2008 ANNUAL REPORT

KORPORATA ENERGJETIKE E KOSOVES (KEK)
NETWORK AND SUPPLY PROJECT
CONTRACT NUMBER EPP-I-00-03-00008-00

THIS PUBLICATION WAS PREPARED BY PA GOVERNMENT SERVICES INC., PIERCE ATWOOD LLP, AND FINANCIAL STIMULUS LTD. FOR THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

MARCH 2009

Executive Summary

Given the severe and continuing problems in Kosovo' power sector, USAID initiated a project in 2007 to provide targeted assistance to the country's electricity company, Korporata Energjetike e Kosoves (KEK). The KEK Network and Supply Project aims to ensure that KEK's new management receives coaching and guidance to address the dire situation, to facilitate the privatization of KEK, and to improve the company's commercial performance.

This summary describes the main results achieved by the project team (PA Government Services, Pierce Atwood, and Financial Stimulus Ltd.), which is embedded in KEK. The results are grouped according to the project's 11 tasks.

Task 1: Support Management and Operation to Preserve Assets

We assisted in the developing the KEK Business Plan for 2008-2009, preparing the quarterly revision of the KEK capital and operating expenditures budgets, and preparing the budgets, revenue forecasts, sales forecasts, and energy forecasts for 2009. Our team also provided a major policy paper on budgeting, procurement and cost control.

Mines. The team continually reminded the government of the needs at the KEK Mines. PA assisted the Managing Director in prioritizing mining needs, contributed to the update of the Complimentary Mining Plan, and assisted in the procurement of two excavators and various other large capital purchases for the mines.

Thermal Generation. We were instrumental in helping generating unit A5 become operational in November 2008, and assisted in the purchase of a replacement step-up transformer for Unit A4, and improved water monitoring and water filtering equipment and new generator rotors for the B units.

Hydro Generation. Our team participated in the preparation of tenders for the rehabilitation of three small hydro plants. We also advised on the implementation of a renewables tariff for hydro, wind, solar, and similar renewable energy sources.

Capacity Management, Power Purchases, and Energy Trading. PA advised KEK not to enter into a take-or-pay contract for firm power, which would cost the utility money.

Network Division (not covered elsewhere). PA assisted KEK in its meetings with the architectural and engineering consultants for the planned new US Embassy in Prishtina, facilitated the creation of topographic maps for NATO peacekeeping bases that show KEK's 10 kV feeder, and facilitated KEK's top management in moving to the Electro Kosova Building. We also continued to advance the need for the Vaganicë 110/35 kV substation (which would assure energy reliability in the north and east) and the rehabilitation and expansion of the Palaj 110/35 kV substation (affecting coal mining, coal transport, and water pumping from the mines).

Task 2: Amend Distribution Structure and Organization

Our team developed a new structure for KEK's seven districts. One manager is now responsible for core services, network and supply in each district. The new structure was implemented first in Ferizaj District, and then in the other six districts. Billings and collections improved markedly as a result.

Task 3: Improve Energy Accounting

After much encouragement and effort, KEK was able to purchase and install a new load flow program that enables it to study technical losses on the extensive 0.4 kV low-voltage network. In the past, this network accounted for more than half of the utility's annual technical losses.

Advanced meters with remote reading capability were installed at KEK's three largest customers, and are now being migrated down to customers served by the lower voltage levels (35 kV and 10 kV). Metering was installed and became operational for non KEK customers in the land that is owned by KEK around the mines and generating plants in 2008. The energy use by theses customers, worth about €1.2 million per year, was previously not metered, billed, or collected. Successful tenders for residential and commercial meters were launched in late 2008; contracts were signed in early 2009.

Task 4: Increase Collections

Billing and collection performance improved significantly in 2008 due to increased controls on meter readings, field verification of abnormal meter reading data, intensified disconnections for non-payment, and the implementation of the new structure in the districts.

The "pay at the bank" program for customers (Kos-Giro) was implemented in 2008 and was well received. It will be expanded to a direct debit system in 2009.

The continuation of the Radio-Television Kosovo fee on all electric bills for public television was opposed by KEK and the PA Team; however, it was forced on KEK by the government.

KEK's metering, billing and collections performance improved during 2008.

	2006	2007	2008
Ratio of energy billed vs. energy available for sale	69.1	69.9	79.7
Percent of money collected vs. billed	74.2	76.6	75.4
Percent collected vs. energy available for sale	51.3	53.5	60.12
Collected revenue (millions of Euros)	96.0	110.8	134.6

Task 5: Assist KEK to Take Over and Clean Up CCP (Customer care Package)

Responsibilities for the support of the CCP and the ABC modules were agreed to by KEK's Supply and Network Divisions, and the Information Services Department. Work on the CCP was prioritized. A major program was launched to clean up problems with data inside CCP.

Task 6: Assist KEK to Take Over the Computerized Accounting System and Un-bundle Accounting

Our team developed methods for tracking mining, generation, network and supply revenues, expenses, assets and liabilities; this led to the unbundling of KEK's accounts, a major milestone on the way to privatize the utility. We also developed a new chart of accounts and terms of reference for implementing it, and assisted in developing new accounting policies. PA contributed to many other tasks, including archiving passive customer account data and impairments, and completing auditor reports and the general ledger.

Task 7: Support Tariff Applications and Improve Regulatory Compliance

We assisted KEK in its tariff filing for 2008 and in preparing the tariff fling for 2009, which began in late 2008. PA also helped it prepare rules on disconnection, reconnection, new connections, customer contracts, and meter maintenance, and trained KEK's Regulatory Department.

Task 8: Improve Internal Controls and Strengthen Internal Audit

In order to improve the existing situation, our team designed a new Organizational Chart of the Internal Audit and Anticorruption Department and developed all necessary procedures for its proper functioning.

Sixty employees were dismissed or suspended for corruption in 2008, and 200 employees received disciplinary actions. Eighty criminal cases were submitted to the prosecutor.

Task 9: Provide Legal Support for Unbundling and Privatization

PA prepared numerous documents for the privatization of KEK, and for amendments to the Law on Publicly Owned Enterprises, license transfers from the old KEK to the new KEK, tender dossiers, contracts, an employee handbook, and a new structure for the districts.

Task 10: Assist Privatization Transaction Advisor

The government's hiring of a transaction advisor for KEK's privatization was delayed, but the PA team began collecting relevant documents, preparing a data room of documents, drafting key documents (see Task 9), and preparing for the external auditor. We met regularly with various stakeholders on the privatization of KEK.

Task 11: Support Normalization of Service to Enclaves

Numerous meetings were held with representatives in the enclaves. Many plans were developed and agreed to, but then not fulfilled by the minorities. Invariably, the answers to KEK were either, "we are waiting to hear from Belgrade," or "Belgrade tells us not to agree to this." Efforts will continue in 2009 to find a way for all people inside Kosovo to somehow pay KEK for the electricity they use.

Contents

Acronyms

BOD	Board of Directors
CAPEX	Capital Expenditures
CAS	Computerized accounting system
CBK	Central Bank of Kosovo
CCP	Customer Care Package
CFO	Chief Financial Officer
CMP	Complementary Mining Plan
COA	Chart of Accounts
EPS	Electric Power of Serbia
ERO	Energy Regulatory Office
FS	Financial Statement
GoK	Government of Kosovo
GSM	Global System for Mobile phones
IA&ID	Internal Audits and Anticorruption Department
IS	Information Services
JTF	Joint Task Force
KCB	Kosovo Central Budget
KEK	Korporata Energjetike e Kosoves
KEMA	Consultants to KOSTT
KFOR	NATO peacekeeping force in Kosovo
KOMTEL	Name of a Company under contract with KEK for programming.
KOSTT	Transmission, System and Market Operator
KTA	Kosovo Trust Agency
LDK Party	Democratic League of Kosovo
LOMAG	Land of Mines and Generation
LVN	Low-Voltage Network
MD	Managing Director
MEF	Ministry of Economy and Finance
MEM	Ministry of Energy and Mines
MoU	Memorandum of Understanding
MVN	Medium-Voltage Network
OSCE	Organization for Security and Cooperation in Europe
OPEX	Operating Expenditures
PISG	Provisional Institutions of Self Government

PM	Prime Minister
POE	Publicly Owned Enterprise
PPA/PPRC/PRB	Public Procurement Agency/Public Procurement Regulatory Commission/Procurement Review Board
RTK	Radio-Television Kosovo
SRSG	Special Representative of UN Secretary General in Kosovo
TAK	Tax Authority of Kosovo
UNMIK	United Nation Mission in Kosovo
USAID	United States Agency for International Development
USKFOR	United State Kosovo Force
VAT	Value-Added Tax

Acknowledgements

This annual report on the Korporata Energjetike e Kosoves (KEK) Network and Supply Project covers the period January 1 to December 31, 2008. It was prepared by PA Government Services Inc., Pierce Atwood LLP, and Financial Stimulus Ltd., under Task Order 4 of Contract EPP-I-00-03-00008-00. The authors gratefully acknowledge the support of the United States Agency for International Development/Kosovo Mission (USAID/Kosovo) in its preparation.

This report was made possible by the support of the American people through USAID/Kosovo. Its contents are the sole responsibility of PA Government Services Inc., Pierce Atwood LLP, and Financial Stimulus Ltd., and do not necessarily reflect the views of USAID or the United States Government.

USAID
Mr. Arben Nagavci
Contracting Officer's Technical Representative

USAID/Kosovo
Prishtina, Kosovo

PA Government Services Inc.
Masoud Keyan
PA Government Services Inc.
4601 North Fairfax Drive, Suite 600
Arlington, VA 22203
Tel: +1 571 227-9000
www.paconsulting.com

1. Introduction

This 3.5-year project (January 2007-June 2010) is intended to build the capacity of the electric utility Kosovo Energjetike e Kosoves (Kosovo Energy Corporation, or KEK), with the ultimate objective of supporting its privatization. The project's three original objectives were to:

- *Objective 1: Provide support to the managing director of KEK*, with an emphasis on enhancing the company's revenues.

- *Objective 2: Increase collections through support to the Network and Supply Divisions of KEK to accelerate potential future private sector participation* (making recommendations on whether the divisions should be combined into a single organizational unit, advising on the interface between the Network Division and the transmission/market operator, providing support to the new Anti-Corruption Department, creating a comprehensive metering program, advising on the operation of the Supply Division, with an emphasis on increasing collections, creating a program for revenue cycle management, instituting an annual external audit of the divisions, and preparing a priority investment plan for the divisions).

- *Objective 3: Improve the institutional, policy and legal environments* in which KEK operates and advise KEK on the revision of laws and regulations to enable it to operate using international best practices.

By April 2008, USAID and the PA Team had determined that KEK's institutional and systemic deficiencies (both external and internal) were more pervasive and acute than anticipated at the time of project design. In addition, the company's management was found to be less than sufficient to manage the complex challenges KEK faces. Last, frequent government interference in KEK's operations and changes in its board of directors necessitated a change in approach. USAID and the Kosovo Government then agreed to accelerate efforts to privatize KEK's distribution (network and supply). It was also agreed that commercialization should proceed in lock step with the preparation of any privatization transaction. Thus, the original contract was amended and the following five additional objectives were added:

- *Objective 4: Preparation of KEK Distribution Functions for Privatization*
- *Objective 5: Support to KEK Commercialization*
- *Objective 6: Anti-Corruption Efforts – The Reduction and Prosecution of Fraud, Waste, and Abuse*
- *Objective 7: Legal and Regulatory Support*

- *Objective 8: Normalization of Service to Enclave Communities.*

These eight objectives were further refined into eleven tasks. Table 1 shows the relationship between the objectives and tasks.

Table 1. Relationships Between Objectives and Tasks

Task Number	Task Title	Objective Title and Number							
		Support to the Managing Director of KEK	Increase Collections through Support to the Network and Supply Divisions to Accelerate Potential Future Private Sector Participation	Improve the Institutional Policy and Legal Environment	Preparation of KEK Distribution Functions for Privatization	Support to KEK Commercialization	Anti-Corruption Efforts – The Reduction and Prosecution of Fraud, Waste, and Abuse	Legal and Regulatory Support	Normalization of Service to Enclave Communities
		1	2	3	4	5	6	7	8
1	Support Management and Operation to Preserve Assets	●				●	●		
2	Amend Distribution Structure and Organization			●	●	●	●		
3	Improve Energy Accounting		●		●	●	●		
4	Increase Collections		●	●	●	●	●		
5	Assist KEK in Taking Over and Cleaning Up CCP				●	●	●		
6	Assist KEK in Taking Over CAS and Un-bundling Accounting				●	●			
7	Support Tariff Applications and Improve Regulatory Compliance			●		●		●	●
8	Improve Internal Controls and Strengthen Internal Audit				●		●		
9	Provide Legal Support for Unbundling and Privatization			●	●	●	●	●	●
10	Assist Privatization Transaction Advisor				●	●	●	●	●
11	Support Normalization of Service to Enclaves		●		●	●			●

2. Summary of 2008 Progress

This section reports the progress made during 2008 against the Project's tasks. Appendix A summarizes the status of Project activities and deliverables. Appendix B summarizes the accomplishments in terms of key performance indicators and related metrics.

Task 1: Support Management and Operation to Preserve Assets

This task contributes to Objective 1. Please refer to Table 1 on page 2.

General

The PA Team assisted the acting Managing Director (MD) on issues related to the company's management and operations. We received his full cooperation on most of the recommendations related to the company's operation, procurement, mining, staffing, and financial activities.

- Several meetings were held with the Government of Kosovo (GoK) – the Prime Minister (PM) and his advisor, the Ministry of Economy and Finance (MEF), and the Ministry of Energy and Mines (MEM) – to inform them about KEK's need for their assistance. Some of the issues discussed during Quarter 4 had been brought to their attention as many as 8 months earlier. Unfortunately, none of the issues was advanced for various reasons, highlighting key counterparts' lack of accountability in making any significant decision.

- The PA Team assisted with the development of a KEK business plan for the two-year period 2008-2009.

- Facilitated KEK's top management move to the Electro Kosova Building in December.

- We assisted with the quarterly revisions of KEK's 2008 operation and maintenance and capital budgets to reflect the company's performance during the previous period and ensure sure that KEK's budgeted expenses would not exceed its budgeted revenue for the year. In the semiannual revision, the budgets of the Mines and Network Division were reduced owing to the fact that KEK's revenue for the first half of the year was below the budgeted amount. The Generation Division's budget was increased to allow the use of funds from

KEK's contingency fund to cover the higher cost of the A5 rehabilitation project. In the 9-month budget review, the budget of Mines was increased to the initially approved amount (before the half-year revision) as KEK's revenue increased and was projected to be on target at the end of the year.

- The PA Team supervised the preparation of the Performance to Plan Reports for Q1 to Q4. The reports detailed the performance of each of the four core divisions (Mines, Generation, Network and Supply) against the approved Key Performance Indicators (Coal Production, Overburden Removal and Coal Stock Pile for the Mines, Availability, Gross Generation, Auxiliary Consumption, Net Generation and Capital Investment for Generation, Commercial Losses, Meter Reading, Meter Installation, Meter Inspection and Calibration for Network and Billing Rate, Bill Delivery and Collection Rate for Supply). We also helped to prepare the Internal Audit Quarterly and Annual Reports against the Internal Audit Annual Plan. PA then assisted with the preparation of action plans for performance improvement based on the reports' analysis.

