

**MUNICIPAL DEVELOPMENT
FUND OF GEORGIA**

LOAN NO.3273-GEO
(SUSTAINABLE URBAN TRANSPORT INVESTMENT
PROGRAM – PROJECT 4)

Special Purpose Project Financial Statements
and Independent Auditor's Report
For the Year Ended 31 December 2016

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA -----
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM –
PROJECT 4
LOAN NO.3273-GEO**

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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 YEAR ENDED 31 DECEMBER 2016

Management of the Sustainable Urban Transport Investment Program - Project 4 (the "Project") financed under the Loan Agreement No. 3273-GEO dated 26 October 2015, 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 project's statement of financial position as at 31 December 2016, the summary of sources and uses of funds, statement of expenditure ("SOE") and imprest account statements, in compliance with the basis of accounting described in Note 2 of accompanying these special purpose project 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 imprest accounts;
- Making an assessment of the Projects 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;
- 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.

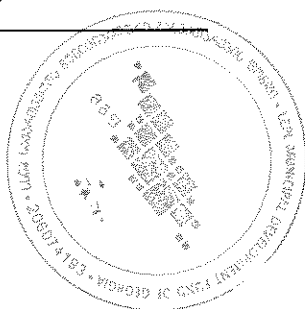
The special purpose project financial statements for the year ended 31 December 2016 were authorised for issue on 30 June 2017 by the Management.

On behalf of Management:



Galaktion Buadze
Executive Director

30 June 2017





Natalie Godziashvili
Head of Financial Management
and Investments Unit

30 June 2017

INDEPENDENT AUDITOR'S REPORT

To the management of the Municipal Development Fund of Georgia:

Opinion

We have audited the accompanying special purpose project financial statements of the Sustainable Urban Transport Investment Program - Project 4 (the "Project") financed under the Loan Agreement No. 3273-GEO dated 26 October 2015, implemented by the Municipal Development Fund of Georgia, which comprise the Project's statement of financial position as at 31 December 2016, the summary of sources and uses of funds, statement of expenditure ("SOE") and imprest account statements for the year ended 31 December 2016 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements"). The special purpose project financial statements are prepared by management of the Municipal Development Fund of Georgia in accordance with the basis of accounting described in Note 2.

In our opinion, the accompanying special purpose financial statements of the Project (including SOE and Imprest Account statements) for the year ended 31 December 2016 are prepared, in all material respects, in accordance with the basis of accounting described as further detailed in Note 2.

We believe that audit evidence we have obtained is sufficient and appropriate to provide basis of our assurance conclusion. The project utilised all proceeds of the loan withdrawn from ADB only for the purposes of the Project as agreed between ADB and Government of Georgia in accordance with the Loan Agreement and no proceeds of the Loan have been utilised for other purposes.

Basis for Opinion

We conducted our audit in accordance with International Standards of Auditing ("ISAs"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Fund in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter – Basis of Accounting and Restriction on Distribution and Use

We draw attention to Note 2 to the special purpose project financial statements, which describes the basis of accounting. The special purpose project financial statements are prepared to assist the Project's management to comply with the financial reporting provisions of the Agreement referred to above. As a result, the special purpose project financial statements may not be suitable for another purpose.

This report is intended solely for use by the Project's management, the Government of Georgia and Asian Development Bank. This report is not intended for the benefit of any other third parties and we accept no responsibility or liability to any party other than the Project's management in respect of the report. Should any third party take decisions based on the contents of the report, the responsibility for such decisions shall remain with those third parties. Our opinion is not modified in respect of this matter.

