Grant Thornton

Special Purpose Project Financial Statements and Independent Auditor's Report

Municipal Development Fund of Georgia

Program for the Promotion of Renewable Energy - Renewable Energy Fund (REF) Disposition Fund - KfW Loan No. 2000 65 367

As of and for the year ended December 31, 2014

Contents

Independent auditor’s report

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To the founder of the Municipal Development Fund of Georgia

We have audited the accompanying special purpose project financial statements of the Disposition Fund of the Program for the Promotion of Renewable Energy – Renewable Energy Fund (the “Program”, “REF”), KfW Loan No. 2000 65 367, implemented by the Municipal Development Fund of Georgia (the “MDF”), which comprise the Statement of cash receipts and disbursements, Statement of expenditures and Statements of special accounts as of and for the year ended December 31, 2014, and a summary of significant accounting policies and other explanatory information.

Management’s Responsibility for the Special Purpose Project Financial Statements

Management of the MDF is responsible for the preparation and fair presentation of these special purpose project financial statements in accordance with the cash basis of accounting described in the note 2 to the special purpose project financial statements, the conditions of the Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and on June 12, 2009. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of special purpose project 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.

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 the International Standards on Auditing. 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall financial statement presentation.

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 special purpose project financial statements present fairly the balances of the Disposition Fund of the "Program for the Promotion of Renewable Energy" under KfW Loan No. 2000 65 367 as of December 31, 2014, and the cash receipts and payments of the Disposition Fund for the year then ended, in accordance with the cash basis of accounting described in the note 2, and in all material respects, payments have been made and Disposition Fund has been maintained in accordance with the conditions of the Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and on June 12, 2009, as well as Supplementary Conditions of KfW for payments under Disposition Fund procedure.

In our opinion, the Statement of expenditures submitted were supported by relevant and reliable evidence and can be relied upon to support the applications for the KfW Loan No. 2000 65 367 withdrawals.

In addition, in our opinion:

a) The payments out of the Disposition Fund have been made in accordance with the conditions of the relevant Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and on June 12, 2009. There were no ineligible expenditures identified.

b) The Disposition Fund has been maintained in accordance with the provisions of the Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and on June 12, 2009. This also comprises interest earned from balances.

c) Expenditures are supported by relevant and reliable evidence. All supporting documents and records with respect to the statements of expenditure submitted as the basis for withdrawal applications have been made available.

d) The audited statements of expenditures can be relied upon to support the related withdrawal applications. Clear linkage exists between the statements of expenditures, the withdrawal applications presented to KfW and accounting records.

e) During the year ended December 31, 2014 no goods have been aquired within the scope of the Disposition Fund of the KFW Loan No. 2000 65 367. Rendered services include only the audit fees, which were financed in accordance with the relevant Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and June 12, 2009, respectively.

f) No specific deficiencies and areas of weakness have been identified in the internal systems and controls of the Project Executing Agency.

Basis of Accounting

Without modifying our opinion, we draw attention to note 2 to the project financial statements, which describes the basis of accounting. The project financial statements are prepared to assist the management of the Municipal Development Fund of Georgia to meet the requirements of KFW. As a result, the project financial statements may not be suitable for another purpose.

June 25, 2015

Gagik Gyulbudaghyan	Emil Vassilyan, *FCCA*
Managing Partner	Engagement Partner

Statement of cash receipts and disbursements

As of and for the year ended December 31, 2014
In Euro

	Note	2014	2013
RECEIPTS			
Fund replenishments from KfW	3	666,807	-
Loan principal repayments from commercial banks	4	716,573	250,445
Interest received from commercial banks	5	113,350	118,798
Interest earned on bank account balances	6	23,847	19,327
Penalties received from commercial banks	7	-	87
Total receipts		1,520,577	388,657
DISBURSEMENTS			
Loans disbursed to commercial banks	8	6,563	315,200
Bank transfer fees	9	134	396
Reimbursement to KfW for prepayments received for rehabilitation of Ritseula and Khadori HPPs		-	60,278
Audit fees		7,644	8,110
Total disbursements		14,341	383,984
Net increase in funds		1,506,236	4,673
Fund balance at the beginning of the year		534,673	530,000
Fund balance at the end of the year		2,040,909	534,673

The special purpose project financial statements were approved on June 25, 2015 by:

Ilia Darchiashvili

Executive Director

Natalie Godziashvili
Head of Financial Management and
Investment Unit

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 9 to 13.

