

## **MUNICIPAL DEVELOPMENT FUND OF GEORGIA**

EIB - FINANCE CONTRACT FIN N° 81.855  
EU - FINANCING AGREEMENT ENPI/2013/335-432  
(WATER INFRASTRUCTURE MODERNISATION  
PROJECT PHASE II)

**Special Purpose Project Financial Statements and Independent  
Auditor's Report  
For the Period Commencing 13 June 2014 to 12 April 2016**

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
**EU - FINANCING AGREEMENT ENPI/2013/335-432**

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## MUNICIPAL DEVELOPMENT FUND OF GEORGIA

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016

Management of the Water Infrastructure Modernization II project (the "Project"), financed under the Finance Contract FIN N° 81.855 between the Government of Georgia ("GoG") and the European Investment Bank ("EIB") dated 20 August 2013 and Financing Agreement ENPI/2013/335-432 between Government of Georgia and European Union ("EU") dated 13 June 2014, implemented by the Municipal Development Fund of Georgia (MDF) is responsible for the preparation of the special purpose project financial statements that present fairly the financial position of the Project as at 12 April 2016, and its expenditure, designated accounts ("DA") balances and movement in designated accounts for the period commencing 13 June 2014 to 12 April 2016, in compliance with the basis of accounting described in Note 2 accompanying these special purpose financial statements.

In preparing the special purpose project financial statements, management is responsible for:


- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures that enable users to understand the impact of particular transactions, other events and conditions on the Project, financial position and its sources and uses of funds and movements in special accounts;
- Making an assessment of the Project's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Project;
- Maintaining adequate accounting records that are sufficient to show and explain the Project's transactions and disclose with reasonable accuracy at any time the financial position of the Project, and which enable them to ensure that the special purpose project financial statements of the Project comply with the requirements, listed in Financing Agreements signed between EIB and MOF and EU and Ministry of Regional Development and Infrastructure ("MRDI");
- Maintaining statutory accounting records in compliance with Georgian legislation;
- Taking such steps that are reasonably available to them to safeguard the assets of the Project; and
- Preventing and detecting fraud and other irregularities.

The special purpose project financial statements for the period commencing 13 June 2014 to 12 April 2016 were authorised for issue on 18 May 2016 by the Management.

On behalf of Management:

  
Juansher Burchuladze  
Executive Director

18 May 2016



  
Natalie Godziashvili  
Head of Financial Management and  
Investments Unit

18 May 2016



## INDEPENDENT AUDITOR'S REPORT

### To the management of the Municipal Development Fund of Georgia:

We have audited the accompanying special purpose project financial statements of the Water Infrastructure Modernization project phase II (the "Project") financed under the Finance Contract FIN N° 81.855 between Government of Georgia ("GoG") and the European Investment Bank ("EIB") dated 20 August 2013 and Financing Agreement ENPI/2013/335-432 between Government of Georgia and European Union ("EU") dated 13 June 2014, implemented by the Municipal Development Fund of Georgia, which comprise the Project's statement of financial position as at 12 April 2016, the Statement of Expenditure and Statements of Designated Account for the period commencing June 13, 2014 to 12 April 2016 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements").

#### *Management's responsibility for the special purpose project financial statements*

Management is responsible for the preparation and fair presentation of these special purpose project financial statements in accordance with the basis of accounting described in Note 2 of these special purpose project financial statements and requirements, listed in the Financing Agreement signed between EU and MRDI and for such internal control as management determines is necessary to enable the preparation of the special purpose project financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's responsibility*

Our responsibility is to express an opinion on these special purpose project financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the special purpose project financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the special purpose project financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the special purpose project financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of the special purpose project financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the special purpose project financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the accompanying special purpose project financial statements present fairly, in all material respects, the financial position of the Project as at 12 April 2016, and statement of expenditure and statement of designated accounts for the period commencing 13 June 2014 to 12 April 2016 in accordance with the basis of accounting described in Note 2 of these special purpose project financial statements and requirements, listed in the Financing Agreement signed between EU and MRDI.