Responsibility of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Organisation's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless management either intends to liquidate the Organisation or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the special purpose project financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and access the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Organisation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Organisation to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte & Touche

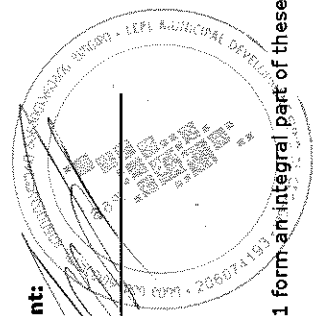
30 June 2017
Tbilisi, Georgia

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**SUMMARY OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2016
(in US Dollars)**

| | Actual | | Planned | | Variance | | PAD Life of the project the project <i>Unaudited</i> |
|--|--------------------------|-----------------------------------|--|--|--|--|--|
| | Year ended 31.12.2016 | Cumulative as at 31.12.2016 | Year ended 31.12.2016 <i>Unaudited</i> | Cumulative as at 31.12.2016 <i>Unaudited</i> | Year ended 31.12.2016 <i>Unaudited</i> | Cumulative as at 31.12.2016 <i>Unaudited</i> | |
| OPENING WORKING CAPITAL | | | | | | | |
| Cash | - | - | - | - | - | - | |
| Prepayments | - | - | - | - | - | - | |
| Payables | - | - | - | - | - | - | |
| SOURCES OF FUNDS | | | | | | | |
| Asian Development Bank | 2,294,279 | 2,294,279 | | | | | 20,000,000 |
| Imprest fund procedure | 2,000,000 | 2,000,000 | | | | | |
| Reimbursement procedure | 257,564 | 257,564 | | | | | |
| Interest and commitment charge | 36,715 | 36,715 | | | | | 4,000,000 |
| Government of Georgia | 196,681 | 196,681 | | | | | |
| TOTAL | 2,490,959 | 2,490,959 | | | | | 24,000,000 |
| EXPENDITURE | | | | | | | |
| Works and goods | 10,140 | 10,140 | 1,500,000 | 1,500,000 | 1,489,860 | 1,489,860 | 14,597,000 |
| Consulting services and incremental administration | 353,246 | 353,246 | 361,299 | 361,299 | 8,053 | 8,053 | 6,600,000 |
| Interest and commitment charges | 36,715 | 36,715 | - | - | (36,715) | (36,715) | 464,000 |
| Unallocated | - | - | - | - | - | - | 2,339,000 |
| TOTAL | 400,101 | 400,101 | 1,861,299 | 1,861,299 | 1,461,198 | 1,461,198 | 24,000,000 |
| Foreign exchange gain | 35,804 | 35,804 | | | | | |
| CLOSING WORKING CAPITAL | | | | | | | |
| Cash | 924,519 | 924,519 | | | | | |
| Prepayments | 1,188,116 | 1,188,116 | | | | | |
| Other assets | 14,028 | 14,028 | | | | | |
| Payables | | | | | | | |
| TOTAL | 2,126,663 | 2,126,663 | | | | | |

On behalf of Management:



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**Galaktion Buzadze
Executive Director**

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

30 June 2017

30 June 2017

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

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2016
(in US Dollars)**

| | Note | <u>31 December 2016</u> |
|-----------------------------------|------|-----------------------------|
| ASSETS | | |
| ADB Imprest Account | | 924,519 |
| Prepayments | 7 | 1,188,116 |
| Other assets | | 14,028 |
| TOTAL ASSETS | | <u>2,126,663</u> |
| | | |
| Cumulative Funds received: | | |
| ADB Loan 3273-GEO | | 2,294,279 |
| Government of Georgia | | 196,681 |
| Total funds received | | <u>2,490,960</u> |
| | | |
| Cumulative expenditure: | | |
| Cumulative project expenditure: | 8 | 400,101 |
| | | <u>400,101</u> |
| Foreign exchange gain | | 35,804 |
| TOTAL NET ASSETS | | <u>2,126,663</u> |

On behalf of Management:


Galaktion Budzge
Executive Director

30 June 2017


Natalie Godzhashvili
Head of Financial Management and
Investments Unit

30 June 2017

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

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**STATEMENT OF EXPENDITURE (“SOE”)
FOR THE YEAR ENDED 31 DECEMBER 2016
(in US Dollars)**