- PA finalized a major policy paper on Budgeting, Procurement and Cost Control Procedures, and discussed the implementation of the new policy with all stakeholders. Our team identified major changes in the existing procedures, organization and job descriptions required for the successful implementation of the new cost control environment.

- PA assisted in preparing all KEK divisions and departments for the 2009 budget campaign.

- We helped prepare KEK's 2009 revenue forecasts based on the approved energy balance under three scenarios that varied by billing and collection rates, and tariff assumptions. The scenarios were labeled: "Minimum," "Good" and "New Tariffs" revenue forecasts.

- PA assisted with the preparation of KEK's 2009 expenditure budget. The company used zero-based budgeting, i.e., all division managers justified their budget requests in detail, regardless of their previous year's expenditures. PA and the Budget Department organized budget hearings with all company divisions to rank all operation and maintenance (OPEX) and capital (CAPEX) expenses in order of priority. Based on their ranking all expenditures included in the consolidated 2009 budget were grouped in "Minimum," "Good" and "New Tariffs" budget categories to match the revenue forecasts. The final expenditure budget was submitted to the Board of Directors. The Board approved the "Minimum" budget category with the recommendation that the new Board review and approve all budget categories.

- PA assisted with the development of a cash flow forecast for 2009.

- PA supervised the execution of KEK's long-term investment plan, which included all high-priority projects for the Mines, Generation, and Network Divisions for the period 2009 to 2011. We also developed procedures for the timely and efficient utilization of the Kosovo Central Budget (KCB) grants to fund the plan.

- KEK, with PA's assistance, revised the KCB funding needs for 2009-2011. The document was re-submitted to MEF and was subsequently agreed to by all stakeholders.

Mines

- The PA Team assisted the MD and Executive Director of Mining to focus on high-priority issues and to ensure coal production from the new SSW mine in 2010.

- The preliminary update of the Complementary Mining Plan (CMP) developed in 2005 revealed several shortcomings, including the boundaries and depth of coal in several areas. New drillings revealed that original CMP assessments were not accurate in certain areas, requiring changes in the dimensions of the mine, the mining plan, and coal production. The mining plan was modified and the SSW mine opening activities will precede based on the revised technical plan.

- PA assisted with the procurement of two new coal excavators. In September, three qualified operators submitted bids and a successful tender was announced. However, a disappointed bidder subsequently made an unsubstantiated complaint, which undermined the process and ultimately – due to improper interference by the Procurement Review Board (PRB) – led to the cancellation of the procurement in October.

- Once again, the Procurement Law was a barrier to obtaining the best-value equipment for KEK. The bidder who was the cause of two tender failures has inferior equipment, but at a lower price. Since product quality is not a criterion, the tender for the compact excavator has become the hostage of this vendor. Given that coal excavator procurement is one year behind schedule, KEK, with PA's assistance, has devised Plans B and C for coal production to ensure coal production by mid-2010.

- PA assisted with decision making for all overburden equipment, which resulted in all contract for overburden equipment being signed in 2008.

- PA helped drafting the contract terms for the rehabilitation of spreaders and conveyor belts, which are part of the overburden removal systems.

- The New Sitnica Mine began production in late September as scheduled and full production capacity was reached in Q4. The mine produced 400,000 tons of coal in 2008.

- KEK removed 14.3 million cubic meters of overburden and produced 7.9 million tons of coal in 2008.

Thermal Generation

- After 8 months, the MD signed the contract for the additional boiler work on Unit A5 per PA's recommendation. The A5 became operational in November 2008, just in time for the winter season.

- KEK's 5-month effort (July- November) to procure a used transformer for Unit A4 failed, resulting in the loss of operation of a 120 MW unit during the winter months. PA provided assistance for procurement and drafted a contract for a used transformer, which was signed in late November. It is anticipated that the transformer will be delivered in late February 2009.

- PA's report assessing Units A1 and A2 and the feasibility of reactivation was completed and presented to KEK's Chief Operating Officer, generation management, and USAID. The report was well received and KEK is considering the implementation of its recommendations.

- PA helped KEK with the specifications for upgrading the B units' water treatment plan, which must be implemented by mid-2010, before the new LP rotors arrive. PA was not an observer during the evaluation process, and the evaluation was botched; it is likely that the tender must be canceled and started over again.

- PA assisted KEK in negotiating the purchase of and drafting a contract for a new generator rotor for the B Units.

- In November, the rehabilitated Unit A5 was successfully commissioned and has been operating since then. PA had presented the financial/business case for the rehabilitation of the Unit during the second quarter of 2007 and provided significant assistance to KEK in concluding the requisite contracts during Q3 and Q4 of 2007.

- We arranged meetings with Alstom France, MEF, and KEK management to address the Alstom tax liabilities, which impacts the B units' operation (digital control system and new generator rotor). Per MEF's intervention the Tax Authority provided a 3-month suspension of claims against Alstom that allowed the signing of the contacts, payment of pending invoices, and submission of documents and records by Alstom to the Tax Authority indicating that they do not owe any taxes on their B units for 2002-2004.

- PA facilitated a discussion to explore the unconventional repair of the spare LP rotor to meet emergency needs in the upcoming winter. The tests of the rotor blades were conducted and Alstom Germany submitted a recommendation for repair along with cost estimates. Unfortunately, despite repeated warnings about the lack of a spare rotor, KEK's generation management has not taken any action to repair it.

Hydro Generation

- PA assisted with the pre-qualification of the bids submitted for rehabilitating the three small hydropower projects owned by KEK. Following the pre-qualification of bids, we helped KEK with finalizing the contents of the tender dossier, which was circulated to bidders in December. The final bids will be submitted in March 2009.

Capacity Management, Power Purchases, and Energy Trading

- With the PA Team's assistance, after several months of game playing by the head of KEK Procurement (the PM's relative) and after MFE assured KEK that funding was available, a tender for power was launched for October 2008 through March 2009. The prices were 20% higher than the earlier tenders. Despite PA's repeated warnings that KEK should not purchase power at these high prices in order to provide 24-hour service (no load shedding) to B and C category customers, per MEM/GOK instructions, KEK contracted for €41 million in firm purchase power for the period. In November, due to warmer weather, KEK had surplus supply, even after providing 24-hour supply to all consumers. Given the circumstances, KEK had to back down it is own generating units while being forced to import power due its take-or-pay power import contracts.

Network Division (Not Covered in Other Tasks)

- PA facilitated the:
  - Meeting between the Network Division and the architectural / engineering consultants from Washington for the construction of the new US Embassy.
  - Creation of topographic maps for the US Army at Camp Bondsteel that show the location of the 10 kV and 6 kV feeders.
  - Management issues related to the relocation of KEK management from offices in the Toscana Building to new offices in the Electro Kosovo Building.

- We assisted KEK's Maintenance Department for the central heating utility (ThermoKos) to repair KEK valves, pumps, and pipes in the Electro Kosova Building.

- PA advised KEK's Network Division and top management on various matters related to KOSTT (the transmission system and market operator):
  - Rehabilitation of 220 kV lines from Kosovo A SS to Macedonia.
  - Limitations on KEK's ability to distribute power to customers in light of the failure of KOSTT's 220/110 kV 100 MVA power transformer at the Kosovo A Substation.
  - Resolution of about two dozen issues, including KEK's payment of monthly fees to KOSTT, and freeing up of office space to KOSTT that KEK was occupying.
  - Comments provided on the obligatory KEK-KOSTT connection agreement.
  - Participation in a presentation (November 25, 2008) by KOSTT on cross-border power trading: Kosovo's and KEK's participation in the regional power market.

- PA advanced the work of the Network Division and Electro Engineering Inc. (KEK's outsourced engineering, design and construction firm) on several key projects:
  - Palaj Substation and the line that is a single point of failure in the electricity supply needed for mining and transporting coal to the Kosovo A and B power plants, and water pumping out of the mines. Two recent incidents of losses on this line and the loss of the substation resulted in a halt in coal production and coal transport, and dewatering of the mines.
  - A new 10 kV distribution line from the Kishnica 35/10 kV Substation to Iber Lepence Pumping Station 1, which is being rehabilitated to provide additional drinking water to the City of Pristina by way of Lake Badovc.
  - Development of a new double-circuit 35 kV feed from Palaj Substation to the Bivolac water pumping station used by Ferro Niklei. Water is critical to the operation of the Ferro Niklei plant in Drenas, and water is pumped 17 km from Bivolac (near the Kosovo B plant) to the Ferro Niklei plant.

- The work on Vaganicë substation project continued into Q3 2008 with the preparation of the tender document for the construction of the 110 / 35 / 20(10) kV Substation. The tender document is now ready to be used; KEK and KOSTT (co-partners on the project) are waiting for the GoK to decide to proceed with the project.

Task 2: Amend Distribution Structure and Organization

This task contributes to Objectives 3, 4, 5 and 6 (please refer to Table 1).

Our team recommended major changes to the structure and organization of KEK's Distribution and Supply Divisions, and proposed to test the new structure and organization on a pilot project basis, first in Ferizaj and subsequently in other districts.

The pilot project introduced new "Regulations for Operations in KEK Districts." KEK appointed the district managers that PA recommended, and all personnel (Network, Supply, and some core services) report to the new district manager. Under the previous structure the Divisions reported directly to Headquarters in Prishtina. As a consequence of these changes:

- One manager is responsible and accountable for the performance of each District.
- Meter readings are now completed in a 5-day cycle, rather than the earlier 21-day cycle.
- Bills are now distributed within 3 days, rather than 21 days.
- More work time is devoted to disconnections in order to enforce payment discipline.
- Non-performing employees are terminated after two warnings.
- KEK's 2008 financial performance improved significantly due to the implementation of the pilot project and its replication.

Descriptions of the implementation and the results of the pilot projects are provided below.

Implementation of Pilot Projects in the Districts

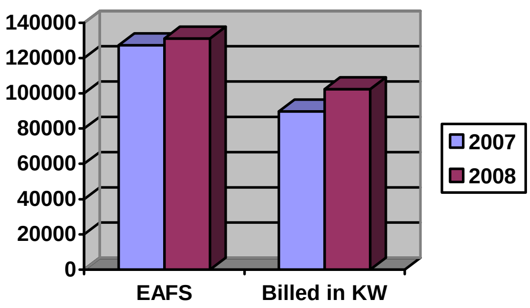
The Board of Directors approved the new regulations, distribution structure and organization for the Ferizaj District at its meeting on 6 August 2008. The new structure was implemented and the new regulations ("Regulations for Operations in KEK Districts") introduced in Ferizaj on 1 September 2008. At this time, KEK also appointed a district manager; all personnel report to this individual. After two months of good results in Ferizaj, the new structure, procedures, and regulations were implemented in Gjilan and Gjakove Districts in November and in Peja, Prizreni and Mitrovica Districts in December. KEK appointed managers in each of these districts after consulting with PA.

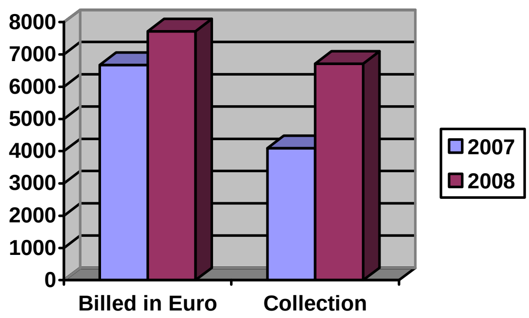
The Acting Managing Director's cooperation was exceptional during this period and the results demonstrate the level of cooperation that PA received from him. However, the sustainability of results and progress in other areas are at risk due to stakeholders' political interference in the company's management decisions and an incompetent Board of Directors. Several decisions taken by KEK's BOD resulted in setbacks and barriers to further improving KEK's performance.

Results of Implementing the New District Structure and Procedures

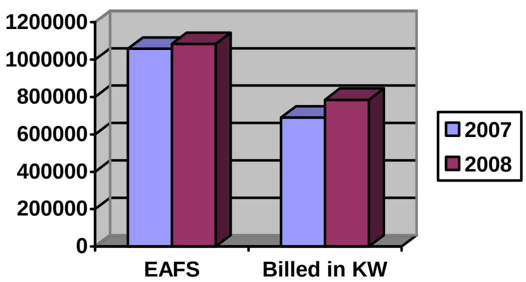
To determine the impact of the pilot project on the KEK's performance, PA conducted a comparative analysis of the Ferizaj District and all of KEK for September to December 2008 and the same period in 2007.

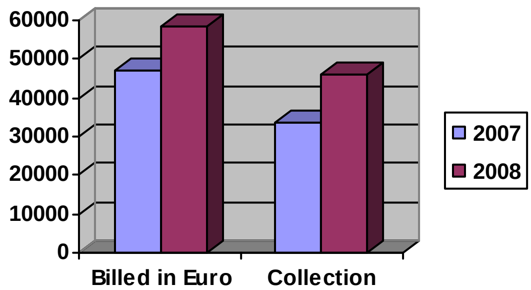
Ferizaj District. The results show that during the pilot project period, the district's billing increased by 8% and collections by 26% (an additional €2.622 million was collected). Therefore, the district's overall performance was 25% higher in 2008 than the same period in 2007.





Other Districts. During the pilot project period, KEK billings increased by 7% [EAFS – Energy Available for Sale] and collections by 8% (an additional €12,510 million was collected). Thus, its overall performance was 10% better in 2008 than during the comparable period in 2007.



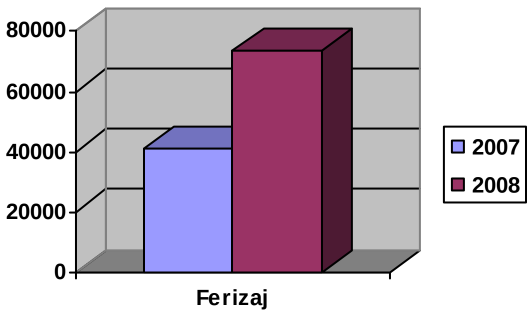


The significant increase in collections in Ferizaj District is attributed mainly to:

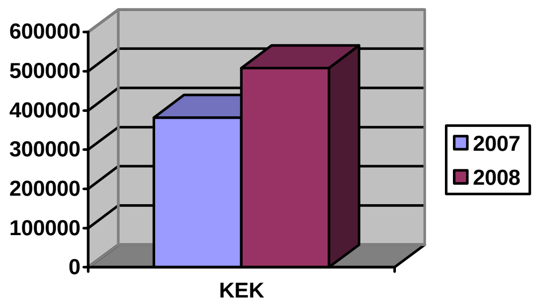
- A more aggressive and targeted disconnection policy (as a result of the disconnections in Ferizaj during the pilot, 79% more payment transactions were made in 2008 and 33% more in all of KEK).
- A new customer relationship management policy that encourages customers to pay every month.

  Improved staff performance as a result of implementing a new performance-based remuneration policy (key performance indicators were developed for district personnel working in substations so they could become part of the bonus pool under the new district structure).

Number of Payments



Number of Payments



New Review

PA conducted a review of the accounting structure, organization, and accounting policies and procedures in Ferizaj, Gjilani, Gjakova, Peja, Mitrovica, Prizreni Districts, and developed recommendations for improvement.

Training

District managers, supply and network managers, and sub-district coordinators from Ferizaj, Gjilani, Gjakova, Peja, Mitrovica, and Prizreni Districts were trained in the field on the following topics:

- Properly organizing the meter reading routes
- Preparing disconnection lists and organizing disconnection plan
- Conducting analyses and preparing reports
- How to manage under the new structure.

