progress of the KTA.

The special chamber decision concerning 'Hotel Trepca' has effectively stopped all contracts being signed at the KTA. In essence, only 2 contracts have been signed since that decision was given, and these contracts were signed with the buyer signing an additional and very onerous undertaking of waiver release to the KTA. The key problem however is the 128 pending contracts which represent some 58.3 million euros of investment bids which are now held in suspended animation. We have advised management repeatedly to return the funds. Bidders are going bankrupt as a result of interest payments on loans, the KTA is subject to claims, and the EU led management seems to have little concern to resolve the issues pending its own imminent demise.

The acting SRSG enacted legislation on 20 March 2008 to enable the appointment of government experts to the KTA board, with the result that the first KTA board meeting since November was held on 26<sup>th</sup> March 2008. Two of the three pending government representative board members were formally appointed the day before, and therefore the board meeting itself only considered two substantive issues: i) 7 final draft employee lists were approved for final publication; and ii) Shkumbin Bicaj was appointed as DMD SOE division.

In essence, with no proper board meetings for 5 months, the KTA tender operations have effectively reduced down to preparation work, and there is an urgent need to reinvigorate the organization.

It appears that there is no transition plan in place to deal with the KTA successor. Much is being made by the management of Pillar IV for legislation which will identify the successor body as a pre-requisite to handover of assets etc. All EU pillar IV staff have been given formal notice that the pillar ceases to be on the 30<sup>th</sup> June 2008, and that their contracts are terminated. National staff have been promised previously that a plan to ensure an orderly transition to a new organization would be put in

---

place, however, no details have been forthcoming on this plan, and it seems that at present there is still much planning to be undertaken.

Trepca policy development has clearly been struck by the above, but probably more so by the breakdown of most of the control in the northern part of Kosovo. The Brezovica Ski resort tender was relaunched. There has been considerable nervousness within the leadership of Pillar IV concerning this politically complex privatization. However, similar to the Trepca issue, with the ongoing protest in Serbian communities, the management effectively closed the resort in Early February and it has not operated since. An announcement of the date for the tender seems unlikely given the hiatus described previously, and the high risk of failure.

On a final positive note, the privatization program had two further successful bid (waves 30 and 31).

#### Issues / Concerns

Pillar IV is closing down. There is no formal succession plan. The KTA could easily collapse given the above.

The legislative approach adopted for privatization has come under question given the Special Chambers decision. Restitution issues will effectively negate all further sales unless legislative clarity is attained.

Liquidation and winding up of the companies 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.

### **Public Private Partnerships / Airport Concession**

#### Progress / Successes against the Work Plan

In the first quarter of 2008, the recently formed PPP Unit continued making strides towards its full consolidation.

With regard to establishing the appropriate Policy Directives, the incoming government confirmed its support for Public-Private-Partnerships and for the establishment of a centralized PPP Unit within the Ministry of Finance and Economy, thereby endorsing the PPP initiative which commenced in the fourth quarter of 2007.

The Government also made a decision regarding the PPP Unit's role and mandate. With the authorization of the new Minister of Finance, amendments approved by Parliament to the Law on Public Financial Management and Accountability (LPFMA) have legally established the PPP Unit within the MFE, setting forth the group's general mandate to vet project and establish best practices for PPP. In short, the basic policy directives associated with the PPP Unit have been achieved.

In additional to the above, significant progress has been made towards the Creation of a Centralized PPP Organization. The Ministry of Finance and Economy has given

---

its support to the Unit's organizational structure, budget, and job descriptions, although uncertainty over sustainable funding sources has momentarily impeded the recruitment and hiring of key personnel. Recruitment is planned to commence in April, 2008.

Despite staffing challenges regarding the centralized PPP Unit, significant progress has been made with regard to Capacity Building across multiple sectors. In coordination with OSCE and municipal authorities, multiple PPP training sessions have been imparted to over 264 municipal functionaries from across Kosovo. Likewise, project-specific technical assistance has been provided to line ministries (including Transport, Health and Education) and municipal governments.

As a product of these training and outreach initiatives, new projects are being identified and analyzed as possible PPP candidates. Examples include the development of roadways (Routes 6 & 7) for the Ministry of Transport, a school / pre-school PFI pilot project at the municipal level, a parking PPP for the Municipality of Prishtina, and city heating (Termokos), amongst others. Other donors and IFI's, including the World Bank have contacted the PPP Unit with regard to analyzing and implementing variety of projects, demonstrating that the Unit is gaining credibility in the eyes of stakeholders and project promoters.