*Basis of accounting and restriction on distribution and use*

Without modifying our opinion, we draw attention to Note 2 to the special purpose project financial statements, which describe the basis of accounting. The special purpose project financial statements are prepared to assist the Project to comply with the requirements of the European Investment Bank and the European Union. As a result, the special purpose project financial statements may not be suitable for another purpose. Our report is intended solely for use by the management of the Project, the GoG, EU and EIB and should not be distributed or used by anyone other than these specified parties.

*Deloitte & Touche*


18 May 2016  
Tbilisi, Georgia

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
**EU - FINANCING AGREEMENT ENPI/2013/335-432**

**STATEMENT OF FINANCIAL POSITION**  
**FOR THE PERIOD ENDED 12 APRIL 2016**  
*(in Euros)*

	Note	EIB	EU	Government of Georgia
Designated account		4,691,255	327,778	-
Advances paid	6	4,413,988	850,986	981,942
<b>TOTAL ASSETS</b>		<b>9,105,243</b>	<b>1,178,764</b>	<b>981,942</b>
Funds received		23,225,891	4,000,000	4,056,508
Project expenditures		(14,070,648)	(2,821,121)	(3,074,565)
Front end fee		(50,000)	-	-
Interbank charges	7	-	(115)	-
Foreign exchange gain/(loss)		-	-	-
<b>TOTAL PROJECT EXPENDITURES AND OTHER FUNDS</b>		<b>9,105,243</b>	<b>1,178,764</b>	<b>981,942</b>

On behalf of Management:

  
**Juansher Burchuladze**  
**Executive Director**

18 May 2016

  
**Natalie Godziashvili**  
**Head of Financial Management and Investments Unit**

18 May 2016

The notes on pages 8 to 11 form an integral part of these special purpose project financial statements.



**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
**EU - FINANCING AGREEMENT ENPI/2013/335-432**

**STATEMENT OF EXPENDITURE**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
**(in Euros)**

	<u>Contract Reference</u>	<u>Contract Description</u>	<u>Expenditures incurred and paid from inception to date (EIB portion)</u>	<u>Expenditures incurred and paid from inception to date (EU portion)</u>
JAVA LTD	EIB/WIMPII/W/NCB/02	Bolnisi Water Network Rehabilitation		
ZIMO LTD	EIB/WIMPII/W/NCB/05	Tsnori Water Network Rehabilitation	930,690	186,657
IN-SI LTD	EIB/WIMPII/W/NCB/01	Senaki Water supply rehabilitation	661,207	133,546
IN-SI LTD	EIB/WIMPII/W/NCB/06-1	Ozurgeti Water Network Rehabilitation	990,887	199,851
IN-SI LTD	EIB/WIMPII/W/NCB/19	Abasha Water Network Rehabilitation	592,765	117,454
IN-SI LTD	EIB/WIMPII/W/NCB/11	Lagodekhi Water Network Rehabilitation	1,103,944	219,279
LUDWIG PFEIFFER	EIB/WIMPII/W/NCB/15	Khobi Water Network Rehabilitation	737,153	150,901
KAINAT TECHIZAT TIKINTI	EIB/WIMPII/W/NCB/14-1	Dusheti Water network Rehabilitation	527,788	103,779
ALLIANCE LTD	EIB/WIMPII/W/NCB/24-1	Zestaphoni Water Network Rehabilitation	39,256	7,986
ASNAF LTD	EIB/WIMPII/W/NCB/30	Akhalsikhe-Aspindza Water Network Rehabilitation	149,238	30,360
ASNAF LTD	EIB/WIMPII/W/NCB/13	Tetritskaro Network Rehabilitation	494,077	98,209
BUILD INDUSTRY LTD	EIB/WIMPII/W/NCB/29	Borjomi - Likani - Tsagveri Water Network Rehabilitation	704,977	141,800
BUILD INDUSTRY LTD	EIB/WIMPII/W/NCB/23	Signagi Water network Rehabilitation	330,033	66,907
NDS - CONSTRUCTION LTD	EIB/WIMPII/W/NCB/21	Oni Water Network Rehabilitation	130,520	26,496
SPECHYDROMSHEN I LTD	EIB/WIMPII/W/NCB/22	Gurjaani Water Network Rehabilitation	202,913	40,855
TBILI SAKHLI LTD	EIB/WIMPII/W/NCB/12	Sagarejo Water Network Rehabilitation	859,322	166,269
JV SABA & TSEKURI	EIB/WIMPII/W/NCB/27	Tsalka Water Network Rehabilitation	938,413	189,632
JV SABA & TSEKURI	EIB/WIMPII/W/NCB/20	Tkibuli Water network Rehabilitation	357,558	72,240
TREST NEFTEGAZ TIKINTI LTD	EIB/WIMPII/W/NCB/08	Telavi (Vil. Kurdgelaure) Water network Rehabilitation	101,239	20,638
TREST NEFTEGAZ TIKINTI LTD	EIB/WIMPII/W/NCB/09	Kareli Water network Rehabilitation	834,440	168,298
DAGI LTD	EIB/WIMPII/W/NCB/10	Akhmeta Water network Rehabilitation	312,047	62,235
JV - ILF & SOUNDERS GROUP	EIB/WIMPII/CS/QCBS/01 (EUR part)	Supervision	891,016	180,320
JV - ILF & SOUNDERS GROUP	EIB/WIMPII/CS/QCBS/01 (USD part)	Supervision	1,464,903	292,302
<b>Total:</b>			<b>716,262</b>	<b>145,107</b>
			<b>14,070,648</b>	<b>2,821,121</b>