Task 3: Improve Energy Accounting

This task contributes to Objectives 2, 4, and 5 (see Table 1).

Load Flow Program

By the end of Q4, with PA's assistance, the data conversion from the previous load flow program (GRAEDOS) to the new program (DIGSILENT) was completed. This new load flow program will contribute to the sketching, mapping, and analysis of the 0.4 kV low-voltage networks, which is part of the CCP clean-up (see the discussion in Task 5).

Meter Installations

Ferro Niklei and Trepca Metering. PA advanced work to install new electronic meters with load profile data recording and remote reading capability at the Ferro Niklei plant and Trepca mining complex. Benefits included: 1) the existing KOSTT metering is backed up by these check meters, 2) the existing KEK metering is backed up by these additional check meters, and 3) KEK in Pristina can read the meters remotely using GSM/GPRS telephone links and thus monitor the Ferro Niklei load without having to bother the substation operators to read the six meters and phone the readings back to Pristina. The metering work at Ferro Niklei was completed in early October 2008, and the metering work at Trepca was completed at the end of December 2008.

Ferizaj Transformer Points. PA assisted KEK in installing 600 half-indirect electronic meters (CT rated, direct connect on voltage) at 600 transformer points in Ferizaji District. Although the meters arrived in the summer of 2007, KEK had not committed to install them until encouraged by PA in Q4 2008. KEK is currently purchasing the miscellaneous equipment (current transformers, boxes, and wiring), some of which has begun to arrive, and installation is planned for Q1 2009. PA has facilitated the involvement other districts to contribute metering personnel to Ferizaji District so that the installation can proceed rapidly once the material arrives.

KEK Self-Consumption and Tariff Customers at the Land of Mines and Generation (LOMAG): The PA Team advanced the metering of KEK self-consumption at the LOMAG by facilitating meetings among the Network Division, Supply Division, and Information Services Department. By the end of December 2008 KEK's Information Services (IS) Department had created an 8th file serve on which a version of the CCP program was installed, except for the installation of the financial parts of CCP. This enables KEK to record and archive the meter readings from LOMAG. This extensive metering project initially started to track KEK self-consumption at the LOMAG (which it does), and how the project supports the privatization of both KEK Distribution and KEK Mining and Generation by identifying, metering, and recording loads and bills of tariff customers located on the LOMAG.

KEK Procedures to Improve Energy Accounting

The PA Team contributed to the development of three KEK procedures:

- Calculation of reclaimed losses (energy and revenue).
- Closing of accounts, especially with regard to eliminating passive customers.
- Customer contracts.

ABC Feeder Ranking for Dispatching under Constrained Conditions

The release of the ABC ranking of feeders, to show the required load shedding schedule, was delayed in November 2008 due to problems with the data; the PA Team facilitated the resolution of the data problems and the subsequent release of the ABC listing in December.

Monthly Energy Accounting Reports to the Board of Directors

The PA Team supported the preparation and submission of the monthly energy accounting report to the Board of Directors. Responsibility for preparing this monthly report was transferred to KEK in Q3, but the PA Team supports KEK in its preparation and the resolution of data problems.

Tenders and Proposals

Meters for Residential Customers Applications: PA led the team that prepared the tender documents for KEK's next purchase of electronic meters for residential customer usage. This involved a total of 42,250 meters (9,750 in 2008 and 32,500 in 2009). Bids are due to the KEK Procurement Department on 9 January 2009. Three other supporting documents were prepared for the tendering. If all options are taken, the estimated value of purchases is €4.2 million.

***Meters for Commercial Customer Applications*:** PA led a team that prepared the tender documents for KEK's next purchase of half-indirect (that is, current transformer rated, but directly connected on voltage) electronic meters for commercial customer usage. This involved a total of 1,500 meters to be delivered in 2009; the estimated value is €375,000. A request for bids went out from KEK Procurement in Q4; and bids are due in Q1 2009.

Meters for Ferizaj District Project: PA drove the effort to purchase 100 meters for Ferizaji District, and prepared the tender document. The contract was awarded by KEK Procurement in Q4 2008 and delivery is scheduled for Q1 2009.

Task 4: Increase Collections

This task contributes to Objectives 2, 3, 4, 5 and 6.

Billing and Collections

KEK's metering, billing and collections performance has improved. The numbers below are from the monthly report to the BOD.

	2006	2007	2008
Ratio of energy billed vs. energy available for sale	69.1	69.9	79.7
Percent of money collected vs. billed	74.2	76.6	75.4
Percent collected vs. energy available for sale	51.3	53.5	60.12
Collected revenue (millions of Euros)	96.0	110.8	134.6

Billing and collection performance improved significantly in 2008 due to increased controls on meter readings, field verification of abnormal meter reading data, intensified disconnections for non-payment, and the implementation of the new structure in Ferizaj District and subsequently five other districts. Although total collections in Euros were significantly higher, the percent of money collected vs. billed was slightly lower, due to more marginal customers being billed..

KOS-Giro Payment Mechanism

The Kos-Giro system (the payment of electricity bills through all commercial banks in Kosovo) went "live" at the end of 2007. PA helped KEK to develop a promotional campaign that encourages customers to use the system. Problems encountered early in 2008 were resolved and since that time, the daily electronic transmittal of payments has been successful and the information can be posted accurately to each KEK customer account in CCP. The payment volumes and amounts for 2008 are shown below.

Use of the KOS-Giro Payment System		
2008 Quarter	**Number of Payments**	**Amount (€ 000)**
First	3,490	1,822
Second	5,258	2,158
Third	5,339	2,286
Fourth	7,086	3,093
Year 2008	21,173	9,359
Source: KEK Supply Division		

Promotional efforts resumed in the fourth quarter and focused on the continued promotion of the KOS-Giro system, especially as far as smaller customers are concerned. (As expected, household and small commercial customers' participation is low compared to larger customers.) PA developed a flyer that is provided to each customer with the bill and when making a payment at a cash office. These promotional efforts resulted in a 30% increase in the number of payments and amounts received from the Kos-Giro System during the fourth quarter.

Direct Debit System

PA facilitated progress on the Central Bank of Kosovo (CBK) initiative to establish a direct debit mechanism in Kosovo. This would provide KEK another opportunity to use the banking system to increase its cash flow. During the fourth quarter a PA advisor developed a discussion document and held meetings with KEK Supply, IT, and Finance personnel to formulate KEK's approach to implementing this new system and with CBK to learn more about the system and procedures they are developing. Since KEK processes all of its customer payments through Raiffeisen Bank (as a condition of its line of credit), a meeting was held with commercial and IS personnel from the CBK in November to discuss how we can move forward together to implement direct debits. Raiffeisen IS personnel estimate that the system will not go live before the middle of the first quarter of 2009.

Ratio-Television Kosovo (RTK)

The contract with RTK expired in November 2008. However, under pressure from the government, KEK decided to continue to collect the RTK fee for an additional year. In December 2008 PA prepared a draft RTK agreement to minimize some of the onerous provisions of the previous contract and recommended that KEK management propose this to RTK. In late December, RTK informed KEK that it would not agree to the new terms. It is most likely that the government will pressure KEK to sign a new contract with identical terms as the old terms.

Expected Change in Value-Added Tax (VAT) Rate

The VAT rate was increased from 15% to 16% effective 1 January 2009. Advisors to the Ministry of Finance indicated that special phase-in rules will be used for industries with cycle billing (electricity, water, heat). It was clarified that as long as the bills to customers for December consumption were delivered in the first half of January, they could carry the 15% VAT rate. Bills for January consumption (delivered in February) would contain the 16% rate. Billing for other services (connections, meter testing, etc.) were coordinated to send bills for outstanding items by 31 December to carry the 15% rate and then all bills issued in 2009 would carry the 16% rate.

Task 5: Assist KEK to Take Over and Clean Up CCP

The objective of this task is to clean up the customer data in CCP and remove erroneous and inaccurate information that exist in the system. This task contributes to Objectives 4, 5 and 6.

Assignment of Responsibilities

In accordance with the document "Responsibility of Users and Administrators in the Process of Operation and Maintenance of the CCP and ABC Modules," approved by the Managing Director, KEK's Supply Division established an Application Software Contact Group to help users resolve problems with procedures, system commands, data entry requirements, etc. The Executive Director of Supply assigned four employees to the group and allocated office space and equipment. The group is operational and functioning as planned.

Prioritizing System Work for CCP

PA organized a working session for KEK Supply and IS personnel to prioritize the 23 outstanding IS requests related to CCP. This was especially important since it is necessary to keep the changes that KOMTEL, contractor, must make to a minimum. As a result of the session, it was determined that:

- 10 requests require KOMTEL involvement
- 6 requests can be completed by KEK IS
- 5 requests are nearing completion
- 1 is no longer needed
- 1 is on hold pending a management decision.

Launch of CCP Cleanup Initiative

PA developed an approach and work plan to undertake the extensive effort needed to improve the integrity of CCP customer information. The approach and work plan were presented individually to the Network and Supply Divisions, and their input and comments were incorporated into a presentation made to the Managing Director. His comments were incorporated into the final plan (included as Attachment Q408TS2). The initiatives included in the plan are:

1. Identify and flag those Serb customers who are currently in CCP. This will allow KEK to analyze the impact of those customers who rarely pay (or have never paid) and who KEK must deal with carefully. This identification will also be helpful in quantifying and disclosing information to potential investors.

2. Implement a Self-Identification Amnesty Plan for those households and entities consuming electricity, but not registered as customers in CCP. PA developed a Public Notice to be given wide circulation in local media and through KEK sources. (See attachment Q408TS3 for the notice.)

3. Develop reports to be used by field personnel to identify questionable accounts.

4. Conduct field inspections to locate unregistered consumers and identify nonexistent "customers."

5. Identify all customer connections. Network personnel are to sketch all connections from every 10/0.4 kV transformer to each connection point.

With all management approvals received, an overview of the project was discussed with all district managers on 19 December. The Executive Director of the Supply Division appointed the KEK Project Manager on 22 December, and on 26 December a PA advisor and the KEK Project Manager presented the project to the Ferizaj District management team.

We also worked on Network Division subtasks related to the CCP Cleanup Project:

Identification Numbering Objects of LVN / "Electrical Location: The PA Team facilitated the Network Division's development of procedures for the identification numbering of devices (poles, junction / splice boxes, customer connection boxes, and meter boxes) on the 0.4 kV low-voltage network (LVN).

Sketching of 0.4 kV LVN: The PA Team facilitated the Network Division's development of written procedures for the sketching the 0.4 kV LVN. This is a first step in a multi-step program:

- Sketch the LVN.
- Assign identification numbers to the LVN objects (poles, boxes, etc.).
- Label (mark) the LVN objects with tags or signs.
- Develop topographic maps of the LVN, using the mapping and topographic functions of the recently purchased three-phase load flow program.

Information Services Support of CCP: The PA Team facilitated the transfer of KEK employees from the Supply Division to the IS Department to support the work on CCP. We also contributed to KEK's work to identify and list the work needed to be done on the Computerized Accounting

System (CAS) and CCP before KEK takes responsibility for maintaining and servicing these programs. We provided consultations and advice to KEK's IS Department on several issues:

- Integrity of data bases
- Web services for new systems
- Data warehousing
- Job descriptions for new employees
- Questionnaires to be used during interviews of KEK IS candidates
- Presentation on the "Status of KEK's Servers and Communication Infrastructure"
- "IS upgrading needs" issues
- Defining necessary changes in the CCP and CAS database related with new VAT value.

PA designed and developed several new tools/utility reports for KEK use; they extract data/reports from the KEK CCP databases:

- *Consumers by Bill Amount* on a monthly basis. The report can be produced for a given time period and category of consumers (more than 60 categories). There is also an option to show the details of bills.
- *Payments by 10 kV and 0.4 kV Feeders* on a daily basis. The report can be generated for any time period including bank or cash (or both) payments. There is an option to show the details of payments.
- *Consumers with More than 3 Months of Repeat Billings*. This report can be produced for any bill amount interval and category of consumers. There are options to show the details of consumers and bills.
- *Consumer Bills by Category of Consumers*. Reports can be generated for any interval of bill amount, period of time or category of consumers. There is an option to show the details of bills.
- *Consumer Debts by Category of Consumer* (example: KEK Employee Debts). This report can be produced for any interval of debt amount or category of consumer. There is an option to show the details of debts.
- *Customers with 000 Coding for the 10/0.4 Transformer Station*. There is an option to show details about consumers.
- *Efficacy of Disconnections* grouped by a list of disconnections or payment days. Reports can be generated for the list of disconnections created in a selected time interval. There is an option to show the details of payments.

Task 6: Assist KEK to Take Over CAS and Un-bundle Accounting

This Task contributes to Objectives 4 and 5.

We continued to advise KEK on finance and accounting issues, mostly related to the takeover of CAS, improving the quality of financial and regulatory reporting, and completing the unbundling of accounting to secure the preparation of financial statements for each of the company's core divisions. The major accomplishments include:

- Developed a methodology for tracking Mining, Generation, Network and Supply revenues and expenses, and allocating headquarters revenues and expenses; and generated unbundled Income Statements for FY 2006 and 2007, and 9 months of FY 2008 for Mining, Generation, Network and Supply using transfer pricing based on full cost.

- Developed a methodology for tracking Mining, Generation, Network and Supply assets and liabilities and allocating headquarters assets and liabilities; and generated unbundled Balance Sheets for FY 2006 and 2007, and 9 months of FY 2008 for Mining, Generation, Network and Supply based on the assumption that KEK net equity is allocated with the difference between the function's assets and liabilities.

- Assisted with the reorganization and staffing of the Finance Division including the finance and accounting functions in the Mines, Generation, Network and Supply Divisions, to facilitate the accounting unbundling of KEK.

- Developed Terms of Reference for a pilot project for the implementation of new chart of accounts (COA). The project will be completed in February 2009. The new COA will be implemented in a separate accounting system, which will operate in parallel with the existing accounting system. The results of the two systems will be compared on a monthly basis to test the new COA thoroughly before it is implemented.

- Assisted in the presentation of the new COA to the Energy Regulatory Office (ERO). During the presentation the regulator's representatives stated that they had not yet decided whether they should prescribe a specific regulatory COA.

- Assisted with the development and implementation of improved accounting policies and procedures, and the introduction of new accounting manuals, including:
    - Account Balances Conversion Manual
    - Transaction Manual
    - Disclosure Manual.

- Helped develop and introduce customer payment priorities for the CCP.

- Assisted with the development of a methodology and procedures for the accounting for social subsidies.

- Developed a new methodology for the assessment of bad debt and provided recommendations for its implementation.

- Developed a methodology for the re-calculation of "negative bills" and provided recommendations on the procedure for recording them into CCP and CAS.

- Developed a methodology for the reassessment of impairment of assets in accordance with International Accounting Standard 36.

- Started work on cleaning the information in the Fixed Asset module of CAS. Developed procedures for reversing the impairment of KEK's assets as a result of the significant improvements and billing and collection rates.

- Recommended changes to the Human Resources/Payroll System to meet the requirements of the Ferizaj Pilot Project and supervised their practical implementation.

- Developed procedures for archiving the accounts of "passive customers" with outstanding debt to KEK.

- Prepared KEK's treasury and accounting functions for the introduction of customer payments through "direct debit."

- Continued to assist in implementing the recommendations contained in the Auditor General's report issued in 2006.