For its part, the Prime Minister's Office has indicated its intention to issue a strongly articulated government policy statement in support of PPP in order to help foster investor confidence in public-private-partnerships. This is expected in June, 2008. This represents a major advancement for the PPP initiative and, when issued, should help facilitate future activities in this regard.

With regard to the development of specific procedural recommendations designed to standardize and institutionalize the review and vetting of potential PPP projects, it should be noted that preliminary progress has been made towards integrating PPP projects within the Public Investment Program (PIP). Also, recommended procedures for the review and approval of PPP projects have been developed.

Finally, the PPP Unit continued its work with existing project initiatives, specifically the Prishtina International Airport (PIA) concession and the Kosovo C energy project. Although the incoming government did not make any efforts to advance these projects during the first quarter of 2008, the PPP Unit continued to support both initiatives with an eye towards ensuring that each transaction will be successful and compliant with international best practices.

With regard to the Prishtina International Airport, it is important to note that the Civil Aviation law, which sets forth the institutional and regulatory framework for all aspects of the aviation sector, was duly approved by the Assembly during the first quarter of 2008. This law was drafted to the satisfaction of international aviation law experts and its approval is seen as a necessary prerequisite to tendering the airport concession. Approval of the law is considered a major achievement for the project.

#### Other Activities Not Included in the Work Plan

Due to its efficiency and knowledge of project management, the PPP Unit has also been very active in supporting other initiatives. Examples include the advice on the preparation of multiple loan documents on behalf of the Ministry of Finance for the funding of projects involving the electricity sector (KEK); advising multiple ministries

---

of project finance and implementation (including the preparation of tender documents and contracts for multiple sectors, i.e. Transport, Health, Education, municipalities, etc.); advising the Prime Minister's advisors on project implementation and financing options (i.e. Route 7 financing), etc. The PPP Unit has also taken a support role to multiple project initiatives, including the drafting of LPFMA provisions relating to PPP and the development of output based performance measures for IT outsourcing at the MFE.

#### Issues / Obstacles

The lack of available funding for salaries in the PPP Unit continues to be a major concern and is the reason that the PPP Unit is not yet fully staffed or trained. Given the need to staff the Unit with western educated professionals of the highest caliber, current public sector salaries (even if available) are insufficient. This issue is expected to be resolved shortly, with the approval of Super-Grade Salaries for PPP personnel.

There is likewise significant concern regarding the lack of action from the incoming government to advance pre-existing PPP projects, i.e. the Prishtina International Airport master concession and the Kosovo C project. A definitive decision regarding these projects is necessary in the near future.

In light of Kosovo's independence, there is growing concern that the enabling framework for PPP will require some strengthening in order to attract significant investment. For instance, there are basic investment benchmarks which are lacking (i.e. a credit rating). This could negatively affect the development of a PPP pipeline.

Finally, given the growing interest in PPP across all sectors, there is increasing concern that the PPP Unit in particular (and the MFE more generally) will not be able to control, standardize, or coordinate these initiatives. This could negatively affect the PPP Unit's ability to implement "best standards" or develop an integrated strategy for PPP.

---

## **Objective 4: Assist Kosovo's Energy Sector to Become More Efficient, Transparent, and Modern**

### **Ministry of Mines and Energy**

#### Progress / Successes against the Work Plan

The Kosovo C project has been significantly delayed since the formation of the new Government, resulting in misinformation in the media, unnecessary doubts and concerns about the project in the minds of the public, government, Assembly and the short-listed foreign investor consortia. Far too many other donor priorities were placed before the new Energy Ministerial team outside the single most important one of attracting a 3 Billion Euro investment into the generation sector. The BearingPoint Advisors have worked hard to restore the focus and bring a consensus decision to move forward with Kosovo C.

During this quarter the BearingPoint Advisors continued their support to MEM and the LPTAP (Kosovo C) Project Office (PO), and initiated support to the newly formed Energy Committee, which consists of representatives from MEM, the Ministry of Economy and Finance (MEF), and the Prime Minister's Office (OPM). In MEM, a new Minister, Deputy Minister, internal policy advisors and mostly new staff were appointed, and the Legal Department remains short-staffed, all together creating challenges to continuity and forward movement on a number of initiatives, particularly the single most important initiative of MEM, the Kosovo C project.

