

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No 5178 GE**

**REPORT OF INDEPENDENT AUDITORS
AND
SPECIAL PURPOSE FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED
31 DECEMBER 2012**

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

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STATEMENT OF MANAGEMENT RESPONSIBILITIES

Management has prepared and is responsible for the special purpose financial statements and related notes of the Second Regional Development Project (the "Project") financed by the International Development Association Credit No. 5178 GE and the Government of Georgia. They have been prepared in accordance with the basis of accounting described in Note 2 of the accompanying special purpose financial statements.

The Project maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorisation and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The system contains self-monitoring mechanisms that allow management to be reasonably confident that controls, as well as the Project's administrative procedures and internal reporting requirements operate effectively. There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error or the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statements preparation.



Elguja Khokrishvili
Director



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REPORT OF INDEPENDENT AUDITORS

TO THE MANAGEMENT OF THE SECOND REGIONAL DEVELOPMENT PROJECT

We have audited the accompanying special purpose financial statements of the Second Regional Development Project (the "Project") implemented by the Municipal Development Fund which comprise the balance sheet as of 31 December 2012, statement of project sources and uses of funds, statement of uses of funds by project activities and designated account statement for the year then ended and a summary of significant accounting policies and other explanatory notes. We have also audited the Project's compliance with the conditions of the relevant Credit and Loan Agreements, the World Bank guidelines and Laws of the Georgia Republic.

Management's responsibility for the financial statements

2. Management is responsible for the preparation and fair presentation of these special purpose financial statements in accordance with the basis of accounting described in Note 2 of the accompanying special purpose financial statements. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of special purpose financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

3. Our responsibility is to express an opinion on these special purpose financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing ("ISA") applicable to the audit of financial statements and to compliance auditing, with special reference to ISA 800 "The Independent Auditor's Report on Special Purpose Audit Engagements" and to the relevant Credit Agreement, the World Bank guidelines and Laws of the Georgia Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement and about whether the Project has complied with the conditions of the relevant agreements, guidelines, laws and regulations.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity'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 financial statements.

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

Opinion

6. In our opinion:
- a) the accompanying special purpose financial statements referred to above, present fairly, in all material respects, the financial position of the Project as of 31 December 2012, and related sources and uses of funds and project activities and movement in the designated account for the year ended 31 December 2012, in accordance with the basis of accounting described in Note 2 to the accompanying special purpose financial statements; and
 - b) the Project is, in all material respects, in compliance with the conditions of the relevant Credit and Loan Agreements, the World Bank guidelines and Laws of the Georgia Republic during the year ended 31 December 2012.



28 June 2013

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
STATEMENT OF FINANCIAL POSITION
AS OF 31 DECEMBER 2012
(Expressed in US dollars)**

	Note	2012
ASSETS		
NON-CURRENT ASSETS		
Accumulated project expenses		1,570,360
		1,570,360
CURRENT ASSETS		
Advances paid to contractors		2,075,224
		2,075,224
TOTAL ASSETS		3,645,584
FUNDS		
Accumulated project financing		3,611,101
TOTAL RESERVES		3,611,101
LIABILITIES		
Accounts payable		34,483
TOTAL LIABILITIES		34,483
TOTAL LIABILITIES AND FUNDS		3,645,584

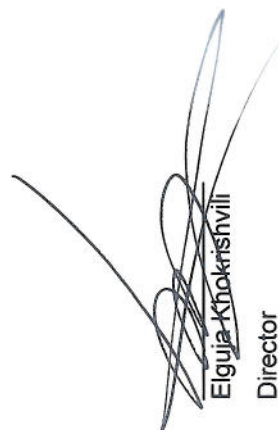

Elguja Khokrishvili
Director


Natalie Godziashvili
Financial Manager

The notes set out on pages 11-13 form an integral part of these financial statements

MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
STATEMENT OF PROJECT SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in US dollars)

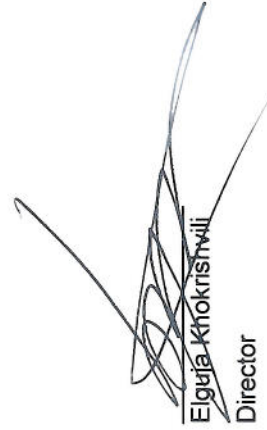
	ACTUAL		PLANNED		VARIANCE		PAD
	For the year ended 31 December 2012	Accumulated at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	
SOURCES OF FUNDS							
IDA funds:							
Government funds	3,611,101	3,611,101	-	-	-	-	-
	3,611,101	3,611,101	-	-	3,611,101	3,611,101	-
LESS: USES OF FUNDS							
Works and goods	(702,274)	(702,274)	(3,580,645)	(3,580,645)	2,878,371	2,878,371	36,750,000
Consultants' services and training	(868,086)	(868,086)	(1,000,000)	(1,000,000)	131,914	131,914	750,000
	(1,570,360)	(1,570,360)	(4,580,645)	(4,580,645)	3,010,285	3,010,285	37,500,000
FX difference							
NET CHANGE IN WORKING CAPITAL	2,040,741	2,040,741					