- Developed a draft policy paper defining the responsibilities of all users and administrators in the operation and maintenance of the CAS, including human resources and payroll modules.

- Reviewed and approved the new version of the General Ledger in CAS, which contains all of the improvements recommended by USAID experts. A plan was developed for implementing the new version, which will complete the transfer of the control and technical support of the CAS from KOMTEL to KEK.

- Assisted with the development and implementation of a financial statement report generator for the new version G/L 1.3 of CAS. Thus, the preparation of balance sheets, income statements and cash flow statements for all the cost centers of KEK as well as consolidated statements for KEK will be done automatically.

- Reviewed the manuals KEK received from Komtel for the Treasury and the Accounts Payable modules of CAS. PA's work with KEK staff on the manuals will conclude in Q1 2009.

- Continued to support the completion of the financial audits. The auditors prepared the draft audited Financial Statements (FS) for FY 2006 and FY 2007, and submitted them for KEK's management review. The acting Audit Committee approved them and recommended them to the BOD for approval. However, a review performed by KEK's Internal Audit staff, with the support of the PA Team, revealed a number of inconsistencies and errors in the draft FS (overstatement of liabilities by more that €50 million, understatement of the results of investment activities by more that €20 million, etc). The FS were adjusted and resubmitted to the auditors. The auditors prepared new versions which were reviewed and recommended for submission to the new Audit Committee.

- Developed terms of reference and prepared a tender dossier for the procurement and appointment of a new external auditor for KEK, to ensure that audited accounts for FY 2008 are available in a timely fashion for the privatization process. However, the launch of the procurement process was delayed by KEK's Internal Audit Committee, which is required by law to approve and initiate the procurement process.

- Prepared an action plan for implementing the recommendations provided in the Management Letters for FY 2006 and FY 2007.

- Took part in negotiating a new Overdraft Agreement with Raiffeisen Bank. PA provided support for the negotiation of a new agreement with the bank to fund KEK's working capital requirements. The terms and conditions of the overdraft were better than in the previous agreement: the interest rate was lowered to Euribor plus 4.85% and the ceiling was increased to €20 million.

- Organized a meeting between KEK's Chief Financial Officer (CFO) and Treasurer and their advisor, and the government's Director of Treasury and his advisor, where we assisted in negotiating the procedures for submitting requests for disbursements from the government loan for the rehabilitation of Unit A5 and the list and format of the supporting documents.

- Brokered an agreement between KEK and Tax Authority of Kosovo (TAK) on VAT. KEK's payment of VAT had traditionally been governed by a Memorandum of Understanding between the Ministry of Economy and Finance and the Kosovo Trust Agency (KTA). The MoU allowed KEK to remit VAT based on payments received from customers as opposed to the amounts billed to customers. This procedure recognized that KEK had a significant amount of billings to customers that went unpaid. The TAK proposed a different set of guidelines for 2008; they were outlined in its "Explanatory Memorandum" and required KEK to phase in the practice of remitting tax based on amounts billed to customers. The administrative burden as well as the large potential cash flow impact of the new procedure would have been detrimental to KEK. PA prepared a response to the proposed MoU that outlined the implementation problems and shared it with the TAK and their advisor. The parties agreed that the existing MoU on VAT would be extended for 2008 and KEK would do their best to prepare for implementing the new VAT guidelines in 2009.

- Assisted KEK in reviewing its VAT liabilities, initiated a new tax audit, and helped reconcile KEK's books with the records in the tax system of TAK. As a result KEK's VAT liabilities were decreased by more than €20 million.

- Assisted KEK in reviewing the RTK liabilities and reconciling them with the liabilities reflected in RTK books. As a result, KEK's VAT liabilities were decreased by more than €25 million.

- Helped KEK in preparing to introduce the change to the VAT rate from 15% to 16% effective 1 January 2009 (see Task 4 discussion).

Task 7: Support Tariff Applications and Improve Regulatory Compliance

This Task contributes to Objectives 3, 5, 7 and 8.

2008 Tariff Filing

The initial tariff filing for 2008 was submitted in late 2007; however, the tariff process carried into 2008 and the formal tariff application was made on 15 February 2008. PA provided support to the KEK regulatory staff in preparing the tariff application and in reviewing and evaluating the ERO proposals, which included reviews of the ERO's tariff model. We recommended several changes and corrections to the model. The ERO issued its decision on 27 June 2008. PA assisted KEK in implementing the new tariffs, including modifications to the billing system.

Proposals on the Rule on Disconnections and Reconnections

With assistance from the PA Team, KEK submitted proposals to the ERO for modifications to this Rule. With PA's guidance, KEK had first proposed that the Rule be divided into two separate rules: one for customers who are delinquent in payments and one for those who are stealing electricity. KEK also proposed that the Rule be adopted for KEK and not include all energy enterprises.

The first submittal was made in April 2008. Following a meeting with the ERO, in which the ERO rejected both KEK proposals, KEK submitted its revised proposal in June. After further discussions with ERO staff, KEK held internal meetings with its working group, with advice from PA staff, and submitted a third proposed revision in September. The ERO then requested that KEK modify its procedures for estimating the amount of "un-authorized use" in order to bill those customers. KEK formed a working group to draft the modifications. PA provided support to the working group in evaluating options. The modifications were submitted to the ERO on 15 December 2008 and it is expected that the ERO will approve the new proposed rule in early 2009.

Renewable Resources

At the insistence of the Ministry of Energy and Mines (MEM), the ERO requested that KEK develop a "Connection Charging Tariff Methodology" for renewable resources, and particularly for hydroelectric plants. With PA's assistance, KEK formed a working group to draft the proposed policy. The group drafted procedures and tariffs for connections of small generators and submitted it to the ERO for approval. In conjunction, KEK also drafted new procedures and tariffs for the connection of new customers. They include not only the processes for customers submitting their requests for connections but also the costs that they would be required to pay KEK for the connection.

The proposed procedures and tariffs were submitted to the ERO for approval in early December. Subsequently, the ERO requested that KEK give a presentation on the treatment of "shallow" and "deep" connections, and the charges that should be applicable for each. With support from PA, a working group of KEK Network and Supply personnel met to discuss the issue. The PA advisor drafted the presentation and received input from KEK personnel; the presentation was made to the ERO and representatives from KOSTT and the MEM. Afterwards, the PA provided support to KEK in modifying and re-submitting the connection procedures for approval. At year-end, the ERO had not yet issued its decision.

Also, in conjunction with the MEM's request for policies and procedures for renewable resources, the ERO issued a "Consultation Paper on Feed-in Tariffs" and requested responses from interested parties. PA drafted a response, which was reviewed and revised by KEK regulatory staff. The response included a report by PA on the potential for new small hydropower facilities. KEK's response to ERO's Consultation Paper (proposal) was submitted in September, then revised and re-submitted October. The ERO issued its decision approving the feed-in tariffs for hydro-electric generators on 21 November 2008. In late November, the ERO issued its "consultation paper" on feed-in tariffs for wind generators. KEK, with PA assistance, will prepare its proposal in early January.

2009 Tariff Filing

PA continued providing guidance to the KEK Regulatory Affairs Department on the initial preparations for the 2009 tariff filing. PA had prepared a tariff filing strategy paper and circulated it to the KEK regulatory staff for input before agreement was reached. On 1 December 2008, the ERO issued two documents concerning the tariff filing; one was a letter outlining the ERO's principles and a timetable, the other was entitled, "Revenue and Tariffs Model User Guide." KEK's regulatory staff and PA met with the ERO to discuss these documents and to clarify the schedule. PA listed numerous questions concerning the Guide and it was decided to meet with the ERO's advisor in January to discuss them. Several other meetings were held with the ERO to discuss the upcoming KEK filing. During these meetings, which were attended by a PA advisor and KEK Regulatory Affairs Director and managers, the following subjects were discussed:

- Tariff design, including time-of-day, block tariffs, un-metered (flat rate) tariffs, and possible new tariffs (the ERO letter indicated that they will likely not approve changes in tariff structures or customer categories).
- A discussion on the future unbundling of KEK into two companies was discussed; however, the ERO believes that the current procedures for the tariff filing will continue until the separation occurs.
- Approved depreciation schedules.

In late December, PA's advisor also provided guidance to the KEK regulatory staff on the preparation of materials that were submitted to the ERO in response to the ERO's tariff schedule.

Launch of Time-of-Use Tariff Study

One of the tasks in the tariff application action plan was to investigate the current time-of-day tariff, particularly the problem of the meters not recording energy use (kWh) during the proper time periods (this is due to the time clocks not functioning properly, resulting in incorrect time periods). The staff of the Regulatory Affairs Department surveyed over 1,000 meters, showing that this assumption was correct. Under the direction of the PA Team, KEK drafted a formal report of the survey.

Tariff Schedules. KEK and the ERO have no written documentation on the requirements for assigning customers to a particular tariff class, nor is there any documentation of many of the aspects of the tariffs. PA drafted tariff schedules that define each tariff category (e.g., voltage level, type of customer) and provided an Albanian version to the KEK Regulatory Affairs staff for review. Our Team and KEK Supply Division staff discussed the draft schedules. Discussions with the ERO staff and KEK BOD members also took place, and received a very favorable response. It is anticipated that KEK will submit the final draft to the ERO for approval in early 2009.

Conditions of Electricity Supply/Service. Earlier in 2008, PA drafted a document entitled "Conditions of Electricity Supply/Service," which is meant to provide more details and clarity to the General Conditions of Supply/Service to consumers (these were approved by the ERO in 2006). A KEK working group was formed and met numerous times during Quarter 3 to discuss and complete the draft document. Some of the more detailed policies and procedures covered collections, connections, and line extensions. The Regulatory Affairs Department, supported by the PA Team, met with the ERO to present the draft document and explain its purposes. Additional meetings with the ERO were expected, but the work load of the ERO staff did not allow time for the meeting. It is expected that meetings will continue with the ERO in early 2009 and that a final set of Conditions of Electricity Supply/Service will be completed and then approved by the ERO.

Training. PA conducted additional training, focusing on tariff development, data requirements for tariff design, regulatory chart of accounts, load research, report writing, and regulatory reporting requirements. We also provided daily on-the-job training for the regulatory director, managers, and other staff.

Meter Maintenance Tariffs

KEK's Network Division has been developing the data needed to file a tariff for meter maintenance and other technical services offered to customers. The current procedures are not well developed and need to be formalized if the charges are to be part of the regulated electric revenues. Our team assisted in reviewing the information provided and made additional suggestions for preparing the filing with the ERO. KEK network engineers prepared the costs for meter maintenance, together with a number of service tariffs (checking wiring and grounding, etc.). PA also assisted the KEK staff who filed the proposed tariffs for approval by the ERO on 14 April 2008.

Customer Supply Contracts

PA assisted KEK in drafting new customer service supply contracts for residential and non-residential customers. These were originally filed with the ERO in March 2008. During the third and fourth quarters, meetings were held with the ERO to discuss the proposed contracts. PA helped KEK in revising the proposed contracts and adding information that the ERO desired. The final revised proposed contracts were submitted to the ERO in September and approval was expected in late 2008; however, the ERO subsequently suggested additional changes. The ERO staff believes that it is necessary for KEK to include a section whereby KEK would compensate customers for "unserved energy." KEK, with advice from PA, is resisting such compensation, particularly given the current energy situation in Kosovo. Additional discussions with the ERO are planned for January 2009 to resolve the situation.

Tariff for Common Areas (Apartment Buildings)

KEK has not billed cmmon areas within apartment buildings and grounds that use electricity since no single person is legally obligated for the payment. PA completed a procedure for metering and billing these common areas. It prescribed that the electricity used for common areas would be billed to each customer within the building, with the amount split evenly among them. Instead of a single bill, each customer's bills would indicate their portion of the amount due for the common areas. This procedure was submitted to the ERO for approval, which occurred on 27 June 2008.

KFOR (NATO Peacekeeping Forces in Kosovo)

PA formed a working group to study the KFOR bases and determine if they represented a special group of customers that is unique and deserves a new type of tariff. Most of the bases have generators and it is unknown whether these are providing a portion of their electricity requirements, whether they are simply serving as backup when the power is out, or whether they may be able to provide electricity into the distribution system. KEK Regulatory Supply and Network employees are studying this matter. It is unclear, given the ERO's statement concerning their plan to have no changes in tariff categories, whether to pursue this study. However, in the course of conducting the study, the KEK regulatory personnel received important on-the-job training on how to perform such a study, the data requirements and analyses techniques.

Compliance with European Union Directives

The MEM is charged with reporting to the European Commission Secretariat on Kosovo's progress in complying with EU Directives. KEK's Regulatory Affairs Director and staff have been participating in quarterly meetings at MEM, which include a representative from the EC in Vienna. PA has been providing needed support to KEK and attended the meetings in response to requests from the MEM and the EC Secretariat. During the fourth quarter, the MEM requested more specific plans from KEK to meet the EU Directives, primarily in unbundling and customer service procedures. PA advisors supported KEK in responding and meeting with the MEM representative.

License Requirements

During Q4, KEK received an extension for its Supply/Trade License from the ERO. PA provided support to the KEK Regulatory staff in applying for the extension, which was granted in mid-summer. PA also assisted Regulatory Affairs staff in preparing several requests to ERO for derogation of some license requirements. Most of these requests dealt with service quality requirements that are, under current conditions, impossible for KEK to meet.

License Monitoring

The ERO License Monitoring Department conducted a two-week exercise to monitor the compliance of license requirements at KEK. PA's support during these activities included:

- The ERO conducted license monitoring activities in each of the licensed divisions of KEK. Our team participated in the meetings between ERO staff and the Capacity Planning and Regulatory Affairs Departments. The ERO then met with all of KEK's top management, including the Division heads, to present their initial finding; PA participated in this meeting.

- The ERO's License Monitoring Department requested a meeting with KEK to discuss some issues concerning compliance with some of the license requirements. Together with the Director of Regulatory Affairs and the Manager of Licensing at KEK, PA met with the ERO license monitoring staff. Their primary concern was the unbundling of KEK's divisions, or at least the account unbundling. We assured them that the account unbundling was completed, but that legal unbundling is not. They had several other minor issues, but requested a written response to their inquiry

Power and Service Standards

Earlier in the year, the ERO held a workshop on Power and Service Quality Standards; PA and KEK personnel participated. The ERO formed a working group to investigate the standards it will impose and monitor on KEK's network and supply functions. Several members of the PA Team participated in the first meeting of the working group to provide advice and assistance in developing the standards, and the monitoring activities that must follow. The network and supply licenses have provisions for minimum power and service quality standards; however, due to the current situation, KEK has requested, and the ERO has granted, derogation of these articles in the licenses. PA advisors supported the KEK efforts. The ERO intends to include some minimum standards as part of the network and supply licenses.

Customer Metering

In 2006, Kosovo laws and regulations stated that billing meters must be owned and maintained by KEK and that customer-owned meters should be acquired, or new meters should be installed by KEK within one year. That schedule was not met. PA began assisting KEK in developing an action plan for the acquisition of customer-owned meters, or installing new meters where this was not possible. A working group was formed and a meeting with the ERO was held in Q4 to discuss the procedures that KEK will follow to meet the legal and regulatory requirements. The legality and objective of the transfer are accepted by KEK and ERO; the issue now is how to compensate the customer for the transfer of metering equipment from customer ownership to KEK ownership.