The Advisors continued their active coordination with the USAID advisors to KEK. During this quarter, the Advisors significantly increased their support to the Legal Department of MEM. There was extensive assistance to the PO and the LPTAP Transaction, Legal and Environmental and Social Safeguard Advisors (TA, LA and EA, respectively), who have provided updates and revisions to certain reports and deliverables. The TA provided the revised Phase 1 Report on the Kosovo C transaction. The LA provided the Revised Interim Diagnostic Report and a report on a possible risk matrix (but not the actual risk matrix as required). The EA provided the updated Strategic Environmental and Social Assessment Report (SESA). The Advisors reviewed all LPTAP deliverables and provided detailed analysis and recommendations for the PO.

Specific activities during the quarter included:

- The Advisors are assisting and building capacity in the Legal Department of MEM. A revised Draft Consolidated Energy Law was prepared, but it was decided to re-segment that Draft into its original three components, the Energy Law, the Law on the Energy Regulator, and the Law on Electricity. The first complete revised drafts of all three laws were completed in the quarter. In addition, it is now planned to develop a new Mining Law to improve the focus of MEM on the mining sector, a new Law on Natural Gas to conform Kosovo's law to EC Directive 2003/55/EC concerning common rules for the internal market in natural gas, and a new law on district heating and energy efficiency. The possibility of additional legislative drafting in the areas of air and water emissions, landfill, and water rights are being considered.
- The revised Draft Phase 1 Report of the TA was reviewed and analyzed. Many of the Advisors comments and recommendations were incorporated into the revised draft. Final recommendations were prepared and submitted to the PO

---

and TA for incorporation into the final report and discussion with the PSC. Significant policy and structural issues now need to be reviewed and decided by the PSC in order for Kosovo C to proceed. It is recommended that the structure include a concession on the Sibovc lignite field, construction of new generation capacity ("C"), commitment to supply electricity to meet domestic demand under a long term PPA, and the operation and maintenance of both Kosovo A and B. It is recommended that KEK distribution and supply (the remaining components of KEK) be privatized by no later than 2009. The Kosovo C transaction is ready to proceed to Phase 2 upon the approval of the government and convening of the PSC.

- The revised Interim Diagnostic Report of the LA was reviewed. The LA report on a risk matrix was reviewed, but it did not constitute an actual Risk Matrix, which is a contract deliverable under LPTAP, and which is critical to a comprehensive analysis and proper development of the Kosovo C transaction. The Risk Matrix is now 5 months late, and this delay is causing significant negative impact to the transaction.
- The revised SESA report of the EA was reviewed and analyzed. The revised draft incorporated most of the previous recommendations of the Advisors. The Advisors provided assistance to the LA and EA on the drafting and legislative process for amendments to the Expropriation Law, Environmental Protection Law, Environmental Impact Assessment Law, and Strategic Environmental Assessment Law.
- Presentations were made to MEM on Good Corporate Governance in the Energy Sector with recommendations for KEK, and on the history, status, benefits, policy issues, and way forward for the Kosovo C project.
- The Advisors made presentations to the Minister Finance on the Kosovo C project and the privatization of KEK distribution and supply. They also met with the Chairperson of the Assembly Committee of Trade, Industry and Energy to discuss tariffs, Kosovo C and the privatization of KEK distribution and supply. The Advisors reviewed the KEK tariff filing and the ERO Consultation Paper in detail.
- The Advisors have presented the basic components of the Energy Strategy in Kosovo to MEM and to the Energy Committee that focuses on: a) Promoting Kosovo-C Project, b) the privatization of KEK, and c) adoption of cost reflective tariffs.
- The Advisors are currently providing language and technical support to a series of 7 articles (out of a total of 10) for publication under the name of Mark Farbman in the Kosovo press to promote an efficient energy sector in the country.
- The Advisors are assisting and building capacity in the Energy Department of MEM to ensure availability of technical expertise to support MEM's decision making capabilities. The first introductory meeting with the selected staff members discussed general topics related to energy policy analysis, and areas in need of further technical support in MEM. Communication and training material are currently being prepared for delivery in the upcoming quarter.

---

### Issues / Obstacles

The government has not yet made a definitive commitment to Kosovo C, and has not yet constituted and convened a PSC, which is required under the World Bank LPTAP agreement as the decision making body.