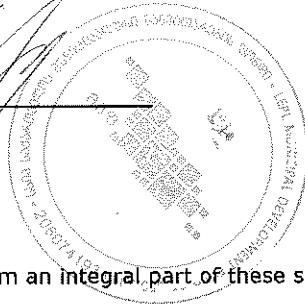
| Withdrawal No. | Withdrawal application date | Total SOE | Works and Goods | Consulting services and incremental administration |
|-----------------------|------------------------------------|------------------|------------------------|---|
| 0002 | 18-Nov-16 | 257,564 | - | 257,564 |
| | | 257,564 | - | 257,564 |

On behalf of Management:



Galaktion Buadze
Executive Director

30 June 2017





Natalie Godziashvili
Head of Financial Management and Investments Unit

30 June 2017

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


**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

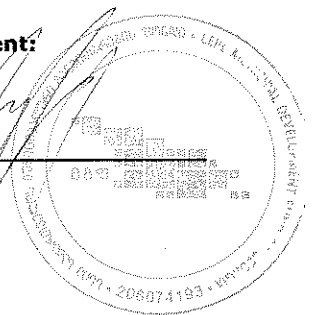
**STATEMENT OF IMPREST ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2016
(in US Dollars)**

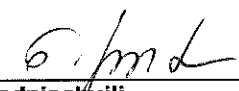
| | |
|------------------------|--|
| Account No. | 210240542 |
| Depository Bank | State Treasury |
| Address | 16 V. Gorgasali street Tbilisi, 0114 Georgia |

| | |
|--|------------------|
| Opening Balance | - |
| Funds received from ADB | 2,294,279 |
| Present outstanding amount advanced to DA | 2,294,279 |
| DA closing balance as at 31 December 2016 | 924,519 |
| Add: Amount of eligible expenditure paid | 1,369,760 |
| Total advance accounted for | 2,294,279 |

On behalf of Management:


Galaktion Buadze
Executive Director
30 June 2017




Natalie Godziasvili
**Head of Financial Management and
Investments Unit**
30 June 2017

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

**MUNICIPAL DEVELOPMENT FUND
REGIONAL DEVELOPMENT PROJECT
LOAN NO. 8148-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016
(in US Dollars)**

1. BACKGROUND

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

The Asian Development Bank Loan Agreement No. 3273-GEO (the "Agreement") in the amount of 20 million United States Dollars ("USD") was signed between the Government of Georgia ("GoG") and Asian Development Bank ("ADB") on 26 October 2015 ("inception"). First payment from the ABD was received on 12 February 2016.

The main objectives of the loan are: construction of a coastal protection structure to provide sustainable shoreline protection for the city of Batumi and strengthening the institutional and monitoring management capacity of MDF. The closing date of the loan is 31 December 2019.

2. ACCOUNTING POLICIES

Basis of accounting – These special purpose project financial statements have been prepared in accordance with the *Accrual Basis of Accounting* and incorporate the following principal accounting policies, which have been consistently followed in all material respects and comply with the Guidelines for the Financial Governance and Management of Investment Projects Financed by the Asian Development Bank.

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 on an accruals basis as a use of project funds when liabilities are incurred.

Functional currency – These special purpose project financial statements are expressed in United States Dollars ("US Dollar" or "USD").

Transactions in other currencies – Transactions in currencies other than reporting currencies are converted to US Dollars at the exchange rate prevailing at the date of the transaction. Monetary items are translated into US Dollars at the National Bank of Georgia ("NBG") official exchange rate at the reporting date.

Cash – Cash comprises balances with State Treasury.