Statement of expenditures

In Euro	Expenditures	
Category	Year ended December 31, 2014	As of December 31, 2014
Loans disbursed to commercial banks for rehabilitation of Ritseula HPP	315,200	1,876,800
Loans disbursed to commercial banks for rehabilitation of Khadori HPP	-	2,200,000
Bank transfer fees	15	2,705
Audit fees	7,644	15,754
Total expenditures	322,859	4,410,459

The expenses presented in the statement of expenditures (with the exception of audit fees) for 2014 have been incurred in 2013. However, they have been presented in the withdrawal applications in 2014.

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 9 to 13.

Statements of special accounts

Account number: **GE82BG0000000264040900**

Depository bank: **Bank of Georgia, Georgia**

Address: **29a Gagarini Street, 0160 Tbilisi, Georgia**

KfW Loan number: **No. 2000 65 367**

Currency: **Euro**

	2014	2013
Balance at the beginning of the year	9,983	530,000
Add:		
Replenishments	-	-
Loan principal repayments from commercial banks	-	99,137
Interest received from commercial banks	-	60,081
Interest earned on bank account balances	-	9,983
Less:		
Transfer of balance on Bank Republic JSC account	-	(688,836)
Bank transfer fees	-	(382)
Balance at the end of the year	9,983	9,983

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 9 to 13.

Account number: GE88BR0000010020794131
Depository bank: Bank Republic, Georgia
Address: 2 Gr. Abashidze Street, 0160 Tbilisi, Georgia
KfW Loan number: No. 2000 65 367
Currency: Euro

	2014	2013
Balance at the beginning of the year	524,655	-
Add:		
Loan principal repayments from commercial banks	716,573	151,308
Interest received from commercial banks	113,350	58,717
Interest earned on bank account balances	23,847	9,344
Penalties received from commercial banks	-	87
Transfer of balance from Bank of Georgia JSC account	-	688,836
Less:		
Transfer to another account in Republic Bank JSC	(9,345)	(383,637)
Loans disbursed to commercial banks for rehabilitation of Pshavela HPP	(6,563)	-
Bank transfer fees	(8)	-
Balance at the end of the year	1,362,509	524,655

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 9 to 13.

Account number: **GE88BR000001030485868**

Depository bank: **Bank Republic, Georgia**

Address: **2 Gr. Abashidze Street, 0160 Tbilisi, Georgia**

KfW Loan number: **No. 2000 65 367**

Currency: **Euro**

	2014	2013
Balance at the beginning of the year	35	-
Add:		
Replenishments	666,717	-
Transfer from another account from Republic Bank JSC	9.345	383,637
Less:		
Loans disbursed to commercial banks	-	(315,200)
Bank transfer fees	(36)	(14)
Audit fee	(7,644)	(8,110)
Reimbursement to KfW for prepayments received for rehabilitation of Ritseula and Khadori HPPs	-	(60,278)
Balance at the end of the year	668,417	35

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 9 to 13.

Notes to the special purpose project financial statements

1 Nature of operations and general information

The Municipal Development Fund of Georgia (the "MDF") was established on June 7, 1997 by the Presidential Decree No. 294 "On Management of Funds Designated for the Development of the Municipal Sector in Georgia" as a legal entity under the public law, the objective of which is to support strengthening institutional and financial capacity of local government units, investing financial resources in local infrastructure and servicing and improving on a sustainable basis the primary economic and social services for the local population (communities). The founder and the governing body of the MDF is the Government of Georgia in the person of Prime-Minister of Georgia.

On the basis of the Agreement on Financial Cooperation dated April 11, 2001 between the Government of the Federal Republic of Germany and the Government of Georgia, on June 1, 2005 KfW and the Ministry of Finance of Georgia entered into a Financing Agreement, which provided financial contribution of Euro 5,112,918.81 for the Program for the Promotion of Renewable Energy (the "Program"). The Program aims to promote utilization of renewable energy by enhancing access to loans for private enterprises. The Program is implemented in accordance with the Separate Agreement to the Financing Agreement, dated June 1, 2005, and entails establishment of the Renewable Energy Fund (the "REF"), primarily to finance the foreign exchange costs for rehabilitation of renewable energy projects in private or commercial ownership. The REF shall disburse funds to Georgian commercial banks, which will in turn extend long-term loans to the ultimate project beneficiaries - the owners and operators of renewable energy facilities (private and municipal operators of existing small scale hydro power plants or geothermal facilities).