The short-listed bidder consortia have become very nervous, and are now considering whether, in the absence of progress and a clear commitment from the government, they should abandon Kosovo and move their teams and resources to other projects in other countries – should that happen, the credibility of Kosovo as a foreign investment destination will be severely damaged, and it will be extremely difficult to get the investors back. Without adequate electricity supply, all other efforts for economic development in Kosovo, including employment, local production, import substitution, and exports will be severely impeded. Kosovo C must proceed and KEK distribution and supply must be privatized, and the government's attention must be focused on these two truly priority strategic initiatives. Now that independence has occurred, the single biggest remaining obstacle to both domestic and foreign investment is lack of reliable electricity supply.

Both for Kosovo C and for KEK privatization it is critical, as has been stressed, that the financial accounts of KEK be completely and accurately unbundled by function (mining, generation – with Kosovo A, B and hydro separate – and distribution network and supply) according to international accounting standards. An audit by the ERO indicates this has not yet been resolved.

The MEM Legal Department has an acting head and is very short staffed. A considerable amount of legislation and regulation has to be drafted or amended, and then shepherded through the Assembly for the Kosovo C project, KEK operations and privatization, the ERO, and the energy sector in general. The sheer volume of work and the short timeframe required for enactment will be a huge challenge without the appointment of a permanent head of the department and additional internal legal professionals.

### **Energy Regulatory Office**

#### Progress / Successes against the Work Plan

ERO now regularly includes the advisor in its discussions of tariff matters of KEK and KOSTT, seeks assistance in matters related to regulatory independence and regulatory laws, seeks support and advice for issues related to Kosovo C, and interacts freely on a range of other matters. The BearingPoint advisor works with both ERO and USAID for planning and execution of training sessions, such as those of ERRA in April 2008 on regulatory processes (for new Government and Assembly officials) and in May at AUK on competition law with examples from the energy industry. ERO completed the technical phase of its annual review of KEK and KOSTT tariffs, and published a Consultation Paper for public review of those tariffs; based in part on suggestions from the BearingPoint advisor. Based also on BearingPoint advice, the ERO kept other Government agencies informed of issues arising in the tariff review, and achieved some success in gaining support from the new Government on the critical issue of tariff increases if needed, and in recognizing that tariff issues are principally the responsibility of the ERO.

---

On March 20 2008, following a five month process that had been previously agreed in detail with KEK; the ERO completed its review of KEK and KOSTT tariffs, and completed the public review of the Consultation Paper. ERO's Consultation Paper provided KEK with almost exactly the total revenue requirement requested (after appropriate adjustments). The Government, in a letter, and other interested persons, provided their views to the ERO by the commenting deadline of March 20. That process is now closed. Yet, efforts to have MEM take a "final position" on issues in that tariff process may imply to the Government that it, and not ERO, determines the tariff process and the outcome which puts at risk the task order objective of creating an independent ERO.

In December, 2007, BearingPoint completed an analysis of Kosovo System load. After vetting that study with key participants, including the PA advisors to KEK, USAID provided the study to the Kosovo C Project Office, to ERO, and to other key stakeholders and international institutions. On suggestion from PA, that study included analysis of supply entirely from market sources, not specifically requiring domestic production (that is, presuming that Kosovo A and B in particular had no relationship to KEK). Two key conclusions from that study were that the least cost supply to Kosovo would be from a fully functioning regional power market, if one existed, and, lacking that, to fully replace the existing Kosovo A and B units with (greater capacity from) Kosovo C at the earliest opportunity. The existing practice of reliance on the A and B units is the most expensive (and least reliable) means of providing supply to Kosovo. Therefore, based on that strategy policy should assure the rapid development of Kosovo C and access to, and functioning of, regional markets as soon as possible, (including support to actions by KOSTT) in addition to the rapid privatization of KEK.

In the quarter, ERO also conducted a license compliance review of all regulated entities. In that review ERO found that KEK has completed no unbundling of accounts and has not implemented its new system of account definitions. The ERO were informed that KEK has no plans to start to do so until 2009. We understand the concerns regarding KEK operational issues, but these should not preempt all other policy analysis or conclusions related to the sector, or indeed take priority over rapid privatization.

In contrast, KOSTT will remain in government ownership for a long time. BearingPoint advisors (to ERO and MEM) thus met with the EAR advisors to KOSTT, to understand KOSTT issues. As KOSTT is the key institution for creating physical access to and from regional markets, and for market operations, then KOSTT, not KEK, is a proper recipient of capital grants from Government or Donor sources. Such grants or donations would be directed toward assuring transmission assets are created and maintained, that are capable of present and expected future import and export transactions, and to assure that adequate equipment within Kosovo is put in place to provide reliability of the grid within the country.

