

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

CREDIT NO.5178-GE
LOAN NO.8607-GE
(SECOND REGIONAL DEVELOPMENT PROJECT)

Special Purpose Project Financial Statements and Independent
Auditor's Report
For the Year Ended 31 December 2017

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO. 8607-GE**

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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 2017

Management of the Second Regional Development Project (the "Project"), financed under the Credit Agreement No. 5178-GE dated 9 November 2012 and Loan Agreement No. 8607-GE dated 7 May 2017, implemented by the Municipal Development Fund of Georgia ("MDF") is responsible for the preparation of the special purpose project financial statements that present the financial position of the Project as at 31 December 2017, and the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure ("SOE"), designated account statements in accordance with the World Bank's Financial Management Sector Board's "Guidelines: Annual Financial Reporting and Auditing for World Bank Financed Activities" (the "World Bank Guidelines").

In preparing the 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 designated accounts;

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 Guidelines on Annual Financial Reporting and Auditing for World Bank – Financed Activities issued by the World Bank's Financial Management Sector Board;
- 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.

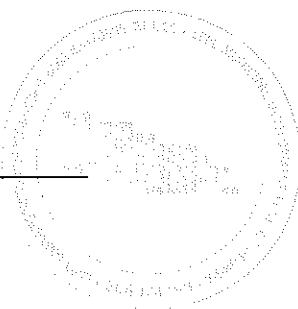
The special purpose project financial statements for the year ended 31 December 2017 were authorised for issue on 15 June 2018 by the Management.

On behalf of Management:



Juansher Burchuladze
Acting Executive Director

15 June 2018





Natalie Godziashvili
Head of Financial Management
and Investments Unit

15 June 2018

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 Second Regional Development Project (the "Project") financed under the Credit Agreement No. 5178-GE dated 9 November 2012 and Loan Agreement No. 8607-GE dated 7 May 2017 (the "Agreements"), implemented by the Municipal Development Fund of Georgia, which comprise the Project's statement of financial position as at 31 December 2017, the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure ("SOE") and designated account statements for the year ended 31 December 2017 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements").

In our opinion, the accompanying special purpose financial statements of the Project for the year ended 31 December 2017 are prepared, in all material respects, in accordance the World Bank's Financial Management Sector Board's "Guidelines: Annual Financial Reporting and Auditing for World Bank Financed Activities" (the "World Bank Guidelines").

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, which requires the special purpose project financial statements to comply with the World Bank's Guidelines. 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 in reporting the information to the Government of Georgia and International Bank for Reconstruction and Development. 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.

Project completion date

We draw your attention to note 1 of these special purpose project financial statements, which discloses that on 2 April 2018 the closing date of the grant has been prolonged to 31 December 2019. Our opinion is not modified in respect of this matter.

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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 in conformity with the World Bank's Financial Management Manual for World Bank Financed Investment Operations 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.

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 scepticism 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.

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.

Tamar Natsvlishvili
On behalf of Deloitte and Touche LLC

15 June 2018
Tbilisi, Georgia

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**SUMMARY OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2017
(in US Dollars)**

	Actual		Planned		Variance		Project appraisal document Life of the project
	Year ended 31.12.2017	Cumulative as at 31.12.2017	Year ended 31.12.2017 <i>Unaudited</i>	Cumulative as at 31.12.2017 <i>Unaudited</i>	Year ended 31.12.2017 <i>Unaudited</i>	Cumulative as at 31.12.2017 <i>Unaudited</i>	
OPENING WORKING CAPITAL							
Cash	2,189,922	-					
Prepayments	619,028	-					
Payables	(309,818)	-					
	2,499,132						
SOURCES OF FUNDS							
IDA Credit	2,435,500	28,953,467					30,000,000
IBRD Loan	-	22,500					9,000,000
Government of Georgia	414,308	7,731,708					7,500,000
TOTAL	2,849,808	36,707,675					46,500,000
EXPENDITURE							
Works and goods	1,584,575	27,812,681	3,000,000	29,228,106	1,415,425	1,415,425	45,918,712
Consulting services and trainings	547,090	5,350,209	800,000	5,603,119	252,910	252,910	
Operating costs	3,837	209,430	-	205,593	(3,837)	(3,837)	558,788
Resettlement costs	-	75,993	-	75,993	-	-	-
Front End Fee	-	22,500	-	22,500	-	-	22,500
TOTAL	2,135,502	33,470,813	3,800,000	35,135,311	1,664,498	1,664,498	46,500,000
Foreign exchange loss, net	(7,027)	(30,451)					
CLOSING WORKING CAPITAL							
Cash	2,982,014	2,982,014					
Prepayments	583,681	583,681					
Payables	(359,284)	(359,284)					
TOTAL	3,206,411	3,206,411					