In accordance with Program management mechanisms described in the Separate Agreement, the MDF has been contracted by the Ministry of Finance of Georgia as the fund manager of the REF, under the agreement dated April 18, 2008, as amended on June 20, 2011. The agreement has a term of 3 years. The principal tasks of the Fund Manager include the liquidity management of the REF, reporting and verification whether the funds are being utilized for the designated purpose, specifically:

- Management of the REF special account
- Signing agreements with partner banks and disbursement of loans to them
- Monitoring of usage of funds by partner banks and the loan portfolio.

According to the fund management agreement, the MDF is entitled to receive an annual fund manager fee of Euro 51,000. The fund manager fee is paid directly by the KFW and is not born by the REF. Total management fees received by the MDF as of December 31, 2012 amount to Euro 153,000 for the years 2010-2012.

Commercial banks selected for participation in the Program are TBC Bank JSC and VTB Bank Georgia JSC.

According to the Separate Agreement to the Financing Agreement between KfW and Ministry of Finance dated June 1, 2005, a supervisory committee is created, which is responsible for monitoring that the funds received by commercial banks from the MDF are disbursed for Program-designated purposes. The committee consists of representatives of the Ministry of Finance of Georgia, the Ministry of Energy and Natural Resources of Georgia, the KfW and the United Nations Development Programme (the UNDP). Key tasks of the supervisory committee are general policy guidance, supervision of Fund administration (notably utilization of funds) and supervision of technical assistance program implementation. On quarterly basis the supervisory committee receives regular reports on implementation of the Program, including reports on utilization of funds by participating commercial banks.

2 Significant accounting policies

2.1 Basis of preparation

The MDF's policy is to prepare the accompanying special purpose project financial statements on the cash basis of accounting, as well as the relevant sections of the Financing Agreement dated June 1, 2005 and the corresponding Separate Agreement dated June 1, 2005, as amended on February 21, 2008 and on June 12, 2009.

Receipts include:

- fund replenishments from KfW;
- loan principal repayments received from commercial banks;
- interest received from commercial banks on the outstanding balances of loans;
- penalties received from commercial banks;
- interest earned on bank account balances.

Receipts are recognized in the special purpose project financial statements when received.

Disbursements include:

- loans disbursed to commercial banks;
- bank transfer fees;
- audit fees;
- reimbursement to KfW for prepayments received for rehabilitation of Ritseula and Khadori HPPs

Disbursements are recognized in the special purpose project financial statements when paid.

2.2 Functional and presentation currency

The national currency of Georgia is Georgian lari ("lari"), which is the MDF's functional currency, since this currency best, reflects the economic substance of the underlying events and transactions of the MDF.

These special purpose project financial statements are presented in Euro since management believes that this currency is more useful for the users of these special purpose project financial statements.

2.3 Foreign currencies

In preparing the special purpose project financial statements, transactions in currencies other than the 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 each reporting date, monetary items denominated in currencies other than the presentation currency are retranslated into Euro at the rate defined by the NBG prevailing as at the reporting date, which is 2.2656 lari for 1 Euro as of December 31, 2014 and 2.3891 lari for 1 Euro as of December 31, 2013. All receipts and disbursements made during 2014 year were made in Euro. Cash balances are held in Euro. Thus, no exchange rate differences arise from measurement of receipts and disbursements and from retranslations of year-end fund balances.

3 Fund replenishments from KfW

Fund replenishments are disbursed by KfW in Euro, in accordance with the Disposition Fund Disbursement Procedure. Replenishments are provided in installments of up to Euro 1,500,000 each, upon utilization of 70% of the preceding replenishment of the Disposition Fund. During 2014 replenishments received from KfW amounted to Euro 666,807 (2013: nil).

4 Loan principal repayments from commercial banks

Loan principal repayments from commercial banks represent payments made by commercial banks towards repayment of principal amount of the loans disbursed by the Fund.

During 2014 principal repayments with total amount of Euro 488,724 were made by TBC Bank JSC (2013: Euro 231,764) for the loans disbursed in 2010, 2011 and 2012 for the Ritseula Hydroelectric Power under the loan agreement dated June 17, 2010 and for the Khadori Hydroelectric Power Plant under the loan agreement dated April 4, 2011.