ERO currently holds a mandatory seat on the Kosovo C Project Steering Committee. BearingPoint acts as an advisor to the ERO for that purpose. When ERO received Phase 1 Reports of the Kosovo C Transaction Advisor (TA), Legal Advisor (LA) and Environmental Advisor (EA), they asked the BearingPoint advisor to assess the findings and recommendations of those reports. We reported that the positions taken in the Final Reports were substantially similar to what was advised in the Draft Final Reports, on matters on which they ERO sought specific advice. As the PSC has

---

been inactive since January, apart from receipt of those Reports, there has been little further activity within ERO on those matters.

BearingPoint advisors continue to develop its model for dispatch of the SEE regional wholesale power market, and of the role of Kosovo (and Kosovo C) in that market. We have updated the model to include regional exports to Greece, and to include Slovenia in the same manner as any of the nine Athens Treaty countries. We have added options to model any of the 35 new generation units proposed for the SEE region in the next 15 years. This will allow comparison to effects of Kosovo C, and other detailed comparisons of market scenarios. We continue to seek that domestic institutions are better equipped to participate in regional markets (for example to assure that AUK provides competition law training now contracted to occur in May 2008). We have begun analysis (request by ERO last fall) of whether ERO's structure is properly oriented toward its statutory duties, including to be proactive on market issues when necessary.

### Issues / Obstacles

Certain activities in the Work Plan have proven difficult to achieve. Since the Government has not appointed sufficient members of the Kosovo-C Project Steering Committee, that body has not met, and thus also, ERO has not been active on those matters. In response to the Transaction Advisor Draft Final Phase I Report in December 2007 and Final Report in January 2008, the advisor provided detailed analyses to ERO of critical issues raised, including of possible critical terms for a PPA. But as the issue of a PPA in specific form has not yet arisen, due to delays in the PSC activities, detailed discussions of options for contract have also not taken place with the ERO. On involvement in Athens treaty issues and development of a regional market, the ERO has been so preoccupied since November 2007 with review of the retail tariff that more general market structure issues have not yet been addressed. On training, in the period completed March 31 2008 the project assisted USAID and ERRA to plan training for the new Government, Assembly and the media, which sessions however took place outside of the reporting period.

On the several detailed substantive training topics, on market structures, and system planning generally, it has not been possible to schedule specific training courses, due in part to preoccupation of ERO in other matters; but also, the energy team has begun to rethink the proper and best placement of this activity within the Government and other institutions, and how best to train for that. As a consequence, the regulatory advisor has begun discussion with AUK for forming a course, possibly to be given via AUK that can deal with these topics, and provide the materials for a broader audience than just ERO, while also seeking to create depth of societal understanding. As part of that, AUK has requested the energy advisor to present the project SEE Market Model to their students of policy (scheduled for late April 2008), as an example of how to do analysis. Specifically, for the course(s) on administrative law and procedure, it has so far proven difficult to gain the attention of any Kosovars to that topic. We propose to raise the matter again, after certain proposals for revisions of energy laws have been made.

### 3. Problems Encountered, Status and Proposed Solutions

Objective	Problem/Issue	Mitigation Plan	Status
1.1 Budget	Appointees of new Government lack understanding of budget process	Provide policy memos to Minister of Finance, support Heads of Budget Department to provide information on process to Minister and others, coordinate with other international groups to ensure common approach	In progress
1.1 Budget	Budget organizations have routinely under spent available funds for capital projects	Encourage Budget Organizations to begin preparing for capital projects prior to enactment of Budget. Establish working groups to understand problem of under spending. Create monthly reports on progress for Cabinet	In progress
1.1 Budget	Aligning the municipal budget with the new structures following elections	Provide briefing to Minister. Provide pros and cons of addressing now or in mid year review process	Briefing delivered, await decision
1.1 Property Tax	New local governments with inexperienced officials and lower property tax levy in some municipalities	Strengthen audit and oversight. Provide education and hands on assistance. Provide monthly reports to Mayors, Minister and Cabinet.	Education and support ongoing. Monthly report designed.
	Inefficient bill delivery leads to late delivery of bills.	Contract for PTK to print and deliver bills	Complete
1.2 Tax Administration	New Director TAK proposed with minimal tax and management experience.	Jointly establish a development plan and conduct a two-day team-building meeting to familiarize director with staff and issues.	To be implemented when new director confirmed
	IT system needs significant maintenance and updating;	Assistance provided to Deputy IT to justify sole source contract for SIGTAS developer to send two employees to TAK for system analysis and determine best approach to making improvements and	Finalization of contract with SOGEMA is pending.

