

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No 8148 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 8148 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 Bank of Reconstruction and Development Credit No 8148 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



Natalie Godziashvili
Financial Manager

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REPORT OF INDEPENDENT AUDITORS

TO THE MANAGEMENT OF THE SECOND REGIONAL DEVELOPMENT PROJECT

1. 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 special purpose financial statements. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of 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 special purpose 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 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.


Moore Stephens Georgian

28 June 2013

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – GE
STATEMENT OF FINANCIAL POSITION
AS OF 31 DECEMBER 2012
(Expressed in US dollars)**

	Note	2012
ASSETS		
NON-CURRENT ASSETS		
Accumulated project expenses		48,709,801
		48,709,801
CURRENT ASSETS		
Advances paid to contractors	3	804,505
Cash and cash equivalents	4	3,247,768
		4,052,273
TOTAL ASSETS		52,762,074
FUNDS		
Accumulated project financing		50,275,794
FX differences		76,477
TOTAL RESERVES		50,352,271
LIABILITIES		
Accounts payable	5	2,409,803
TOTAL LIABILITIES		2,409,803
TOTAL LIABILITIES AND FUNDS		52,762,074


Elguja Khokrishvili
Director


Natalie Godziashvili
Financial Manager

The notes set out on pages 11-15 form an integral part of these financial statements

MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – GE
STATEMENT OF PROJECT SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in US dollars)

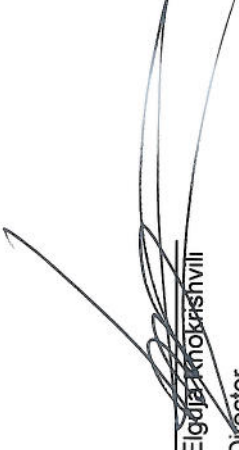
	ACTUAL		PLANNED		VARIANCE		PAD
	For the year ended 31 December 2012	Accumulated at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	For the year ended 31 December 2012	As at 31 December 2012	
SOURCES OF FUNDS							
IBRD funds:							
IBRD advance payment	6,700,000	6,700,000	-	-	6,700,000	6,700,000	-
IBRD retrospective financing	11,100,084	11,100,084	-	-	11,100,084	11,100,084	-
IBRD replenishments	22,553,757	22,553,757	-	-	22,553,757	22,553,757	-
Government funds	9,921,953	9,921,953	-	-	9,921,953	9,921,953	-
	50,275,794	50,275,794	-	-	50,275,794	50,275,794	-
LESS: USES OF FUNDS							
Works and goods	(47,985,240)	(47,985,240)	(46,123,663)	(46,123,663)	(1,861,577)	(1,861,577)	69,641,250
Consultants' services and training	(622,799)	(622,799)	(1,461,573)	(1,461,573)	838,774	838,774	3,681,250
Operating costs	(17,771)	(17,771)	(20,000)	(20,000)	2,229	2,229	1,530,000
Resettlement expenses	(83,991)	(83,991)	(80,000)	(80,000)	(3,991)	(3,991)	-
	(48,709,801)	(48,709,801)	(47,685,236)	(47,685,236)	(1,024,565)	(1,024,565)	74,852,500
FX difference	76,477	76,477	-	-	-	-	-
NET CHANGE IN WORKING CAPITAL (Note 6)	1,642,470	1,642,470	-	-	-	-	-



Ekvita Khokrishvili
 Director


Natalie Godziashvili
 Financial Manager

MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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	(47,985,240)	(47,985,240)	(46,123,663)	(46,123,663)	(1,861,577)	(1,861,577)	69,641,250
Resettlement expenses	(83,991)	(83,991)	(80,000)	(80,000)	(3,991)	(3,991)	-
	(48,069,231)	(48,069,231)	(46,203,663)	(46,203,663)	(1,865,568)	(1,865,568)	69,641,250
Part B: Institutional Development							
Operating costs	(17,771)	(17,771)	(20,000)	(20,000)	2,229	2,229	1,530,000
Consultants' services and training	(622,799)	(622,799)	(1,461,573)	(1,461,573)	838,774	838,774	3,681,250
	(640,570)	(640,570)	(1,481,573)	(1,481,573)	841,003	841,003	5,211,250
TOTAL	(48,709,801)	(48,709,801)	(47,685,236)	(47,685,236)	(1,024,565)	(1,024,565)	74,852,500