During 2014 principal repayments with total amount of Euro 227,849 were made by VTB Bank Georgia JSC (2013: Euro 18,681) for the loans disbursed in 2012 for the Khadori Hydroelectric Power Plant under the loan agreements dated April 4, 2011.

5 Interest received from commercial banks

Interest received represents payments made by commercial banks for interest accrued on the outstanding balances of loans disbursed by the KFW.

As of December 31, 2014 and December 31, 2013 the Program had two partner commercial banks – TBC Bank JSC and VBT Bank Georgia JSC.

According to the loan agreements with TBC Bank JSC dated June 17, 2010 and April 4, 2011 and the loan agreement with VTB Bank Georgia JSC dated April 4, 2011, the loans disbursed by the Fund to both partner banks are subject to annual interest rate of 3%.

During 2014 interest repayments with total amount of Euro 84,027 were made by TBC Bank JSC (2013: Euro 85,870) for the loans disbursed in 2010, 2011 and 2012 for the Ritseula Hydroelectric Power under the loan agreement dated June 17, 2010 and for the Khadori Hydroelectric Power Plant under the loan agreement dated April 4, 2011.

During 2014 interest repayments with total amount of Euro 29,323 were made by VTB Bank Georgia JSC (2013: Euro 32,928) for the loans disbursed in 2012 for the Khadori Hydroelectric Power Plant under the loan agreements dated April 4, 2011.

6 Interest earned on bank account balances

Interest earned on bank account balances represents amounts accrued on the balances of funds on the REF special account held at Bank of Georgia JSC and Bank Republic JSC.

7 Penalties received from commercial banks

Penalties received from commercial banks represent amounts accrued on the overdue payments, which comprise 0.05% for each day of delay during the period beginning with the due date and ending with the date at which such payment is credited to the REF account. The amount was received from TBC Bank JSC.

8 Loans disbursed to commercial banks

Disbursements to commercial banks (disclosed in note 1) are made based on evidence provided by the commercial banks that the loan agreements eligible for financing under the Program have been concluded with end-borrowers, which undertake hydroelectric power plants investments.

As of the reporting dates the Program had two partner commercial banks – TBC Bank JSC and VTB Bank JSC.

In the framework of the Project it was planned to transfer to VTB JSC an amount of Euro 675,000 for rehabilitation of the Pshavela Hydroelectric Power Plant. During 2014 the MDF has successfully transferred Euro 6,563 to VTB Bank JSC. Since the closing date of the Project was defined as December 31, 2014, the last payment for rehabilitation of the Pshavela Hydroelectric Power Plant was made to VTB Bank JSC at the amount of Euro 668,437on December 30, 2014. However, since VTB Bank JSC has Russian origins and due to international sanctions imposed on the Russian Federation, the funds were returned by an intermediary bank to the account of the MDF, whereas the intermediary bank charged the MDF a bank service fee of Euro 20. Taking into account the fact, that the transfer became visible in the bank account of the MDF in the evening of December 31, 2014, the MDF could not physically transfer this amount in 2014. The withheld bank charge of the euro 20 was reimbursed using the MDF own funds.

9 Bank transfer fees

The MDF maintains KfW funds on separate special accounts at Bank of Georgia JSC and Republic Bank JSC.

Since 2013 there was only one special account in Bank of Georgia JSC. In June 2013 the MDF opened special account for KfW fund in Bank Republic JSC and transferred remaining balance from Bank of Georgia JSC's account. In October 2013 another special account in Bank Republic JSC was opened for separating receipts from commercial banks and for payments made from funds for programmes of KfW.

Bank transfer fees are charged by Bank of Georgia JSC and Bank Republic JSC while disbursements from separate special accounts are made to participating commercial banks (to TBC Bank JSC and VTB Bank Georgia JSC).

In addition, intermediary bank charges are incurred by the REF on receipt of fund replenishments from KfW. Intermediary bank charges are included as project expenses. In 2014 no replenishments were received from KfW and the intermediary expenses incurred at the amount of Euro 90.

10 Events after the reporting period

As explained in note 8, as of December 31, 2014 the MDF was not able to transfer the amount of Euro 668,417 to VTB Bank SJC for the rehabilitation of Pshavela Hydroelectric Power Plant. This amount has been successfully transferred to VTB Bank JSC in January 15, 2015.

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