3. IMPREST ACCOUNT

Imprest account is a special disbursement account of the Project maintained in US Dollars at the State Treasury to ensure the payment of eligible expenditures, within defined limits, which do not require individual authorisation from ADB in accordance with the Agreement.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)
(in US Dollars)**

4. BASIS OF FUNDING

According to the terms of the Agreement, the expenditure is co-financed by proceeds received from ADB and the Government of Georgia ("GoG"). ADB finances 100% of the expenditures with GoG financing all taxes and duties imposed on the territory of Georgia.

| | <u>ADB financing</u> | <u>GoG financing</u> | <u>Total</u> |
|--|--------------------------|--------------------------|--------------------------|
| Works and goods | 12,007,000 | 2,590,000 | 14,597,000 |
| Consulting services and Incremental Administration | 5,190,000 | 1,410,000 | 6,600,000 |
| Interest and commitment charges | 464,000 | - | 464,000 |
| Unallocated | 2,339,000 | - | 2,339,000 |
| Total: | <u>20,000,000</u> | <u>4,000,000</u> | <u>24,000,000</u> |

5. METHODS OF WITHDRAWAL

The methods for the withdrawal of loan proceeds are as follows:

- (a) Direct payment procedure**, where the Asian Development Bank (ADB), at the borrower's request, pays a designated beneficiary directly.
- (b) Commitment procedure**, where ADB, at the borrower's request, provides an irrevocable undertaking to reimburse a commercial bank for payments made or to be made to a supplier against a letter of credit (LC) financed from the loan account.
- (c) Reimbursement procedure**, where ADB pays from the loan account to the borrower's account for eligible expenditures which have been incurred and paid for by the project out of its budget allocation or its own resources.
- (d) Imprest fund procedure**, where ADB makes an advance disbursement from the loan account for deposit to an imprest account to be used exclusively for ADB's share of eligible expenditures

6. PREPAYMENTS

| | <u>31 December 2016</u> |
|-------------------------|-----------------------------|
| Advances to contractors | <u>1,188,116</u> |
| Total: | <u>1,188,116</u> |

Payments of advances to contractors are made at the beginning of the contract in amount of 10%-20% of total contract amount. Retention of advance is done periodically upon submission of works completed certificates by contractors.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)
(in US Dollars)**

7. OTHER ASSETS

| | <u>31 December 2016</u> |
|---------------|-----------------------------|
| Inventory | 14,006 |
| Other | <u>22</u> |
| Total: | <u>14,028</u> |

8. PROJECT EXPENDITURE BY FUND

| Project activities | Actual | |
|--|-------------------------|-------------------------------|
| | <u>Year to date</u> | <u>Cumulative to date</u> |
| Works and goods | 58 | 58 |
| Consulting services and incremental administration | 281,941 | 281,941 |
| Interest and commitment charges | <u>36,715</u> | <u>36,715</u> |
| ADB TOTAL | <u>318,714</u> | <u>318,714</u> |
| Works and goods | 10,082 | 10,082 |
| Consulting services and incremental administration | 71,305 | 71,305 |
| Interest and commitment charges | - | - |
| GoG TOTAL | <u>81,387</u> | <u>81,387</u> |
| TOTAL PROJECT EXPENDITURE | <u>400,101</u> | <u>400,101</u> |

The Project consists of the following main components:

- (a) Construction of a coastal protection structure, designed according to international best practices, which will provide sustainable shoreline protection for the city of Batumi
- (b) Strengthening the institutional and monitoring management capacity of MDF through a management information system for MDF, project preparatory activities, detailed engineering design and bidding documents for the Kobuleti coastal protection project and related recreational area and bicycle lanes, project preparatory activities, detailed engineering design and bidding documents for other projects under the investment program, and implementation support through financial audit and independent safeguards monitoring.

9. COMMITMENTS AND CONTINGENCIES

Management is not aware of any commitments and contingencies which would have a material impact on the financial position of the Project and the Special Account Statement as at 31 December 2016 and on the funds received and disbursed during the year then ended.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SUSTAINABLE URBAN TRANSPORT INVESTMENT PROGRAM – PROJECT 4
LOAN NO. 3273-GEO**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)
(in US Dollars)**

10. 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 2016 Georgia's neighbouring countries, which are the 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.

11. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

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

12. APPROVAL OF SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS

These special purpose financial statements were authorised for issue by the Management of MDF on 30 June 2017.