Elgorja Knokashvili
 Director


Natalie Godziashvili
 Financial Manager

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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	6,700,000
Credit replenishment during the year	22,553,757
PRESENT OUTSTANDING AMOUNT ADVANCED TO DESIGNATED ACCOUNT (1)	29,253,757
CLOSING BALANCE AT 31 DECEMBER 2012	3,247,768
ADD:	
Amount of eligible expenses paid during the year	26,005,989
TOTAL ADVANCE ACCOUNTED FOR (2)	29,253,757
DISCEPANCY TO BE EXPLAINED (1)- (2)	-


Elguja Khokrishvili
Director


Natalie Godziashvili
Financial Manager

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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 Development Credit Agreement No 8148-GE for Regional Development project (the "Project") was signed on 28 March 2012 between the Government of Georgia and International Bank for Reconstruction and Development ("IBRD"). The objective of the project is to improve infrastructure services and institutional capacity to support the development of tourism based economy and cultural heritage circuits in the Kakheti region.

The total financing required for the project has been estimated at USD 75 million. The IBRD financing according to the terms of the Credit Agreement is USD 60 million.

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

1. Provision of financing on a grant basis to local self-government authorities in Kakheti region to carry out investment subprojects for: (a) urban regeneration which includes: (i) the rehabilitation of municipal infrastructure and utilities in the central historical areas; (ii) the conservation and upgrading of public spaces and cultural buildings, and (iii) the conversation of building facades with vernacular architecture; and (b) tourism circuit development which includes: (i) improving urban landscaping and public parking; (ii) construction of info kiosks, cafes and public toilets; and (iii) improving access roads, through the carrying out of works and provision of goods and consultants' services.

2. Provision of financing on a grant basis for local self-government authorities in Kakheti region to carry out investment subprojects for public infrastructure to attract private sector investments in tourism and agro-processing, 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) destination management and promotion, including local outreach campaign; (2) setting up the geotourism routes and tourism portal; (3) skilled workforce development and capacity building; (4) supervision of construction and sustainable site management of cultural heritage; and (5) performance monitoring and evaluation activities, through the provision of goods, consultants' services and training.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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)**

1. GENERAL INFORMATION (CONTINUED)

The following table illustrates the categories of eligible expenditures to be financed by IBRD 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	USD	%
Works and goods	55,681,000	80
Consultants' services and training	2,945,000	80
Operating costs	1,224,000	80
Front-end Fee	150,000	The commission charged by the IBRD from the Government of Georgia equal to 025% of the loan amount
Total	60,000,000	

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 (the "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.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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)**

Cash and cash equivalents

Cash and cash equivalents balance consists of the designated account of the IBRD 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 IBRD 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.

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 IBRD 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 IBRD and the Government. The IBRD 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.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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)**

3. ADVANCES PAID TO CONTRACTORS

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

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents represent balance of the Designated Account.

5. ACCOUNTS PAYABLE

	2012
Retentions payable to contractors	2,391,794
Other accounts payable	18,009
	2,409,803

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

6. NET CHANGE IN WORKING CAPITAL

	2012
Cash and cash equivalents	3,247,768
Advances paid to contractors	804,505
Retentions payable to contractors	(2,391,794)
Other accounts payable	(18,009)
	1,642,470

MUNICIPAL DEVELOPMENT FUND OF GEORGIA
REGIONAL DEVELOPMENT PROJECT
IBRD CREDIT No. 8148 – 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)

7. RECONCILIATION BETWEEN THE AMOUNTS RECEIVED BY MDF AND DISBURSED BY THE WORLD BANK

	CATEGORY					Diff.
	1	2	3	Unallocated	Total	
Application No	Application date	Works and goods	Consultants' services and training	Operating costs	Advance payment	Total
WA-001	6-Jun-12	8,671,400	-	-	-	8,671,400
WA-003	7-Jun-12	-	-	-	6,700,000	6,700,000
WA-002	7-Jun-12	1,706,315	-	-	-	1,706,315
WA-004	19-Jun-12	578,400	-	-	-	578,400
WA-005	22-Jun-12	2,640,198	-	-	-	2,640,198
WA-006	10-Jul-12	143,970	-	-	-	143,970
WA-007	10-Jul-12	2,696,679	-	766	-	2,697,445
WA-008	20-Jul-12	2,807,561	-	1,874	-	2,809,435
WA-009	13-Aug-12	1,367,658	-	810	-	1,368,468
WA-010	17-Aug-12	2,394,076	-	1,450	-	2,395,527
WA-011	27-Aug-12	2,317,808	-	1,340	-	2,319,148
WA-012	7-Aug-12	1,628,841	-	2,399	-	1,631,240
WA-013	17-Sep-12	2,748,278	-	1,304	-	2,749,582
WA-014	17-Oct-12	3,939,958	-	2,756	-	3,942,714
Total		33,641,141	-	12,700	6,700,000	40,353,841
						40,353,842
						-