On behalf of Management:

[Signature]
Juansher Burchuladze
Acting Executive Director

15 June 2018

[Signature]
Natalie Godziashvili
Head of Financial Management and
Investments Unit

15 June 2018

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2017
(in US Dollars)**

	Note	31 December 2017	31 December 2016
ASSETS			
IDA Designated Account		2,982,014	2,189,922
Prepayments	7	583,681	619,028
TOTAL ASSETS		3,565,695	2,808,950
LIABILITIES			
Payables		359,284	309,818
TOTAL LIABILITIES		359,284	309,818
NET ASSETS		3,206,411	2,499,132
Funds received:			
IDA Credit		28,953,467	26,517,967
IBRD Loan		22,500	22,500
Government of Georgia		7,731,708	7,317,400
Total funds received		36,707,675	33,857,867
Expenditure:			
Project expenditure:	8	33,470,813	31,335,311
		33,470,813	31,335,311
Foreign exchange loss, net		(30,451)	(23,424)
TOTAL NET ASSETS		3,206,411	2,499,132

On behalf of Management:


Juansher Burchuladze
Acting Executive Director

15 June 2018


Natalie Godziashvili
Head of Financial Management and
Investments Unit

15 June 2018

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**SUMMARY OF EXPENDITURE BY ACTIVITY
FOR THE YEAR ENDED 31 DECEMBER 2017
(in US Dollars)**

Project activities	Actual		Planned		Variance	
	Year ended 31.12.2017	Cumulative as at 31.12.2017	Year ended 31.12.2017 <i>Unaudited</i>	Cumulative as at 31.12.2017 <i>Unaudited</i>	Year ended 31.12.2017 <i>Unaudited</i>	Cumulative as at 31.12.2017 <i>Unaudited</i>
Component 1:						
Infrastructure investment	1,584,575	27,888,674	3,000,000	29,304,099	1,415,425	1,415,425
Component 2:						
Institutional development	550,927	5,559,639	800,000	5,808,712	249,073	249,073
Front end fee	-	22,500	-	22,500	-	-
TOTAL EXPENDITURES	2,135,502	33,470,813	3,800,000	35,135,311	1,664,498	1,664,498

On behalf of Management:


Juansher Burchuladze
Acting Executive Director


Natalie Godziashvili
Head of Financial Management and
Investments Unit

15 June 2018

15 June 2018

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE**

**STATEMENT OF EXPENDITURE ("SOE")
FOR THE YEAR ENDED 31 DECEMBER 2017
(in US Dollars)**

Withdrawal No.	Withdrawal application date	Total SOE	Works and goods and consulting services	Operating costs
13	31.05.2017	1,360,622	1,360,622	-
14	28.09.2017	781,456	781,456	-
		<u>2,142,078</u>	<u>2,142,078</u>	<u>-</u>

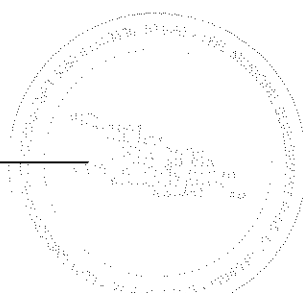
The total expenditure under withdrawal application No. 13 is attributable to 2016 and recorded as expenditure in the 2016 financial statements respectively. The withdrawal application for these expenses were submitted to International Bank for Reconstruction and Development in 2017.