On behalf of Management:

Juansher Burchuladze  
Executive Director

18 May 2016

Natalie Godziashvili  
Head of Financial Management and Investments Unit

18 May 2016

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
**EU - FINANCING AGREEMENT ENPI/2013/335-432**

**STATEMENT OF DESIGNATED ACCOUNT - EIB**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
**(in Euros)**

Code	217250935
Depository Bank	State Treasury
Address	16 V. Gorgasali street Tbilisi, 0114 Georgia

Opening Balance	Note	-
Funds received from EIB		23,225,891
Less: front end fee		(50,000)
Present outstanding amount advanced to Designated account (DA)		<u>23,175,891</u>
DA closing balance as at 12 April 2016		4,691,255
Add: Amount of expenditure paid		14,070,648
Add: Amount of advances paid		<u>4,413,988</u>
Total advance accounted for		<u>23,175,891</u>

On behalf of Management:

  
**Juansher Burchuladze**  
**Executive Director**

18 May 2016

  
**Natalie Godziashvili**  
**Head of Financial Management and Investments Unit**

18 May 2016

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
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**STATEMENT OF DESIGNATED ACCOUNT - EU**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
*(in Euros)*

Code	216230935
Depository Bank	State Treasury
Address	16 V. Gorgasali street Tbilisi, 0114 Georgia
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Opening Balance	Note <u>-</u>
Funds received from EU	4,000,000
Present outstanding amount advanced to DA	<u>4,000,000</u>
DA closing balance as at 12 April 2016	327,778
Add: Amount of expenditure paid	2,821,121
Add: Amount of advances paid	850,986
Intermediary bank charges	7 <u>115</u>
Total advance accounted for	<u>4,000,000</u>

On behalf of Management:

  
**Juansher Burchuladze**  
 Executive Director

18 May 2016

  
**Natalie Godziashvili**  
 Head of Financial Management and  
 Investments Unit

18 May 2016

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
**EIB - FINANCE CONTRACT FIN N° 81.855**  
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
**(in Euros)**

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**1. BACKGROUND**

Municipal Development Fund of Georgia ("MDF") was established by the Government of Georgia by Presidential Decree # 294 of 7 June 1997 to manage allocated credits/loans received from the International Development Association ("IDA"), the International Bank for Reconstruction and Development ("IBRD"), the Asian Development Bank (ADB) and the European Investment Bank (EIB) and monitor the implementation of infrastructure sector projects.