	<p>TAK programming personnel receiving favorable offers of positions providing better salary structure. Programmers are critical to the ability of the project to develop the risk assessment program required by the USAID Contract;</p> <p>SIGTAS is currently not capable of implementing payments process required by UNIREF. Reconciliation of revenue with Treasury adversely impacted until system is changed.</p>	<p>updating.</p> <p>Determine if MEF will support salary increases for programmers; proposal made for project to assist with salary supplement for balance of 2008 pending government funding higher salaries.</p> <p>Local contract for making necessary revisions to SIGTAS to allow full use of UNIREF.</p>	<p>Deputy Director IT has been in contact with Permanent Secretary and Deputy Minister who have indicated they will consider salary request at mid-year budget.</p> <p>TAK seeking authority to let sole-source contract for the payments program.</p>
	<p>Interpretation of tax laws weak</p>	<p>Design and develop trainings around key concepts of the tax laws such as Permanent Establishment and Transfer pricing issues.</p>	<p>Training given in Permanent Establishment issues and attribution of profits of PE. Additional courses planned later in the year on transfer pricing issues.</p>
2.0 Commercial laws	<p>The Government is drafting a Concession Law which, from information obtained could be damaging to obtaining interest in PPP projects</p>	<p>Work with Minister of Finance and OPM to alert them to the potential negative consequences associated with the implementation of such a law. Aim to provide direct technical assistance to improve law.</p>	<p>In progress.</p>
3.0 Privatization	<p>Trepa complex in a difficult unresolved situation that can only be unlocked through a Chapter 11 type solution</p>	<p>Work through USAID to provide briefing material and supporting documents to decision makers</p>	<p>In progress</p>
4.0 Energy	<p>Kosovo C PSC not convened to move project forward.</p>	<p>BearingPoint Advisors working with MEM, OPM, MFE and Assembly to lobby for action.</p>	<p>Created legal opinion on need to convene PSC. Being reviewed by Minister Pula.</p>

## 4. Success Stories

**Treasury:** Improvement in the scope of reconciliations has been achieved through the implementation of the UNIREF.

**Tax Administration 1.2:** The development of the Audit Model is the first tool of its kind developed for use in TAK. This tool is a combination risk assessment and audit planning tool. In addition, to providing a snapshot view of the taxpayer as described in the quarterly narrative, it also provides the ability to analyze groups of taxpayers according to their industry code, which increases its use for risk assessment purposes. The loss of one programmer temporarily set the project back in late December, but a second programmer quickly grasped the concepts and has been vital to the progress made. The report will be available to regional managers and team leaders for their access on their computers.

## 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	Release 2008 Budget Book	Budget Departments and organizations	Spring 2008
1.1 Budget	Release revised 2009-2011 Medium Term Expenditure Framework (MTEF)	Budget Department, Macro Department	April 2008
1.1 Treasury	Results of audit of 2007 financial Statements	Treasury MFE	Sept 2008
1.1 Property Tax	Sida mission to assist in drafting tender document for finalizing of property tax system.	MFE Property Tax Office and Sida	April 2008
1.2 Tax Administration	IMF Technical Assistance Visit	TAK Director and Staff	16 – 29 April 2008
	Review and update VAT Law	TAK, MEF	Began 28 March 2008
2.0 Commercial Law	Present three commercial law training courses, and deliver a substantive reference guide, to judges and lawyers of Kosovo on the policies underlying and substantive provisions of the Kosovo Laws on Trademarks, Arbitration, and Business Organizations.	Kosovo Judicial Institute (KJI) and Kosovo Chamber of Advocates (OAC).	April, May and June 2008

---

3.0 Privatization	Government Policy Directive in favor of development of infrastructure with PPP.	Prime Minister / Minister of Finance	Second quarter 2008
4.0 Energy	Athens Forum Meeting to present Kosovo C project, Zhur Hydro and KEK privatization	MEM	May 2008
	KEK Retail Tariffs and KOSTT Transmission Tariff filing, review and approval	ERO	Approval by end of April 2008