On behalf of Management:



Juansher Burchuladze
Acting Executive Director

15 June 2018





Natalie Godziashvili
Head of Financial Management and Investments Unit

15 June 2018

The notes on pages 9 to 12 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**STATEMENT OF DESIGNATED ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2017
(in US Dollars)**

Account No.	202250947
Depository Bank	State Treasury
Address	16 V. Gorgasali street Tbilisi, 0114 Georgia
Opening Balance	<u>2,189,922</u>
Funds received from IDA	2,435,500
Present outstanding amount advanced to DA	<u>4,625,422</u>
DA closing balance as at 31 December 2017	2,982,014
Add: Amount of eligible expenditure paid	9 1,643,408
Total advance accounted for	<u>4,625,422</u>

Designated account for Loan No.8607-GE was opened in State Treasury. No disbursement has been made to the account during 2017.

On behalf of Management:



Juansher Burchuladze
Acting Executive Director

15 June 2018





Natalie Godzhashvili
Head of Financial Management and
Investments Unit

15 June 2018

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)
(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 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 International Development Association Credit Agreement No. 5178-GE (the "Agreement") in the amount of 19.8 million Special Drawing Rights ("SDR") was signed between the Government of Georgia ("GoG") and International Development Association ("IDA") on 9 November 2012 ("inception"). Loan Agreement No.8607-GE on additional financing in the amount of USD 9 million was signed between the Government of Georgia ("GoG"), International Bank for Reconstruction and Development ("IBRD") and International Development Association ("IDA") on 7 May 2017.

The main objectives of the loan are: to provide finance for Investment Subprojects for the urban regeneration of Tskaltubo including the rehabilitation of municipal infrastructure and utilities in the central area, upgrading of public spaces, parks; restoration of public buildings; refurbishment of the exterior and interior of the Vani museum; Enhance the institutional capacity and performance of the Georgia National Tourism Administration, the Agency for Culture Heritage Preservation of Georgia, the National Museum, MDF and other local and regional entities. The initial closing date of the loan was 30 December 2018. On 2nd April 2018, the closing date of the grant has been prolonged to 31 December 2019.

2. ACCOUNTING POLICIES

Basis of accounting – These special purpose project financial statements have been prepared in accordance with the World Bank's Financial Management Sector Board's "Guidelines: Annual Financial Reporting and Auditing for World Bank Financed Activities" and the accounting policies set out below.

The special purpose project financial statements have been prepared on the accrual basis of accounting.

These special purpose project financial statements, in accordance with the provisions of the Agreement, are prepared to report the information to the Government of Georgia and International Bank for Reconstruction and Development. As a result these special purpose project financial statements may not be suitable for another purpose.

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.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)**
(in US Dollars)

3. DESIGNATED ACCOUNT

Designated 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 IDA/IBRD in accordance with the Agreement.

4. BASIS OF FUNDING

According to the terms of the Credit Agreement NO.5178-GE, the expenditure is co-financed by proceeds received from IDA and the Government of Georgia ("GoG") at a proportional rate of 80% and 20%, respectively.

	IDA		GoG	Total
	Special Drawing Rights	USD Equivalent	USD Equivalent	USD Equivalent
Works and goods, consulting services and trainings	19,600,000	29,696,970	7,424,242	37,121,212
Operating costs	200,000	303,030	75,758	378,788
Total:	19,800,000	30,000,000	7,500,000	37,500,000

According to the terms of the Loan Agreement NO 8607-GE, the expenditure is fully financed by IBRD.

	IBRD	Total
	USD	USD
Works and goods, consulting services and trainings	8,797,500	8,797,500
Operating costs	180,000	180,000
Front end fee	22,500	22,500
Total:	9,000,000	9,000,000

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)
(in US Dollars)**

5. METHODS OF WITHDRAWAL

The methods of withdrawal used from the inception of the loan to 31 December 2017 were as follows:

(a) Designated Account

Municipal Development Fund withdraws the eligible amounts from the designated account and prepares and sends replenishment requests to the World Bank with authorised signatures. The replenishment requests and respective documentation are reviewed by the World Bank and an approved amount is transferred to the designated account.