The European Investment Bank Finance Contract FIN N° 81.855 (the "Contract") in the amount of EUR 40 million was signed between the Government of Georgia ("GoG"), represented by the Ministry of Finance of Georgia and European Investment Bank ("EIB") on 20 August 2013. European Union ("EU") Financing Agreement ENPI/2013/335-432 (the "Agreement") in the amount of EUR 8 million was signed between the Government of Georgia, represented by the Ministry of Regional Development and Infrastructure of Georgia and European Union, represented by the European Commission ("EC") on 13 June 2014 to co-finance the Project through Neighborhood Investment Facility ("NIF") non-reimbursable grant.

The program concerns priority investment schemes for water and sanitation within the service area of the United Water Supply Company of Georgia, the purpose of which is to improve efficiency, service, public health and the environment.

MDF coordinates, manages and evaluates all aspects of the implementation of the Project.

**2. ACCOUNTING POLICIES**

**Basis of accounting** – These special purpose project financial statements have been prepared in accordance with the Cash Basis of Accounting and incorporate the following principal accounting policies, which have been consistently followed in all material respects and comply with the requirements, listed in the Financing Agreements signed between the EU and MRDI and EIB and Ministry of Finance of Georgia.

**Funds received** – Project financing is recognised as sources of funds in the period when the cash inflow can be reasonably estimated and they become available and measurable.

**Expenditure** – Expenditure is recognised when the following two criteria are met: (1) the expenditure is incurred, and (2) the actual payment is made.

**Advances paid** – Advances are recognised when the payment is made but the expenditure criteria are not met.

**Foreign exchange rate** – Expenditure incurred in Georgian Lari (GEL) is recorded in EURO (EUR) using the exchange rate prevailing at the date when respective funds were converted to GEL. Therefore, there were instances during the year when different GEL/EUR exchange rate was used to record EU and EIB expenditures. The funds conversion and expenditure payment dates are generally the same for the EIB portion, while they may be different for the EU portion. The reason is that financing is received from the EU later than the expenditures incurred. In such cases, the expenditure is normally financed from the overdraft received from the Government of Georgia.

**Cash** – Cash comprises balances with the State Treasury.



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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
*(in Euros)*

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**3. DESIGNATED ACCOUNT**

This account is a designated disbursement account of the Project maintained in EUR at the State Treasury to ensure the payment of eligible expenditures, within defined limits, which do not require individual authorisation from EIB and EU in accordance with the Agreement.

**4. BASIS OF FUNDING**

According to the terms of the Agreement, the expenditure is co-financed by proceeds received from EIB and EU at a proportional rate of 83% and 17%, respectively. The co-financing split is calculated on the GEL amounts; therefore, the EUR equivalent is not always equal to the 83%/17% proportion.

The Government of Georgia (GoG) finances all applicable taxes.

**5. METHODS OF WITHDRAWAL**

The methods of withdrawal used from the inception of the loan to 12 April 2016 were as follows:

**(a) Special Account** - Purchase of service, works, equipment and supplies are authorised by EIB and performed through open international tender or other acceptable procurement procedures complying with EIB Guide to Procurement. Municipal Development Fund of Georgia withdraws the eligible amounts from the special accounts based on contract terms and conditions and invoices submitted by a contractor.

**(b) GoG Current Account** - The Project maintains a separate account where funds from the Government of Georgia are accumulated. The funds are further disbursed to contractors based on the share of expenditures to be incurred.



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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
*(in Euros)*

**6. ADVANCES PAID**

Payments of advances to contractors are made at the beginning of the contract in the amount of 10%-30% of the total contract amount. Retention of advance is made periodically upon submission of works completed certificates by contractors.