Unmetered Customers

KEK has been evaluating various options for dealing with unmetered customers. Currently, a tariff category exists whereby these customers pay a flat monthly rate; over 10,000 customers are in this tariff category. Concurrent with the KEK Supply Division's efforts to clean up the CCP, regulatory staff is developing a plan for eliminating this tariff category with advice from PA. Meetings with the ERO have been held to discuss the issue and the ERO's letter of 1 December concerning the tariff filing states that the tariff category should be gradually eliminated. An action plan will be developed and implemented in 2009. PA will support the Supply Division and the Regulatory Affairs Department in this effort.

Access to Property Rules

ERO requested that KEK and KOSTT develop and submit for approval rules on "Access to Property." Although access to property is found in the Law on Energy and the General Conditions of Supply, the ERO believes these rules are needed to provide additional details for customers. PA assisted KEK in drafting these rules, which are in the final stages of internal review and are expected to be submitted to ERO by early 2009.

NARUC/USAID/ERO Partnership

PA provided support to the partnership program with the Illinois Commerce Commission and the ERO. We prepared a presentation on KEK, which was given at the workshop by KEK's Director of Regulatory Affairs. We also made suggestions for the workshop agenda.

New Connection Procedures

PA's regulatory advisor drafted a document for connection procedures and tariffs for new customers, or the increased loads of existing customers requiring added electricity service. The draft document was translated into Albanian and circulated to the KEK staff (Network and Supply) for input. The final document was completed and submitted to the ERO for approval. However, they declined to approve it as drafted, so a revised version was drafted and at year-end was nearly ready to be re-submitted. The ERO requested that KEK conduct a workshop to present the KEK position on shallow connection charges and why its proposed connection procedures did not include deep connection charges. Several meetings with the KEK Supply and Network personnel were held to discuss this issue. PA drafted a power point presentation for the ERO workshop.

Task 8: Improve Internal Controls and Strengthen Internal Audit

This task contributes to Objectives 4 and 6.

Audit, Anti-Corruption and Revenue Protection

The very first field studies made it clear that most of KEK's operational problems were due to the lack of a proper control function. The lack of procedures, and deficient control of processes and performance led to flourishing corruption, underperformance, excessive costs and a general perception of impunity.

In order to correct this situation, the PA Team designed a new Organizational Chart of the Internal Audit and Anticorruption Department (IA&AD), and developed all necessary procedures for its proper functioning. IA&AD has four units:

- Financial Audit: finances, assets, procurement
- Revenue Protection: commercial losses, technical losses, theft, performance of distribution operators
- Technical Supervision: technical support to IA&AD Units and inspection of Technical Division activities
- Anticorruption: fraud, embezzlement, abuses of official duties and authorities, etc.

To ensure the Department's autonomy, an Internal Audit Committee was established within KEK's Board of Directors. This entity has oversight responsibility and authority over IA&AD activities.

During the first two quarters of 2008, the PA Team managed the full staffing of the Anticorruption Unit, and the partial staffing of the Revenue Protection and Financial Audit Units. They became functional and performed well in accordance with the Internal Audit Plan for 2008.

The Internal Audit Committee began operations in Quarter 3. In June/July it reviewed the volume and quality of work performed by IA&AD, which received high marks. However, owing to the inability of the Internal Audit Function and supposedly, internal and external influences, the BOD decided to reorganize IA&AD. Financial Audit was put under the Internal Audit Committee, while the old Internal Audit staff was restored (they had been dismissed due to their inability to perform simple audit tasks). No decisions were made on the remaining three units, which were effectively left out of the structure. At the same time, the BOD cut Department salaries by 38%, ignoring best international practices, Kosovo law, and PA's recommendations. This effectively paralyzed the control function for a period, three staff resigned, and the remaining IA&AD employees were demoralized. PA undertook all possible steps (meetings with shareholders, interested parties, BOD, and KEK management; official letters; recommendations, etc.) to correct this situation, but no relevant decisions have been made to date.

Despite these difficulties, under PA's direct guidance KEK managed not only to retain the remaining staff members but also to hire five new professionals for the Revenue Protection Unit. Nonetheless, in 2008 IA&AD performed the following activities:

Audits and investigations. An unprecedented 100 investigations and audits were performed related to fraud, embezzlement, extortion, bribery, abuses of official duties and authorities, different types of corruption, and various types of illegal activities by customers and KEK employees, including violations and non-compliance with written policies and procedures.

Disciplinary actions. As a result of investigations, about 60 KEK employees were dismissed or suspended as a result of fraud or other illegal activities, as well as grave violations of KEK policies and procedures. About 200 were disciplined through demotions, temporary salary cuts offs, etc.

Enforcement. PA leadership resulted in KEK submitting an unprecedented 80 criminal cases to law enforcement bodies for follow-up action. These cases involved fraud, bribery, official document falsification, theft, and other forms of corruption.

Network and Supply operations analyses. Under PA leadership, IA&AD conducted 14 large system analyses of Network and Supply operations. As a result of these audits, several serious instances of underperformances and violations were identified:

- ***Meter reading***. KEK was not performing readings of the minimum 30% of customers, and a considerable number of readings were incorrect or false.

- ***Bill delivery.*** For the analysis period, up to 35% of customers were not receiving bills monthly.

- ***Disconnections.*** One disconnection crew was making an average of only 1.4 disconnections a day. Under the same conditions and with less experienced audit forces, experiments showed that at least 25-35 disconnections could be performed each day.

- ***Passive customers.*** The vast number of customers are registered as passive customers, but in reality are consuming electricity.

- ***Commercial losses.*** The audits revealed severe underperformance in loss reduction-antitheft: there are hundreds of illegal connections in the buildings next to KEK's offices, tampered meters have been sealed by KEK employees, and dozens of methods are used for electricity theft. For example, in Ferizaj District, 68% of the detected electricity theft cases were committed by KEK employees, while only 32% of the electricity was stolen by customers. As a result of this finding, employees were dismissed and criminal charges were submitted to law enforcement authorities.

- ***Segregation of duties, lack of accountability and control over processes***. The audits revealed that KEK's existing structure was not able to establish control over such vital issues as responsibility for commercial losses. In spite of having a large staff, independent Network and Supply Divisions, a structure, job descriptions and a process, there was little accountability for commercial losses. Similarly, in dozens of discovered failures and violations, no controls were in place for billing cycle, making it impossible to assign responsibility to units or individuals. The business process itself was very vague and ineffective. Most of these weaknesses were addressed through the design and implementation of the Pilot Project.

Support for the Implementation of Pilot Project

From the first days of Pilot Project's implementation, IA&AD, and especially the Revenue

Protection Unit, was fully involved in the operations audits. Staff performed audits and dozens of comprehensive analyses (on the district level), enabling KEK management and the PA Team to identify underperforming persons and units, as well as areas requiring special attention.

Excessive Cost

Under PA Team leadership, IA&AD performed inspections aimed at identifying excessive costs, identifying the following problems:

- So-called Representation Expenses were authorizing managerial-level employees to receive funds for formal and informal meetings (including meals, etc.) organized for KEK business purposes. There were no procedures or rules on these expenses, and as a result they were severely exaggerated. Invoices submitted did not include information on when and why they were incurred. However, KEK paid out all such expenses. Frequently, KEK funds were used for personal purposes, with expenses for cosmetics, T-shirts and other private items submitted to KEK as Representation Expenses. Recommendations to change this situation were submitted, the situation corrected, and such costs were reduced by at least 50%.

- Most KEK staff members were was using vehicles for private purposes during and after working hours, decreasing transport efficiency while severely increasing fuel and maintenance costs. IA&AD drafted a special Vehicle Regulation, which puts vehicle usage processes controls in place. The Regulation was approved and its implementation resulted in average fuel cost reductions of 20% by the end of 2008.

- Communication expenses were also exaggerated. The audits found that up to 170 KEK office phones had international access, and almost all land phones had unrestricted mobile phone access. At the same time, people were using KEK mobile phone allowances. The audits showed that only 15 employees needed international access and only 40% of the land lines needed mobile phone access. Through the implementation of proper oversight, costs were reduced by 25% on average.

Human Resources

Due to restricted time and staff resources, only two audits were performed for this function; they identified serious violations that jeopardized the company's commercial interest. Inspections disclosed a lack (and often, non-existence) of procedural and human controls in the Department, which was unable to account for even the number of staff employed at KEK. The audits identified 163 employees who were unassigned, but were receiving salaries and benefits. The number of staff required to perform tasks was also severely exaggerated. An illustration of this is the "Fenol" project; KEK has assigned 84 employees to this project, but only 12 were actually working on it.

Training

To build the new control function, PA conducted training for IA&AD staff, in the form of field studies, special office sessions, and on-the-job training. These enabled Department staff to become acquainted with best practices and special methods. Through these efforts, the Revenue Protection Unit took its first successful steps and generated both qualitative and operative results.

Performance Evaluations

PA initiated performance evaluations of IA&AD staff for 2008. The evaluations were sent to top KEK management, and IA&AD staff received good appraisals and special bonuses.

Task 9: Provide Legal Support for Unbundling and Privatization

This task contributes to Objectives 3, 4, 5, 6, 7 and 8.

During 2008, PA provided legal advice and assistance to KEK on a wide range of matters, as outlined below.

The Unbundling/Privatization Process

PA undertook the following steps in support of the unbundling/privatization process:

- Drafted corporate documents for the new Distribution Company, including the by-laws and charter.
- Drafted an amendment to the Law on Publicly Owned Enterprises (POEs) to address the governance of KEK and the proposed new Distribution Company.
- Began an analysis of the registration status of KEK-owned land in cadastral records. In conjunction with this analysis, and in the absence of an existing central KEK archive/depository PA began collating and recording all documents evidencing KEK title to land.
- PA advisors and KEK representatives met with the Licensing Department of the Energy Regulatory Office (ERO) to discuss the prospective transfer of licenses from KEK to the new Distribution Company. As a result of the discussions, PA will assist KEK with the preparation of a formal request to be sent to ERO in the first quarter of 2009 for an agreement in principle to the transfer of licenses.
- The process was initiated to identify which licenses, contracts and assets will be transferred to the new Distribution Company.

Employment

PA assisted in finalizing the draft KEK Employment Regulations. The document was presented to the Acting Managing Director, with the recommendation that the regulations be approved and duly implemented in the first quarter of 2009. In addition, PA drafted a new set of KEK Rules and Procedures on Redundancy, which were presented to, and approved by, KEK's BOD during the second quarter of 2008.

Monitoring Progress on New/Draft Laws

At the beginning of the third quarter, PA provided comments and analysis to USAID on over 30 laws that were either draft laws that were currently being considered by the Kosovo Assembly or laws that had previously been approved by the Assembly, but had not been promulgated by the Special Representative of the UN Secretary General in Kosovo (SRSG). A significant number of the aforementioned laws have a potential impact on KEK's operations (e.g., Labor Law, Law on the

Treatment of Illegal Constructions, Law on Mines and Minerals). In addition, during the third and fourth quarters, we provided advice and recommendations to KEK's management and BOD on the requirements of the new Law for POEs, particularly in relation to the composition of the BOD's Audit Committee, the appointment of KEK officers, and the proper delineation of responsibilities and duties between the BOD and management. PA also attended BOD meetings as an observer, and to provide for damage control.

Debt Recovery

PA continued to work with KEK's debt recovery team to improve its processes. Specifically, we initiated a new pilot project in conjunction with NCSC (a USAID implementing partner in the justice reform sector). The pilot project focuses on the enforcement of debt judgments in Gjilan Municipal Court and the Economic District Court, Pristina. Initial meetings were held in November and December with the relevant court staff, and follow-up actions are planned for the first quarter 2009.

Overall, there was a steady increase in the percentage of debt recovered through legal proceedings in the first and second quarters. However, this trend was negated during the second half of the year when the number of debt claims filed by KEK for non-payment of electricity increased significantly (e.g., over 5,500 claims were issued in the last 6 months of 2008, compared with 1,200 claims in the first 6 months). The increase in the number of claims filed was attributed to interference from the Ministry of Energy and Mines, which orally instructed KEK's legal office to issue more claims. PA has cautioned KEK against simply filing more claims at court without a coherent strategy for the actual enforcement of debts.

Other Advice to KEK on Discrete Legal Issues

- PA assisted in drafting contracts for the following high-value capital mining projects:
  - The refurbishment of spreaders for overburden removal (Systems II and III) in the amount of €23 million.
  - The refurbishment of conveyor belts for overburden removal (Systems II and III) in the amount of €50 million.
  - The supply of parts and services for refurbishment of the excavator (System I) in the amount of €3 million.
  - The supply of parts and services for refurbishment of the spreader (System I) in the amount of €2 million.
  - The refurbishment of the excavators for overburden removal (Systems II and III) in the amount of €20 million,

- PA assisted in drafting contracts for the following high-value capital generation projects:
  - The purchase of a used transformer for the Kosova A power plant in the amount of €3 million.
  - The purchase of a new generator rotor for the Kosova B power plant in the amount of €5 million.
  - The supplementary commercial contracts for additional work required for the overhaul of Unit A5, particularly in relation to the overhaul of the rotors / turbines and repair of the boiler.

- PA assisted with drafting the tender dossiers for new procurements, to include:

- the construction of the Vaganicë Substation
- the purchase of new household and commercial customer meters
- the purchase of two new bucket wheel excavators
- the rehabilitation, operation and transfer of three small hydro plants owned by KEK.

- PA assisted with drafting the new Regulation for Operations in the Districts. This document was produced in support of, and to facilitate the implementation of, the Ferijaz Project. In particular, it outlined the procedures for dealing with the poor performance and serious misconduct of employees in the district, together with an incentive payment scheme.

- PA assisted with finalizing two Credit Facility Agreements totaling €84 million between KEK and the MEF to finance the opening of the new Sibovc South West mine and the overhaul of Unit A5 of the Kosova A power plant.

- We worked with KTA and the UN Mission in Kosovo's (UNMIK) legal office in connection with drafting a determination for the SRSG to designate those parcels of land required for the construction of a new 7 km transmission line in Northern Kosovo as being in the "public interest." Thereafter, assistance was provided to KEK's legal office to implement the terms of the SRSG's decision, to include meetings with the Municipal Offices in Mitrovicia and liaising with landowners.

Task 10: Assist Privatization Transaction Advisor

This task contributes to Objectives 4, 5, 6, 7 and 8.

During the third quarter, the PA Team worked with other implementing partners and stakeholders to formulate a strategy for private sector participation in the Distribution Network and Supply businesses (Disco). In particular, we prepared a white paper ("Privatization Roadmap") recommending a practical approach to the privatization of the network and supply functions of KEK, which would be implemented in conjunction with the "New Kosovo" project [the new generation project, previously called "Kosovo C"]. As a result, the GoK has approved the unbundling of KEK (Decision No. 04/36) and the privatization by sale of shares of KEK Distribution and Supply (Decision No. 03/38), and has appointed the Privatization Committee to implement the privatization (Decision No. 08/39).

Following on from these Decisions, the tender for hiring the privatization transaction advisor was launched in October, and it is expected that the winning bidder will be announced in January 2009. In anticipation of this advisor's appointment, PA has taken the following steps:

- Started collating all relevant information that may be included in the "data room."

- Prepared a tender dossier for the procurement and appointment of a new external auditor for KEK, to ensure that audited accounts for FY 2008 are available in a timely fashion for the privatization process. However, the launch of the procurement process has been delayed because of the failings of KEK's Internal Audit committee, which is required under the POE law to approve and initiate the procurement process.