(b) Direct Payment

Available amounts are drawn from time to time within limits determined under the loan agreement for direct payments of eligible expenditures for sub-projects. Direct payments are made by the World Bank directly to third parties. MDF forms withdrawal applications for request of direct payments and sends it to the World Bank, for settlement.

(c) GoG Current Account

The Project maintains a separate account where funds from the Government of Georgia are accumulated. The funds are further disbursed to sub-contractors based on the share of expenditures to be incurred.

6. STATEMENT OF EXPENDITURE

Withdrawals are to be made on the basis of SOEs for expenses on contracts within the following contractual limits:

- (i) All expenditures for works valued at less than USD 4,000,000;
- (ii) Consultant services contracts (firms) valued at less than USD 200,000;
- (iii) Consultant services contracts (individuals) valued at less than USD 50,000; and
- (iv) All expenditures for goods valued at less than USD 300,000.

7. PREPAYMENTS

	31 December 2017	31 December 2016
Prepayments to contractors	<u>583,681</u>	<u>619,028</u>
Total:	<u>583,681</u>	<u>619,028</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
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)
(in US Dollars)**

8. PROJECT EXPENDITURE BY FUND

Project activities	Actual	
	Year to Date	Cumulative to date
Works and goods, consulting services and trainings	1,706,528	24,467,799
Operating costs	-	163,105
IDA TOTAL	1,706,528	24,630,904
Front end fee	-	22,500
IBRD TOTAL	-	22,500
Works and goods, consulting services and trainings	425,137	7,195,376
Operating costs	3,837	46,325
Resettlement costs	-	75,993
GoG TOTAL	428,974	7,317,694
Works and goods, non-consulting services, consulting services and training	-	1,499,715
OTHER SOURCES TOTAL	-	1,499,715
TOTAL PROJECT EXPENDITURE	2,135,502	33,470,813

The Project consists of the following main components:

Component 1 - Infrastructure Investment

- Urban Regeneration in Tskaltubo
- Tourism services and infrastructure in six cultural heritage sites
- Vani Museum rehabilitation

Component 2 - Institutional Development

- Tourism related Institutional development activities
- Tskaltubo destination management and development office
- Performance monitoring and evaluation
- Procurement, safeguards, financial management, disbursement and supervision of all project Activities

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
CREDIT NO.5178-GE
LOAN NO 8607-GE**

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)
(in US Dollars)**

9. RECONCILIATION OF DESIGNATED ACCOUNT

	IDA	IBRD	GoG	Total
Expenditures incurred during the year	1,706,528	-	428,974	2,135,502
Change in prepayments	(28,262)	-	(7,085)	(35,347)
Change in payables	(40,653)	-	(8,813)	(49,466)
Foreign exchange	5,795	-	(12,822)	(7,027)
Amount of eligible expenditure Paid	1,643,408	-	400,253	

10. COMMITMENTS AND CONTINGENCIES

Legal proceedings - As at 31 December 2017 the Fund had the outstanding claim raised by supplier where the Fund is acting as a defendant: "Sani" LLC requested to return the penalty and payments for terminated contracts in the amount of GEL 7,262,263. Based on negotiations to date, the management believes that probability to win these cases is more than 75%, therefore no provision has been accrued by the Fund.

Management is not aware of any other 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 2017 and on the funds received and disbursed during the year then ended.

11. 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, 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.

For the last two years Georgia has experienced a number of legislative changes, which have been largely related to the European Union Association Agreement. Whilst the legislative changes implemented during 2016 and 2017 paved the way, more can be expected as Georgia's action plan for achieving accession to the European Union continues to develop.

12. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

Except the matters, disclosed in the Note 1, there were no other significant events subsequent to the balance sheet date that would require adjustment or disclosure in these special purpose project financial statements.

13. APPROVAL OF SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS

These special purpose financial statements were authorised for issue by the Management of MDF on 15 June 2018.