The detailed breakdown of the advances paid for from the inception to date for EIB and EU portions is shown in the table below:

	<u>Contract Reference</u>	<u>Contract Description</u>	<u>Advances paid from inception to date (EIB portion)</u>	<u>Advances paid from inception to date (EU portion)</u>
JAVA LTD	EIB/WIMPII/W/NCB/02	Bolnisi Water Network Rehabilitation		
ZIMO LTD	EIB/WIMPII/W/NCB/05	Tsnori Water Network Rehabilitation	5,669	1,161
IN-SI LTD	EIB/WIMPII/W/NCB/01	Senaki Water supply rehabilitation	680,796	130,901
IN-SI LTD	EIB/WIMPII/W/NCB/06-1	Ozurgeti Water Network Rehabilitation	257,745	50,323
IN-SI LTD	EIB/WIMPII/W/NCB/19	Abasha Water Network Rehabilitation	319,487	61,430
IN-SI LTD	EIB/WIMPII/W/NCB/11	Lagodekhi Water Network Rehabilitation	65,711	12,426
LUDWIG PFEIFFER	EIB/WIMPII/W/NCB/15	Khobi Water Network Rehabilitation	549,279	107,176
KAINAT TECHIZAT TIKINTI	EIB/WIMPII/W/NCB/14-1	Dusheti Water network Rehabilitation	6,064	1,257
ALLIANCE LTD	EIB/WIMPII/W/NCB/24-1	Zestaphoni Water Network Rehabilitation	91,922	17,675
BUILD INDUSTRY LTD	EIB/WIMPII/W/NCB/29	Borjomi - Likani - Tsagveri Water Network Rehabilitation	308,959	59,405
BUILD INDUSTRY LTD	EIB/WIMPII/W/NCB/23	Signagi Water network Rehabilitation	197,456	37,967
TBILI SAKHLI LTD	EIB/WIMPII/W/NCB/12	Sagarejo Water Network Rehabilitation	89,422	17,194
JV SABA & TSEKURI	EIB/WIMPII/W/NCB/27	Tsalka Water Network Rehabilitation	362,027	69,609
JV SABA & TSEKURI	EIB/WIMPII/W/NCB/20	Tkibuli Water network Rehabilitation	211,395	40,647
TREST NEFTEGAZ TIKINTI LTD	EIB/WIMPII/W/NCB/08	Telavi (Vil. Kurdgelauri) Water network Rehabilitation	351,711	67,625
DAGI LTD	EIB/WIMPII/W/NCB/10	Akhmeta Waternetwork Rehabilitation	381,953	73,440
TREST NEFTEGAZ TIKINTI LTD	EIB/WIMPII/W/NCB/09	Kareli Water network Rehabilitation	508,490	97,770
<b>Total:</b>			<u>25,902</u> <u><b>4,413,988</b></u>	<u>4,980</u> <u><b>850,986</b></u>

**7. INTERBANK CHARGES**

EUR 115 represents the interbank charge for the transfer of money to the designated account and is part of the funds received under this project. The amount received by the Company on designated account was net of interbank charges. However, it was accounted as funds received as well as project expenditure.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
**WATER INFRASTRUCTURE MODERNISATION PROJECT PHASE II**  
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE PERIOD COMMENCING 13 JUNE 2014 TO 12 APRIL 2016**  
*(in Euros)*

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**8. COMMITMENTS AND CONTINGENCIES**

Management are not aware of any commitments and contingencies which would have a material impact on the special purpose project financial statements as at 12 April 2016 and on the funds received and disbursed during the period then ended.

**9. OPERATING ENVIRONMENT**

Emerging markets such as Georgia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Georgia continue to change rapidly and tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Georgia is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

Throughout 2015 Georgia's neighbouring countries, which are large trading partners of Georgia, have experienced significant political and economic turmoil which has had a knock-on effect on the Georgian economy. This has resulted in a significant devaluation of the Georgian Lari against the US dollar and other major currencies.

**10. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE**

There were no significant events subsequent to the balance sheet date.

**11. APPROVAL OF FINANCIAL STATEMENTS**

These project financial statements were authorised for issue by the Management of MDF on 18 May 2016.