PA also provided various support for activities related to privatization during the 4th Quarter:

- A statement was drafted for the Minister of Energy and Mining to dispel a myth that was circulating in the local press (see Attachment Q408TS4). The press stories implied that KEK customers don't have to pay debts to KEK since the new private investor will forgive the debt.

- PA prepared a brief statement on "Social Aspects of Energy Sector Restructuring" that was provided to the KEK Managing Director and Executive Director of Supply for their use in discussions with the government and media (see Attachment Q408TS5).

- Talking points concerning KEK privatization were prepared and provided to the Executive Director of Supply for his use in discussions with the government and media (see Attachment Q408TS6).

- Organization charts and estimates of the number of personnel related to the Supply Division within the new Distribution Company were prepared.

- Organization structure (charts, reporting structure, and staffing level) were prepared for the Network Division for the New Disco in preparation for legal unbundling and privatization in late 2009.

- PA met with Bearing Point representatives in December to review the problems and ways forward with regard to land use, rights of way, and property rights in preparation for the privatization of KEK Distribution.

- PA prepared an assessment of "assets at risk" for KEK privatization. This included the 110 kV power system, small hydro plants, rights of way and land property, enclaves / minority areas, and the region north of the Iber River.

Task 11: Support Normalization of Service to Enclaves

This Task contributes to Objectives 2, 4, 5, and 8.

Estimating the Ethnic Composition of Kosovo

PA prepared a report entitled "Estimate of the Ethnic Composition of Kosovo by Region" to give a picture of the Albanian, Serbian, Ashkali, Roma, Gorani, Bosniak, Turk, Egyptian, and Croat populations in each of the country's 30 regions. The source of the information was the Organization for Security and Cooperation in Europe's (OSCE) Municipal Profile reports. This information will be of use in formulating the approach toward these ethnic groups in relation to this task.

Initiatives in Gracanica

On 6 August KEK was invited to the monthly security meeting at the municipality building in Gracanica chaired by the Kosovo Police Service. A PA advisor also attended the meeting, along with the Kosovo Police Service, KFOR (Irish and Swedish), representatives of Serb villages, UNMIK and the UNMIK police force, OSCE, UNHCR, the water company, and Mercy Corps. The primary topic of discussion was security issues in Gracanica and the surrounding villages. In addition, KEK representatives and the water company were asked to listen to concerns and comment.

KEK expressed an interest in working with municipal leaders to improve the energy situation. It would like consumers to be regularized as KEK customers and metered, billed and paying so they can move from Category C to B or A depending on payments. The point was made that KEK has an office in Gracanica, although no payments are made there. Serb representatives commented that KEK performs much more load shedding in Serb areas than Albanian areas of Kosovo. We explained that 1) UNMIK requires KEK to treat all areas of Kosovo, regardless of ethnicity, on an equal basis, 2) the ABC lead shedding program was developed to handle the situation when demand exceeds supply, and 3) feeder rankings are done using ERO technical and financial criteria with no consideration of ethnicity. One of the Serb representatives expressed his opinion that there may be problems metering, billing, and collecting from individual consumers and some type of master metering may be needed. As instructed by the Managing Director, KEK representatives made no comments on communal metering, but mentioned that such options could be considered at future meetings. The Serbs mentioned that many of the residents are very poor and may not be able to pay for electricity. They expressed concern about the ability to pay for past consumption. We made no comment on past consumption, but made the point that the Ministry of Labor and Social Welfare provides a subsidy to those households qualifying as Social Cases.

It was agreed that KEK representatives would meet on 13 August with the Serb representatives to jointly explore options. That meeting was not held, however, since Serb representatives insisted that EPS (the Serbian electric utility) lead the meeting. They also wanted the meeting to be held in the offices of the Parallel Leadership as opposed to in the Gracanica municipal building.

PA met with personnel from the local OSCE office in Gracanica in order to obtain some insight into local issue there as far as the Serb community is concerned.

Initiatives in Vitia

On 5 September Radio Kllokot reported that KEK was disconnecting electricity to all Serb households on one street in Vitia. The reporter portrayed an interviewee (Mr. Stanojevic) as a "representative" of the Serb residents in the area. On 9 September, KIM Radio interviewed Vitko Sotic, another resident in the area who was disconnected. KEK did disconnect several Serb households based on the large outstanding debts and the fact that payments were never made. Mr. Stanojevic has been a customer of KEK since at least 2002 when the customer record system was developed. He has a meter that is being read and he receives a bill each month. He has never paid KEK and, therefore has a debt of €5,500. Over the years he has received four disconnection warnings, but records indicate he has not been disconnected.

On 12 September, KEK representatives along with PA advisors met with Mr. Stanojevic and his family at his home to discuss the radio reports. He indicated that he was misquoted several times in the article. A key point, however, was that Mr. Stanojevic was not disconnected since he would not let the KEK crew perform the disconnection. Although he stated again that he was not a representative of his neighbors, he said that he would arrange for his neighbors to meet with KEK on 16 September in the neighborhood church.

The meeting was attended by 22 residents. PA chaired the meeting and explained KEK's situation and the reasons for the disconnections. Ample time was provided to the residents to vent their concerns to KEK. The meeting ended on a cordial note. KEK agreed to reconnect all the Serbian households in Vitia that were disconnected. However, on the next day when KEK crews went to reconnect, they discovered that the households had already reconnected themselves.

Another meeting was held on 23 September with a slightly larger group of residents. At that meeting KEK addressed issues of concern including the Social Cases Subsidy, ABC load shedding, and disconnection policy. An attempt was made to have residents concur that they would at least pay for current consumption going forward. The group was adamant that they would not agree to pay at all unless KEK forgave all past debts. When we made it clear that KEK could no longer provide electricity unless individual households pay for current consumption, the residents walked out of the meeting.

In response to the situation in Vitia, PA prepared a white paper entitled "Dealing with Energy Issues of Kosovo Serbs Living in Mixed Areas." The paper (included as Attachment Q308TS1) outlined the unique situation of these mixed areas and identified a range of options for the way forward. This paper was used as the basis for a paper developed by USAID staff for discussion with the US Ambassador and other embassy personnel.

Other Minority Initiatives

PA prepared a white paper entitled "Addressing the Issue of Electricity Supply to Minority Areas" as well as a PowerPoint presentation with the same title. The materials proposed a plan to move forward by identifying all stakeholders and decision makers, providing them with background information on the issues, clarifying various misconceptions related to this issue, presenting long- and near-term options, and proposing a timetable for stakeholders to take action. The materials were provided to the USAID as well as the Minister of Energy and Mining with the expectation that stakeholders would be called together to address the situation. No such meeting occurred in 2008.

Joint Initiatives with US KFOR

US KFOR (NATO peacekeeping force in Kosovo) has been very supportive of KEK, especially in its dealings with the minority communities. During 2008, PA cooperated with KEK personnel and US KFOR on the following:

- US KFOR invited KEK to make a presentation at the mayoral luncheon held at Camp Bondsteel for mayors in the US KFOR region. PA gave a presentation (see Attachment Q408TS7) at the meeting covering the Ferizaj Pilot, ABC Load Shedding, Disconnection Policy, and approach toward minority customers. The mayors from Serbian areas attended and raised concerns about the RTK fee being assessed in areas that do not receive the RTK signal and the apparent excessive load shedding in Serbian areas.

- PA coordinated the responses to a series of questions that KFOR had received from the general public and community leaders in its area of operations. The intent was to have a coordinated response KFOR can give to the public in its day-to-day dealings with them. An updated contact list of KEK personnel was provided to US KFOR so they have contact information on specific people to call as technical, safety, or commercial issues arise.

Metering
PA and USAID are reconsidering the commodity (metering) component of this Task. Although KEK and the GoK wish KEK to proceed to meter, bill, collect, and disconnect in the enclaves, representatives of Belgrade are hindering efforts to incorporate the enclaves into independent Kosovo. Also, the international stakeholders (US Embassy, KFOR, etc.) are signaling KEK and PA not to start metering, billing, collections, and disconnections in the enclaves. Therefore, it may not be practical to install enhanced metering as planned, considering the charged climate, the impending end of the USAID-PA contract, and the new focus of the contract to privatize KEK. The project, however, continues to work with the enclaves and stakeholders to normalize service and KEK operations in the enclaves. For example, KEK plans to extend the definition of minorities to include the Ashkali, Dragas, Roma, Gorani, Bosniak, Turk, Egyptian, and Croat minorities, who are not hostile to Kosovo and to KEK.

3. Summary of Results Achieved

Appendix A shows the project's progress against its planned results under a performance-based management system (PBMS). The results are reported according to key indicators.

Appendix B shows the project's progress under a PBMS, reporting results according to milestones. This appendix also shows the project's training activities disaggregated by gender and project contextual indicators.

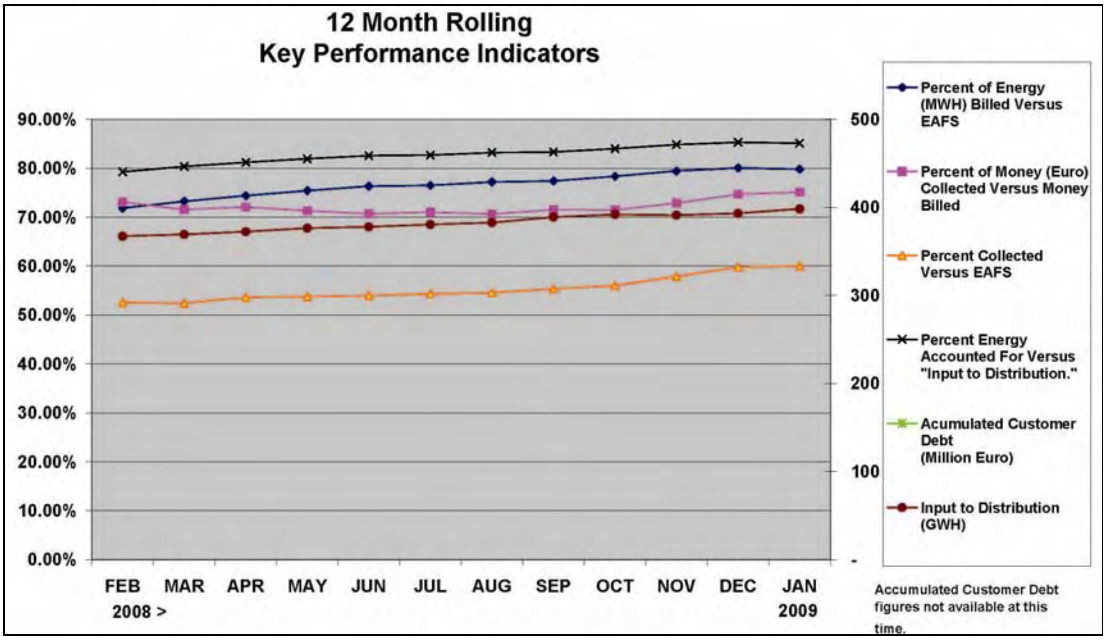
The table below shows the key indicator targets and results for 2008. A more extensive version of this chart is in Appendix B.

No.	Definition of Indicator and Unit of Measure	2008 Target	2008 Actual
1	Reduce commercial losses as compared with previous year (ratio of commercial losses vs. energy available for sale)	25%	20%
2 [1]	Reduce technical losses (ratio of technical losses vs. energy delivered to distribution)	17%	16.6%
3	Ratio of energy billed vs. energy available for sale	75%	79.7%
4	Ratio of revenue collected versus billed	80.0%	75.4%
5	Revenue collected as a percentage of value of energy available for sale [ratio of revenue collected vs. billed] x [ratio of energy billed vs. energy available for sale]	60%	60.1%
6	Ratio of debt collected vs. claimed[2]	30%	17.5%
7	Collected revenue	€116mm	€135 mm

[1] Given the updated information, the target for Key Indicator 2 was revised to 1% below 2006 actual/ calculated for 2007 (17.2%) and for 2008 it should be 1% below the 2007 number (16.2%).

[2] Under Kosovo law, executing judgments for debt is the sole responsibility of the courts. Accordingly, this target will ultimately depend on the cooperation of the courts and their willingness to work with and support KEK.

The chart for the 12-month rolling average of the Key Performance Indicators shows continual improvement. This average is indicative of improvements because it averages out seasonal effects, which otherwise can distort the interpretation of the results.



4. Problems Encountered and Actions Taken

Governance

Incompetent Board of Directors

With only one notable exception, the new KEK Board members nominated by the GoK during the first quarter of 2008 possessed neither the experience nor the knowledge to perform their duties, and had no comprehension of their fiduciary responsibilities. However, they demanded furnished offices in KEK with new laptops and actively micromanaged KEK on a daily basis.

By the end of their mandate in December, they had taken the following actions, which had a substantial adverse effect on KEK's performance:

- Removal of the Managing Director and appointing an acting MD. This is the third MD, appointed by the third BOD, that PA has had to work with, making progress and management very difficult.

- The Chairman of the BOD cancelled the meeting called by the Chairman of the Audit Committee to discuss internal audit problems. The Chairman of the Audit Committee resigned, and the BOD appointed a new Audit Committee, in contravention of POE Law. Also, the BOD changed and split the Internal Audit Unit into two departments and restored the rights of the "old" internal auditors who had been dismissed from their positions by the previous BOD based on the results of the investigations of their work performed by the Audit Committee and by independent auditors from KPMG, Deloitte & Touche, and Grant Thornton. This created great hurdles in the Unit's work; for example, HR refused to announce the opening for the position of Internal Auditor externally, Procurement and other Departments refused to submit to an audit and requested a "written order for the audit" from the Audit Committee, and the KEK's IT was pressured to cooperate with Internal Audit and delete "data" from KEK's accounting database.

- KEK's BOD participated in negotiations with disgruntled union employees, formed a committee, and approved a 15% pay increase to about 7, 500 employees in non-management positions. The financial impact of this increase is €6 million to KEK's annual payroll.

- The BOD decided to harmonize management and key professionals' pay with those of GoK employees. As a result, 98% of 130 employees in key positions received pay cuts ranging from 5% to 60%. This action resulted pay decreases for some of KEK's best professionals (appointed after executive searches conducted with the assistance of PA) by as much as 60%. As a result, most of them have warned that they searching for new jobs, while the motivation of the rest has plunged. The implicit adverse effects are numerous and include: failure to transfer the ownership of CAS and CCP to KEK, inability to introduce the new Chart of Accounts, and failure to adequately record and report revenues and expenses and manage treasury.

- The acting MD, with the active support of the BOD, refused to implement the new organization structure recommended by PA and approved by the previous BOD.

- Despite the numerous "extraordinary" meetings held by the BOD, they were slow to react, even on issues that required immediate action. This often created "crisis" situations in which management and USAID advisors spent much time and effort on damage control.

- In November the Board approved the KEK/PA-proposed strategy for outsourced companies, which had been approved by the previous Board in August 2007. However, at the December meeting, with only three Board members present, the Board withdrew its decision to go forward and instructed the acting MD to obtain shareholders' consent before moving forward for competitive tender.

Insufficient Project Resources to Support BOD Meetings

In Quarter 2, the new BOD announced its plans to hold two meetings a month. Neither PA nor KEK had the resources to support two BOD meetings and one Joint Task Force (JTF) meeting per month. Since the main body of the JTF is present at the BOD meetings, PA recommended that JTF meetings be held only on an as-needed basis. PA's recommendations were partially accepted.