Elguja Khokrishvili
 Director


Natalie Godziashvili
 Financial Manager

MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
STATEMENT OF USES OF FUNDS BY PROJECT ACTIVITY
FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in US dollars)

	ACTUAL		PLANNED		VARIANCE		PAD
	For the year ended 31 December 2012	Accumulated at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	
Part A: infrastructure investment							
Works and goods	(702,274)	(702,274)	(3,580,645)	(3,580,645)	2,878,371	2,878,371	36,750,000
	(702,274)	(702,274)	(3,580,645)	(3,580,645)	2,878,371	2,878,371	36,750,000
Part B: Institutional Development							
Consultants' services and training	(868,086)	(868,086)	(1,000,000)	(1,000,000)	131,914	131,914	750,000
	(868,086)	(868,086)	(1,000,000)	(1,000,000)	131,914	131,914	750,000
TOTAL	(1,570,360)	(1,570,360)	(4,580,645)	(4,580,645)	3,010,285	3,010,285	37,500,000


Elguja Khokrishvili
Director


Natalie Godziashvili
Financial Manager

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
SOE WITHDRAWAL SCHEDULE
FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in US dollars)**

The Project management did not file any withdrawal applications during the reporting year. Neither did the IDA extend the advance payment under the Financing Agreement. All expenditures under the project during the reporting year have been paid for by the Government in compliance with the Project agreement signed on 9 November 2012 between the International Development Association and the Municipal Development Fund and based on the Procurement and Consultant Guidelines of the World Bank. The extension of an advance payment and reimbursement of eligible expenditures under the project incurred during the reporting year took place in accordance with the Financing Agreement (Credit No.5178-GE) in 2013 in the form of retroactive financing. Such arrangement has been agreed between the representatives of the Government of Georgia, the Municipal Development Fund and the International Development Association based on negotiations held on 27-28 September 2012, which were properly documented in the form of Minutes of Negotiation between Georgia and International Development Association for the Second Regional Development Project.



Elguja Khokrishvili
Director



Natalie Godziashvili
Financial Manager

The notes set out on pages 11-13 form an integral part of these financial statements

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
DESIGNATED ACCOUNT STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in US dollars)**

	2012
OPENING BALANCE AT 1 January 2012	-
ADD:	
Cumulative unexplained discrepancy	-
Advances paid during the year	-
Credit replenishment during the year	-
PRESENT OUTSTANDING AMOUNT ADVANCED TO DESIGNATED ACCOUNT (1)	-
CLOSING BALANCE AT 31 December 2012	-
ADD:	
Amount of eligible expenses paid during the year	-
TOTAL ADVANCE ACCOUNTED FOR (2)	-
DISCEPANCY TO BE EXPLAINED (1)- (2)	-


Erguja Khokriashvili
Director


Natalie Godziashvili
Financial Manager

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012
(Amounts are expressed in US dollars unless otherwise indicated)**

1. GENERAL INFORMATION

The Financing Agreement (Credit No.5178-GE) on the Second Regional Development Project (the "Project") was signed on 9 November 2012 between the Government of Georgia and International Development Association ("IDA"). The objective of the project is to improve infrastructure services and institutional capacity to support increased contribution of tourism in the local economy of the Imereti region.

The total financing required for the project has been estimated at SDR 24,750,000, which is equivalent to USD 37,500,000 with the applicable exchange rate of 1SDR = 1.522010 USD. The IDA financing according to the terms of the Credit Agreement is SDR19,800,000 million, which is equivalent to USD 30,000,000.

The Project is managed by the Municipal Fund of Georgia (the "Fund") established pursuant to Presidential Decree No. 294 dated 7 June 1997.

The project consists of the following parts:

Part A: Infrastructure Investment

Provision of financing for investment subprojects for: (1) the urban regeneration of Tskaltubo which includes: (a) the rehabilitation of municipal infrastructure and utilities in the central area; (b) the upgrading of public spaces, parks and construction of tourism amenities; and (c) the restoration of public buildings with vernacular architecture; and (2) tourism circuit development which includes: (a) improving local landscaping and public parking; (b) the construction of info kiosks, cafes and public toilets; (c) the restoration and refurbishment of exterior and interior of the Vani museum; (d) improving access roads; and (e) the preservation of selected cultural heritage sites, through the carrying out of works and provision of goods and consultants' services.