Interference with KEK Management

In Quarter 2, PA observed that the Ministry of Energy and Mines (MEM) was micro managing KEK and that KEK's Board was beginning to get involved in management issues outside its domain. PA requested USAID's assistance in preventing further erosion of the KEK management's responsibilities. Unfortunately, the interference continued throughout the rest of the year.

MEM and other BOD members also expressed the desire for further management changes in KEK. Given that the LDK party had three members on KEK's Board and that four members of the BOD had no business experience or background in governance issues, PA was greatly concerned about the consequence of further BOD actions and changes in management. Such actions could render KEK inoperable. Further, the November elections were feared to have a significant impact on KEK through the interference of the new parties in power.

In Quarter 3, PA requested that USAID sign a Memorandum of Understanding with the new government that obligates them not to interfere with KEK's management and operation. USAID indicated that it planned to sign an MoU with the new government. PA also requested USAID's assistance in replacing the unqualified BOD members and ensuring that the KEK Board members meet the qualification requirements outlined in KEK's bylaws. Unfortunately, the unqualified BOD member continued serving on the Board.

Stakeholder Interference

Stakeholders' interference in KEK's operation, power imports, RTK, obtaining mining licenses, procurement for A5, disconnection of non-paying customers, the ABC program, and many other areas has made PA's task very difficult. Furthermore, the Procurement Law, as it affects KEK, has to be reviewed since KEK lacks the ability to procure equipment in a timely manner (as a 24x7 operation), consistent with KEK's license obligations to provide power, and hence is putting its entire operation in serious jeopardy. Continued USAID support and leadership will be needed to ensure that stakeholder involvement and interest in KEK can be managed properly.

Structure and Organization

KEK Organizational Weaknesses

The Internal Audit function of KEK was split into two departments: Internal Audit and Anti-Corruption. The Anti-Corruption Department was ordered to report to the MD. The Revenue Protection Department was completely left out of the picture. The BOD appointed Ismet Vrapcani (previously terminated as internal auditor based on recommendations by the Audit Committee) as KEK's Internal Audit Officer without following due process and procedure. The inadequate organization and staffing of the Internal Audit function resulted in poor quality and long delays in the financial statements of the company, and caused a setback in the fight against fraud and embezzlement.

Policies and Procedures

Poor Relations with the Courts

The approach of Kosovo's courts with respect to legal challenges on employment matters posed a persistent and serious problem in 2008. Employees who had been dismissed by KEK on disciplinary grounds frequently challenged KEK's decision and requested re-instatement. Also, KEK continued to be the subject of a significant number of unmeritorious property or economic damages claims. However, owing to the endemic problems within Kosovo's judicial system, KEK must typically appeal these claims to the Supreme Court in order to obtain a "fair" determination.

Budgeting, Planning and Cost Control

Delayed Approval of the 2009 Budget

As a result of the delay in appointing new members of the BOD, the discussions and approval of KEK's 2009 budget were delayed until the beginning of the second quarter of 2009. This may result in delays in some important capital projects.

Stalled Implementation of Cost Control Procedures

The implementation of the new cost control procedures recommended by PA has met with considerable opposition from the both the Finance and other core divisions of KEK.

Operation and Maintenance

Corrupt Meter Reading Practices

PA discovered that the results of KEK-KOSTT meter readings were often changed, even after several months. A review of this process was conducted in Quarter 2, and in Quarter 3, a formal procedure was written, approved, and published to minimize corruption and inaccurate reporting of meter readings.

Lack of Vehicles for the Network Division

In Quarter 1, it was apparent that this Division needed more vehicles for its meter readers, disconnectors, and controllers. This request was examined in Quarter 2, taking into account what vehicles the Division already had and how they were used. Some reallocation of the vehicles among the staff did occur, consistent with the new organization structure. KEK obtained 20 used vehicles from UNMIK; 15 of them were delivered to the disconnect and control crews.

KEK also implemented a program of reimbursing its meter reader employees for the use of their personal cars on a Euro cents per kilometer basis. In Quarter 3, an additional 50 used cars were identified at UNMIK and KEK began negotiations to purchase them.

Energy Usage at the Land of Mines and Generation

In the past the use of energy at all KEK facilities had not been uniformly accounted for in terms of either energy units (which affect the energy balance) or financial accounting. This was a significant matter for KEK Mines, which is the second-largest user of electricity in Kosovo (tied with Sharrcem and second only to Ferro-Niklei). PA developed a procedure to uniformly account for energy used by KEK facilities and the customers on the land of mines and generation. The procedure was approved by the MD of KEK and implementation began on 31 March 2007, thereby improving the accuracy of the energy balance and accounting for cost. What the improved metering data revealed was startling.

- KEK Mining used 100.5 GWh of energy in 2008.
- 28 % - "Percent of Energy (MWh) Billed versus EAFS, was far worse than in the Districts.
- 22 % - "Percent of Money (Euro) Collected versus Money Billed, was far worse than in the Districts.
- 6 % - "Percent Collected versus EAFS," was far worse than in the Districts.
- 89% - "Percent of Energy Accounted for versus Input to Distribution" is better than in many Districts.

The bottom line is that KEK, specifically Prishtina District, is not collecting from the customers at the land of mines and generation. KEK only billed €345,000 in 2008, when they should have billed €1,233,000. They collected only €77,000 in 2008.

Procurements and Contracts

Difficulties with KEK procurement continued throughout 2008. These difficulties were attributable to Kosovo's rigid public procurement regulations, which are ill-suited to utilities, and to the lack of professional procurement staff within KEK. As a consequence, the PA Team provided extensive advice and support to KEK on high-value capital investment, particularly for mines and generation. PA's support also extended to drafting complex contracts with international contractors.

With respect to the legal framework, PA advised stakeholders that the EU Procurement Regime for Utilities (2004/17/EC) should be applied in Kosovo. This issue will become more pressing with KEK's privatization, since the private investors for both New Kosovo and KEK Disco will be subject to Kosovo's current Public Procurement Law.

Finance and Accounting

The absence of a duly appointed CFO (KEK has had an "acting" CFO for more than a year) has resulted in stalling the reforms in the Finance Division. Accounting staff with inadequate qualifications remain in power and efforts to appoint qualified staff have been discontinued. The delays in the preparation KEK's financial statements remain significant and their quality is questionable. KEK has still to produce clean financial statements (the company's statements for 2005, 2006 and 2007 have all been qualified by the external auditors).

Work Force

Poorly Enforced Disciplinary Measures

While some progress was made in 2008, particularly based on the new KEK District Regulations, poor discipline and performance continue to be tolerated by KEK management. Except for operations in KEK Districts, committees were still being created to adjudicate disciplinary matters, and these committees as a rule diluted the charges and recommended disciplinary measures. In mid-2008, without consultation with PA's advisors, KEK produced a revised Disciplinary Code, which made some inroads into the "committee-based" procedure, but remained ill defined and weak in most places. The BOD approved the revised Code against PA's advice. In response, PA finalized a new KEK Employment Regulation for KEK, which included a new disciplinary procedure that eliminates all "disciplinary" committees and introduces modern practices in employee relations. This was presented to the Acting Managing Director for adoption.

Tariffs and Regulatory

Regulatory Process

There continues to be a lack of transparency of some regulatory filings. An example is the feed-in tariff that was approved by the ERO. Although the ERO requested input from the stakeholders, they did not allow the stakeholders to review the working papers, more precisely the calculations of how the tariff was developed. When asked, they indicated that the information was "proprietary." Also, the regulatory process has not allowed for a process whereby the ERO conducts open meetings to gather input from the public. Instead, all input is requested on the ERO website; thus, only those with Internet access and knowledge of the website are able to provide input. The ERO has refused meetings with KEK's regulatory staff, indicating that the meetings "were not necessary"; thus, KEK could only communicate with the ERO through written exchanges. Additionally, the ERO has not even acknowledged the receipt of some regulatory submittals by KEK, nor have they acted on them.

An example is the meter maintenance tariff filed by KEK in March 2008; the ERO did not acknowledge the filing and has yet to act on it.

Chart of Accounts. The ERO rejected KEK's submittal of a proposed regulatory Chart of Accounts and stated that they didn't think that such a chart is necessary.

Tariff Process. The ERO has not set up a tariff process that is consistent with many of the best practices of other international regulatory bodies. In the electricity sector they have adopted a tariff model that requires KEK and KOSTT to post simultaneously data that are input into the model, which uses various internal algorithms to calculate the tariffs for both companies. Both companies are also ordered to submit formal tariff applications, following the ERO's Tariff Application Guidelines. The ERO then analyzes the tariff applications and their model results, and publishes a "Consultation Paper" of their analysis, which is then posted on their web site with a request for the public to provide comments on their paper. They have not requested that the public provide comments on the company's tariff applications.

Public Relations and Communications

PA assisted KEK with the implementation of the proposed organization structure for Corporate Communications. This included interviewing and selecting qualified candidates for corporate promotions specialist, customer communications and corporate spokesperson. We also advised on developing a communication plan for all eventualities during the week of the Kosovo Declaration of Independence.

Briefs were developed for customer communications campaigns promoting customer care, customer service and energy saving tips.

A press brief was developed to announce the need for amendments to the Criminal Code to include electricity-specific laws.

A PR brief was developed announcing major disconnection activities requiring the assistance of law enforcement officers.

In response to misinformation on the Kosovo B Power Plant, a clarifying press brief was provided. A PR brief was developed for the 2008 KEK tariff application.

Project Framework

Lack of an MOU to Formalize Project Activities

There is no MoU among USAID and KEK/PISG/UNMIK/KTA that formalizes PA's activities in KEK and commits stakeholders to certain actions. PA was also confronted by UNMIK on several occasions, requesting a MoU. PA communicated these requests to USAID during 2007 and 2008. USAID informed PA that it plans to implement a MoU with the new Kosovo Government. However, there was still no MOU in place as at the end of 2008. The lack of a MoU has created a lack of accountability by KEK and its stakeholders, hampering PA's ability to make significant progress in KEK.

Network

Metering

Meters and metering in KEK are in poor condition. However, the present employment structure (low pay, too many employees) does not motivate employees to improve metering because it is a source of under-the-table income. Metering improvements are easily blocked or derailed at several stages: 1) excessively complicated technical specifications (Network Division), 2) commitment of funding (Finance Department), and 3) the procurement process (Procurement Department).

The solution is to privatize KEK as soon as possible. The new owner will be able 1) to reduce the number of personnel in the Network Division, 2) to increase their pay, 3) terminate employees, 4) financially reward employees for great performance, and 5) adopt EU / WTO procurement procedures. Given the above framework of a privatized and financially motivated KEK, the employees will quickly implement the needed metering changes.

Rehabilitation and Expansion of the Power System Network

Kosovo is growing very fast, faster than the electric distribution system can keep pace. Kosovars are moving back to Kosovo in record numbers, and families are expanding greatly. Kosovars living overseas are investing their money in property (houses, apartments, stores, factories, etc.) in Kosovo. All this is driving up electric demand. KEK's present rehabilitation and expansion projects (ranging from €3 to 5 million of KCB funds in past years) are not keeping up. The problem is compounded since KCB funding ended on 31 December 2008; KEK now needs to internally generate the needed funds. The transmission licensee (KOSTT) is in the middle of a large capacity expansion program that will increase their capacity from 1000 MVA to 1650 MVA by the end of 2011. Unfortunately, the bottleneck to getting power to the people will thus move to the KEK distribution system at the end of 2011.

Over the next three years, KEK needs to rapidly increase construction for the following:

- 110 kV to 10 kV step-down transformation (property and responsibility of KEK, not KOSTT)
- 10 kV feeders
- 10/0.4 kV distribution transformers.

Ironically, KEK has at its own disposal the mechanism to fund the above network expansions. In 2008 unaccounted for (unmetered, stolen, bypassed, etc.) energy could have generated €36.8 million. This is enough to both fund the metering program and the network expansions listed above.

Furthermore, KEK can dramatically increase the transfer capability of the 10 kV feeders by proceeding with the program to raise the voltage to 20 kV. Doubling the feeder voltage quadruples the transfer capability. Whereas a 10 kV feeder nominally carries 3.5 MVA, the same poles and wires will carry 14.0 MVA at 20 kV. All feeders, distribution transformers and switchgear installed in Kosovo since 1984 are 20 kV capable. Only now 110 / 20 kV large power transformers are needed for the substations.

Vaganicë 110 / 35/ (20)10 kV Substation

KEK and Kosovo need to construct the proposed Vaganicë substation in northern Kosovo. The tender documentation is prepared; only the funding and the government go ahead are needed. There are many benefits:

- Both KEK and Trepca privatization will be advanced when KEK stops using the power distribution system owned by Trepca Mining POE.
- 126 MVA of additional transformation capability (110 kV step down to 35 kV and 10 kV) will become available to Kosovo. Vaganicë SS will have 2x63 MVA transformers.
- The security of electric supply in northern and western Kosovo will be assured since Vallaq SS will be backed up.

Palaj 110 / 35 kV Substation

All of electricity for KEK's coal mining and coal transport operations comes from the Palaj Substation. As mentioned elsewhere in this report, KEK's coal mining and transport operations make it the second-largest user of electricity in Kosovo, second only to Ferro Niklei. In 2008 KEK used 100.5 GWh of energy, worth about €2.7 million. The Palaj SS is in precarious shape: it is old, is supplied by only one 110 kV line, and has only two 40 MVA transformers.

KEK and KOSTT have begun the design work to bring two additional 110 kV lines into Palaj, to add a third power transformer, and upgrade and expand the 35 kV switchgear. KEK needs to authorize this project and start construction.

5. Coordination with Other USAID Implementing Partners and Other Donors

Donor/ Counterpart	Activity	Q1	Q2	Q3	Q4
USAID implementing partners and other donors	Meetings at which PA communicated KEK's needs for assistance in financing 1) residential and commercial meters, securing meter boxes, conduits, etc., 2) rehabilitating mining equipment, and 3) an employee severance program.	●	●		
Bearing Point	Met with Bearing Point's chief of party and advisors to MEM to discuss issues of concern and to share information.	●	●	●	●
	Met with Bearing Point's advisor at the Ministry of Finance to discuss non-payment of electricity bills by budgetary institutions, KEK load forecast and issues related to New Kosovo and KEK's privatization, KEK's Board of Directors, KEK CAPEX and OPEX requests from KCB, and KEK's financial plan.	●	●		
	Met with advisors at the Tax Administration to clarify certain questions pertaining to the VAT payable by KEK and/or its contractors, and the terms of the MoU for KEK's treatment of VAT.	●	●	●	●
	Developed a series of "white papers" on critical issues of the Kosovo power sector.		●	●	●
US Energy Agency	Met to formulate a meaningful training program for KEK. It was suggested that USEA focus on third-country training for KEK's revenue protection teams.			●	●
KfW	Met and discussed Coal System I and the potential for buying a new excavator.		●	●	
ERO and its World Bank-funded consultant	Met to discuss tariff issues in relation to the pending KEK tariff decision and other regulatory issues including the need for entities selling power to KEK at the border of Kosovo to be licensed by ERO.	●	●		
USAID Justice Reform Team	Met on several occasions to discuss the PA Team's efforts to improve court processes for executing debt cases. Valuable information was exchanged.	●	●	●	●

Donor/ Counterpart	Activity	Q1	Q2	Q3	Q4
World Bank	Met with the Bank to update it on KEK's status and coordinate issues and activities such as the SSW mine opening, inclusion of A&B units in "Kosovo C," an a donor's conference.	•	•	•	•
KTA	Held regular meetings to share KEK status and management issues; the PA Team is maintaining a good working relationship with KTA and has this body's support.	•	•		
KTA, UNMIK and others	Spent considerable time to formulate and quantify issues related to energy provided to the minority areas.	•	•	•	•
USAID, Bearing Point, Pillar IV, OSCE, and other stakeholders	Held a series of meetings on the issue of KEK providing notice of cancellation of the contract to collect the fee for RTK. Background information, documentation of the business case, and proposed alternative funding mechanisms were presented.	•	•	•	•
Kosovo Small Business Center (KCBI)	Met with advisors from the Center regarding the quality of electricity supply to commercial businesses clients in Gjilan.	•	•	•	
KFOR Command	Maintained close contact with KFOR Command and the various KFOR bases throughout Kosovo; maintained close coordination for Coordinated Declaration of Independence. Provided updates on the status of the sector to the new commanders, and provided detailed topographic maps with all 10 kV feeders drawn on them so that KFOR can visually assess each day the impact on villages of the ABC load shedding program.	•	•	•	•
KOSTT and KEK	Continued to meet and discuss regularly the integrated and harmonized expansion plans of the distribution and transmission systems in Kosovo, and of Kosovo participation in the regional power pool.	•	•	•	•
KEMA	Interfaced regularly with the KEMA consultants to KOSTT (see above). KEMA's contract ended on 31 May 2008.	•	•		
EULEX	Met with the Head of Mission to discuss KEK-related matters and requested further meetings with EULEX's judicial and prosecutorial components.				•
ICO	Met with the Head of Mission to discuss KEK, and energy sector related matters.				•

Appendix A: PBMS – Key Indicators

No.	Objectives Supporting These Results	Task Reference Supporting These Results	Definition of Indicator and Unit of Measure	2006 Actual/ Calculation[1]	2007 Actual	2008 Target	2008 Actual	2009 Target	Status
1	1, 2, 3, 5, 6, 7, 8	1 through 6, and 8	Reduce commercial losses as compared with previous year (ratio of commercial losses vs. energy available for sale)	31%	30%	25%	20%	10%	26.0% for Q4 2008 20.2% for full year 2008
2[2]	1, 2, 3, 5, 6, 7, 8	1	Reduce technical losses (ratio of technical losses vs. energy delivered to distribution)	18.2%[3]	17.4%	17%	16.6%	16.5%	16.9% for Q4 2008 16.6% for full year 2008
3	1, 2, 5, 6, 8	1 through 6, and 8	Ratio of energy billed vs. energy available for sale	69.1%[4]	69.9%	75%	79.8%	90.0%	74.0% for Q4 2008 79.8% for full year 2008
4		1 through 6, and 8	Ratio of revenue collected versus billed	74.2%	76.6%	80.0%	75.6%	89.0%	76.2% for Q4 2008 75.6 % for full year 2008
5	1,.2, 3, 5, 6, 7, 8	1 through 6, and 8	Revenue collected as a percentage of value of energy available for sale [ratio of revenue collected vs. billed] x [ratio of energy billed vs. energy available for sale]	51.3%	53.5%	60%	60.3%	80.0%	56.4% for Q4 2008 60.3% for full year 2008
6		1 and 4	Ratio of debt collected vs. claimed[5]	not available	23.48 %	30%	17.5%	35%	As of 31 December 2008 the recovery rate was approximately 17.5% of the debt claimed.
7	1, 2, 3, 5, 6, 7, 8	1 through 8, and 11	Collected revenue in Euros	€96mm	€110.8 mm	€116mm	€135 mm	€140 mm	€40.4 million for Q4 2008 €134.7 million for full year 2008

[1] Due to KEK's quality of information and calculation methodology, upon further review, the 2006 data used as Key Indicators 1 and 2 had to be revised. The updated numbers are shown in the status section for the two items in Bold.

[2] Given the updated information, the target for Key Indicator 2 needed to be revised to 1% below 2006 actual/ calculated for 2007 (17.2%) and for 2008 it should be 1% below the 2007 number (16.2%).

[3] The "First Year Work Plan" presented 2006 actual at 15%. The higher figure of 18.2% above is the result of restating 2006 results with the same methodology used in 2007 and 2008.

[4] The "First Year Work Plan" presented 2006 actual at 61.78%. The higher figure of 69.1% above is the result of restating 2006 results with the same methodology used in years 2007 and 2008.

[5] Under Kosovo law, executing judgments for debt is the sole responsibility of the courts. Accordingly, this target will ultimately depend on the cooperation of the courts and their willingness to work with and support KEK.

Appendix B: PBMS – Milestone Indicators

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 1 Support Management	Performance Indicators	PA will have issued all required reports during the first six months that will have recommended improved planning, capital and operating budgeting, and accounting and financial systems in KEK, and will have designated baseline and targets to measure PA'a progress on accomplishment of the task objectives, including training.	Quarterly	Support KEK management	Improve KEK management capabilities	Reports, recommend-dations and targets were developed and are under implementation
	Impact Indicators	The MD will have implemented the enhanced organization structure with skilled individuals along the lines PA recommended. KEK operations will have become noticeably smoother due to increased management capability of the MD and her team. This will be indicated by the ability to formulate improved business processes at KEK. Private sector participation strategy in Network and Supply is communicated to stakeholders and potential investors, while basic requirements for investment attraction have been instituted.	Quarterly	Improve KEK management	Limit future distribution- and generation-related demands on the KCB to higher-than-anticipated supply costs, unplanned CAPEX, emergency situations or payments for customers that are not permitted to be disconnected.	KEK's performance has improved in all areas: mines, generation, and collections. And the MD has communicated the results to stakeholders and public.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 2: Distribution Structure and Organization	Performance Indicators	PA will have implemented the pilot project in Ferizaj	Quarterly	Complete Ferizaj pilot project	Roll out Ferizaj pilot project to all districts	Ferizaj pilot was implemented on September 1
	Impact Indicators	KEK will have implemented the enhanced organization structure and organization in the pilot district, and billing and collection rates will have improved substantially	Quarterly	Improve Ferizaj financial performance	Improve KEK financial performance	Significant improvement in collection was achieved in September – December
Task 3: Energy Accounting	Performance Indicators	The PA Team will have completed its activities for improvement in energy accounting including: recommendations on the functional interface between Network/Supply and Transmission/Market Operator and resolving disputes between KEK and KOSTT; including the agreements reached in KEK-KOSTT contract and monitored their implementation; created the KEK metering projects and assisted KEK in moving forward with implementing this program.	Quarterly	Improve energy accounting	Recom-mendations submitted to KEK in line with the deliverables timeline.	The monthly reports to the BoD are considered to be the final word on energy reports in KEK. "Billed versus EAFS" continues to improve each month.

Task	Performance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
	Impact Indicators	KEK will have implemented the recommendations made by PA within one month of PA presenting the recommendations; KEK will meet the targets of the Network action plan and the loss reduction targets approved by the Board of Directors; and Network and Supply will be working towards common goals.	Quarterly	Recommendations submitted to KEK in line with the deliverables timeline.	Reduce unaccounted for electricity to 10%	Underway.
Task 4: Increase Collections	Performance Indicators	PA will have completed its activities in this task to improve the operation of KEK Supply with a view to improving its managerial and financial performance in billings, collections, and customer service. PA will have developed an action plan for Supply to implement the recommendations; success will be measured based on PBMS indicators, and PA will have monitored KEK Supply in implementing the plan.	Quarterly	Achieve reduction of the average use of electricity by households by 10% due to demand response at end-user level to the enforcement of collection and disconnection policies	Improve the financial performance of KEK by striving to achieve a collection ratio of 80%	Billing and collection results are good based on PBMS measures
	Impact Indicators	KEK Supply will have implemented the recommendations made in this task and will have created a schedule for increasing collections over the next three years. KEK will achieve the collections target as shown in Appendix A.	Quarterly	Debt recovery rate is 30% of the debt claimed	Debt recovery rate is 35% of the debt claimed	Billing and collection results are good based on PBMS measures

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 5: Take Over and Clean Up CCP	Performance Indicators	PA will have completed its activities in this task, developed an action plan for KEK to implement the recommendations; success will be measured based on the efficiency and effectiveness of operation of CCP.	Quarterly	Take over CCP		Tasks 5.1, 5.2, and 5.5 completed. Rules developed and CCP Clean Up Team in place. Work plan developed and rolled out to districts
	Impact Indicators	KEK will have adopted the rules and regulations for the operation and maintenance of CCP by the Network, Supply, Finance and IT divisions, and will have taken over the operation and maintenance of CCP and cleaned up the CCP database.	Quarterly		Clean up CCP database	Tasks 5.1, 5.2, and 5.5 completed. Rules developed and CCP Clean Up Team in place. Work plan developed and rolled out to districts
Task 6: Take Over CAS and Fin. Unbundling	Performance Indicators	PA will have completed its activities in this task, developed an action plan for KEK to implement the recommendations; success will be measured based on the efficiency and effectiveness of operation of CAS (including HR and Payroll).	Quarterly	Prepare a pilot project to test the new chart of accounts	Implement the new chart of accounts including Balance Sheets, Income Statements, etc.	Underway.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
	Impact Indicators	KEK will have adopted the rules and regulations for the operation and maintenance of CAS by all KEK divisions and the IT Division, and will have taken over the operation and maintenance of CAS and cleaned up the CAS database. The new Chart of Accounts will have been implemented and financial statements of all KEK functions generated.	Quarterly	Un-bundle KEK financial accounting	Improved Regulatory Reports	KEK IT has taken over the KEK IT support with limited support from the outside contractor.
Task 7: Tariffs and Regulatory Support	Impact Indicators	PA will have completed its activities on this task, developed an action plan for KEK to implement the recommendations; success will be measured based on the approval of the tariffs and proposed regulations.	Quarterly	File for new tariffs	File for new tariffs	Tariff plan has been developed and preparation for tariff filing is underway.
	Performance Indicators	KEK will have filed for new tariffs and rules, and ERO will have approved them.	Quarterly	Obtain ERO approval	Obtain ERO approval	Several filings regarding various rules are pending ERO approvals.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 8: Strengthen Internal Controls and Internal Audit	Performance Indicators	PA will have assisted KEK's Internal Audit Department, to address all forms of loss or theft, excessive costs, fraud and embezzlement. Indicators will measure the results of this effort.	Quarterly	Establish a fully operational Internal Audit function in KEK	Support the continued strengthening of Internal Audit	Structural formation, staffing processes are on-going. Daily tuition and training are on-going. Dozens of investigations are completed and 40 more are underway.
	Impact Indicators	KEK will have achieved significant results in fighting losses, fraud and embezzlement. Measurable results in adherence to procedures will be shown within KEK, which will begin to improve the image of KEK to its customers and to the community.	Quarterly	Improve internal controls	Substantially reduce fraud and embezzlement	12 employees have been terminated Facts of electricity theft, corruption, bribery identified. and many cases have been filed with the prosecutor.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 9": Legal Support for Unbundling	Performance Indicators	PA will have drafted documents required for the agreed unbundling strategy, to include incorporation documents for new corporation(s), documentation transferring assets and liabilities to any new corporation(s) and contractual arrangements post-unbundling between the corporations. Other indicators include: a) presenting to the KEK Board of Directors, new Employment Regulations for KEK employees; and b) focusing on successfully enforcing debt judgments for non-payment of electricity against a select number of defendants.	July, October, January	Documents submitted to KEK in line with the deliverables timeline.	Documents submitted to KEK in line with the deliverables timeline.	Employment Regulations completed. Pilot project with NSCS for judgment debts is underway. Draft Corporate documentation for the New Company completed.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
	Impact Indicators	New unbundled corporation(s) have been created and all relevant contractual and corporate documents have been concluded. New Employment Regulations have been adopted and are being implemented. Prioritized civil cases are being processed more effectively by the courts and debt judgments for non-payment of electricity are actually being enforced by the courts.	July, October, January	All documents and recommend-dations have been accepted and adopted by KEK in accordance with the deliverables timetable. Debt recovery rate is 30% of the debt claimed	All documents and recommend-dations have been accepted and adopted by KEK in accordance with the deliverables timetable. Debt recovery rate is 35% of the debt claimed	New Employment Regulations not yet adopted. Draft corporate documentation being considered by stakeholders. KEK remains focused on filing large numbers of debt cases, instead of case management and recovery rates. Debt recovery rate is 17.5% of the debt claimed

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
Task 10: Assist TA for KEK Privatization	Performance Indicators	PA will have assisted the privatization Transaction Advisor with defining the structure of the privatization transaction and the preparation of an Information Memorandum.	Quarterly	Support of the privatization of KEK distribution network and supply to a competent strategic investor	Support of the privatization of KEK distribution network and supply to a competent strategic investor	Plans have been prepared to assist the Transaction Adviser once he is on board.
	Impact Indicators	Information Memorandum Issued, privatization deal structure identified	Quarterly	Privatization is underway	Information Memorandum is issued	TBD
Task 11: Normalization of Services to Enclaves	Performance Indicators	PA will have implemented the communal metering project.	Quarterly	Recommen-dations submitted to KEK in line with the deliverables timeline.	Recom-mendations submitted to KEK in line with the deliverables timeline.	PA facilitated conciliation meetings among enclaves and stakeholders. Commodity component of metering is being reviewed by PA and USAID.

Task	Perform-ance or Impact	Indicators Definition and Unit of Measure	Reporting Frequency	2008 Target	2009 Target	2008 Actual
	Impact Indicators	Electric services to enclaves will be provided and billed based on communal metering.	Quarterly	Recommen-dations submitted to KEK in line with the deliverables timeline.	Recommen-dations submitted to KEK in line with the deliverables timeline.	Underway.

Training Indicators

No.	Task Order Objective	Indicator and Unit of Measure	2006 Actual/ Calculated	2007 Target	2007 Actual	2008 Target Actual	2009 Target	Status, Notes
1	1, 2, & 3	Number of people receiving training in technical energy field	0	40	231	Target 60 (M=42 and W=18) Actual 54 (M=54 and W=0)	60 (M=48 and W=12)	For all of year 2008 54 men were trained and no women were trained, for a total of 54 persons.
2	1, 2 &3	Number of people receiving training in energy-related business management field	0	80	149	Target 100 (M= 70 and W=30) Actual 69 (M=61 and W=8)	60 (M=30 and W=30)	For all of year 2008 61 men were trained, 8 women were trained, for a total of 69 persons.

Contextual Indicators (Reported Quarterly)

No.	Task Order Objective Reference	Definition of Indicator & Unit of Measure	FY 2006 Actual	FY 2007 Actual	FY 2008 Actual	Q4 2008 Actual	FY 2009 Target	FY 2010 Target	FY 2011 Target	FY 2012 Target	Status
1.	1&2	Percentage (%) of served demand (ratio of "un-served energy" to "supplied energy plus un-served energy") based upon data provided by the KEK Capacity Management Department.	12.92 %	10.24 %	14.70 %	9.24 %	11.01 % +/- 2 %	10.72 % +/- 2 %	10.44 % +/- 2 %	10.19 % +/- 2 %	Due to increased imports and improved availability of Kosovo A and B Units, un-served energy is 9.24 % for Q4 of year 2008.

Note: The Fiscal Year (FY) runs 01 October of one year to 30 September of the following year; Q4 is the fourth quarter (October through December) of the calendar year.