Part B: Institutional Development

Enhancing the institutional capacity and performance of the Georgia National Tourism Administration (GNTA), the Agency for Culture Heritage Preservation of Georgia (ACHP), the MD, and other local and regional entities to carry out the following activities: (1) the establishment of the Tskaltubo destination management and development office; (2) sustainable development and promotion; the establishment of the geotourism routes and tourism portal and conducting a local outreach campaign; (3) the preparation of visitors' management plans for the sustainability of the Project's cultural heritage sites; (4) skilled workforce development and capacity building; (5) monitoring and evaluation of performance; and (6) the provision of construction supervision support, through the provision of goods, consultants' services and training.

The following table illustrates the categories of eligible expenditures to be financed by IDA under the Project, the allocation of the total amount of loan to each category and the percentage of expenditures to be financed for each category:

	Amount of loan allocated	Percentage of expenditures to be financed
Category	SDR	%
(1) Goods, works, non-consulting services. Consultants' services and Training	19,600,000	80
(2) Operating costs	200,000	80
Total	19,800,000	

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2012
(Amounts are expressed in US dollars unless otherwise indicated)**

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These special purpose financial statements have been prepared based on the accrual basis of accounting and in compliance with the World Bank Accounting and Reporting Guidelines.

Translation of foreign currencies

The functional currency of the Company is Georgian Lari ("GEL"). The presentation currency of these special purpose financial statements is US dollars ("USD"). Transactions in currencies other than presentation currency are recorded at the rates of exchange defined by the National Bank of Georgia ("NBG") prevailing on the dates of transactions. At the reporting date, the monetary items denominated in currencies other than the presentation currency are translated into USD at the NBG rate effective at the reporting date.

	Official currency rate of the National Bank of Georgia	
	USD	EUR
Exchange rate as at 31 December 2012	1.6567	2.1825
Exchange rate as at 31 December 2011	1.6703	2.1614

All exchange rate differences are recognized in the statement of project Sources and Uses of Funds and the accumulated figure of exchange rate differences is disclosed in the statement of financial position.

Cash and cash equivalents

Cash and cash equivalents balance consists of the designated account of the IDA in the NBG and the treasure account of the Government of Georgia.

Advances paid to contractors

Advances paid to contractors are stated at cost and include prepayments made to subcontractors under the works and goods category expenditures.

Sources of funds

The IDA and Government financing of the project is recognized when earned at the time of receipts of funds or direct payments made to contractors. The accumulated project financing is disclosed under the Funds caption in the Statement of Financial Position. The amount of funds received during the reporting year is disclosed in the Statement of Project Sources and Uses of Funds.

Accounts payable

Accounts payable are stated at cost and include retentions and other payables to contractors. The balance of retentions payable to contractors represents amounts retained from progress payments against certificates of executed works, for the purpose of liquidation of post-completion faults and defects.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
IDA CREDIT No. 5178 – GE
NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2012
(Amounts are expressed in US dollars unless otherwise indicated)**

**2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Project expenses

Project expenses are recognized when incurred. The accumulated project expenses are disclosed in the Statement of Financial Position.

The World Bank financing

To facilitate timely disbursements for eligible expenses the Designated Account (DA) in US dollars is established and maintained until the Project completion. The DA is opened as the state Treasury's foreign currency account at the NBG. The DA is drawn upon to make payments to contractors, suppliers and consultants under the project. The movement of amounts on the DA is shown in the Designated Account Statement.

Project funds flow from the IDA either through the DA which is replenished on the basis of withdrawal applications or statements of expenditures (SOE's) or on the basis of direct payment withdrawal applications and/or special commitments on the terms and conditions agreed between the IDA and the Government. The IDA also reimburses the Government for eligible expenses paid by the Government.

Project closing date

According to the Credit Agreement the closing date of the Project is 31 December 2016.

3. ADVANCES PAID TO CONTRACTORS

Advances paid to contractors represent prepayments made to contractors under the works and goods category expenditures.

4. ACCOUNTS PAYABLE

Under the Works and Goods category expenditures, 5% of total contract amount is retained to be paid to contractor after the expiration of the faults and defects period (normally 1 year). Amounts are retained from each progress payment made to contractors against presented acceptance acts for executed works.

5. NET CHANGE IN WORKING CAPITAL

	2012
Advances paid to contractors	2,075,224
Retentions payable to contractors	(34,483)
	2,040,741