

SECOND REGIONAL DEVELOPMENT PROJECT

IDA CREDIT 5178-GE

**IMPLEMENTED BY
MUNICIPAL DEVELOPMENT FUND OF GEORGIA**

**Special Purpose Project Financial Statements
and
Independent Auditor's Report**

For the year ended 31 December 2014

SECOND REGIONAL DEVELOPMENT PROJECT

IDA CREDIT 5178-GE

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"SOS-AUDIT" LTD

INDEPENDENT AUDITOR'S REPORT N 72

*On the special purpose financial statements of the
"Second Regional Development Project"
for the year ended 31 December 2014*

To the management of Municipal Development Fund of Georgia

We have audited the accompanying special purpose financial statements of the "Second Regional Development Project" (the Project) financed under IDA Credit 5178-GE and implemented by Municipal Development Fund of Georgia (the MDF), which comprise the Project's statement of financial position as at 31 December 2014, the statement of sources and uses of funds, statement of expenditures by activities, statement of Summary Reports and SOEs, statement of Designated account for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

The Management of the MDF is responsible for the preparation and fair presentation of these special purpose financial statements in accordance with the basis of accounting described in the Note 2 accompanying these special purpose financial statements, and Financial Management Manual for World Bank Financed Investment Operations (WB Guidelines), and for such internal control as management determines is necessary to enable the preparation of the special purpose financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

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 as issued by International Auditing and Assurance Standards Board of the IFAC. 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.

An audit involves performing procedures to obtain reasonable audit evidence about the amounts and disclosures in the special purpose financial statements. The procedures selected depend on the auditor's judgment including the assessment of the risk of material misstatement of the special purpose financial statements, whether due to fraud or error. In making those assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the special purpose financial statement 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 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.

Քրոու Հորվաթ Բիզնես Ալյանսի Ասոցիացված Անդամ

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"SOS-AUDIT" LTD

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

Opinion

In our opinion,

1. the special purpose financial statements present fairly in all material respects the financial position of the Project as at 31 December 2014, as well as sources and uses of funds for the year then ended in accordance with the basis of accounting described in the Note 2 accompanying these special purpose financial statements and WB Guidelines;
2. funds have been used in accordance with the conditions of the Financing Agreement IDA Credit 5178-GE signed on 9 Nov 2012 between the Georgia and the International Development Association (IDA), and World Bank related guidelines, with due attention to economy and efficiency, and only for the purposes for which the financing was provided;
3. supporting documents, records and accounts have been maintained to support claims for reimbursement of expenditures incurred. Expenditures included in the withdrawal applications and reimbursed against are eligible for financing under the IDA Credit 5178-GE.
4. The Designated account used has been maintained in accordance with the provision of the IDA Credit 5178-GE, and World Bank related guidelines.

"SOS-Audit" LLC
30 June 2015



Manvel Ghazaryan,
Director


Gnel Khachatryan, FCCA
Auditor

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**Second Regional Development Project
IDA Credit 5178-GE**

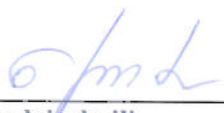
Statement of Financial Position

As at 31 December 2014

(Amounts are shown in US dollars)

| | Note | 31 December 2014 | 31 December 2013 |
|--|-------------|-----------------------------|-----------------------------|
| ASSETS | | | |
| Cash | 3 | 1,724,472 | 2,024,745 |
| Prepayments and receivables | 4 | 2,358,796 | 2,842,558 |
| Total Assets | | 4,083,268 | 4,867,303 |
| LIABILITIES | | | |
| Payables | 5 | 863,687 | 543,419 |
| Total Liabilities | | 863,687 | 543,419 |
| NET ASSETS | | | |
| Cumulative Funds Received | 6 | | |
| IDA Credit 5178-GE | | 17,653,407 | 10,640,550 |
| Government of GE | | 5,153,111 | 3,329,560 |
| Other income | | 1,499,716 | - |
| | | 24,306,234 | 13,970,110 |
| Cumulative Project Expenditures | 7 | | |
| Project Expenditures | | 21,000,204 | 9,755,401 |
| | | 21,000,204 | 9,755,401 |
| Foreign exchange gain/(loss) | | (86,449) | 109,175 |
| Total Net Assets | | 3,219,581 | 4,323,884 |


Ilia Darchiashvili
Executive Director


Natalie Godziashvili
Head of Financial Management
and Investments Unit

30 June 2015

The notes on pages 11-17 form an integral part of these special purpose project financial statements.

Second Regional Development Project
IDA Credit 5178-GE

Statement of sources and uses of funds
For the year ended 31 December 2014
(Amounts are shown in US dollars)

| | Actual | | Budget | | Variance | | PAD |
|--|--------------------------|--------------------------------|--------------------------|--------------------------------|--------------------------|--------------------------------|-------------------|
| | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | |
| OPENING WORKING CAPITAL | | | | | | | |
| Cash | 2,024,745 | - | | | | | |
| Prepayments and receivables | 2,842,558 | - | | | | | |
| Payables | (543,419) | - | | | | | |
| | 4,323,884 | - | | | | | |
| SOURCES OF FUNDS | | | | | | | |
| IDA Credit 5178-GE | 7,012,858 | 17,653,407 | | | | | 30,000,000 |
| Government of GE | 1,823,551 | 5,153,111 | | | | | 7,500,000 |
| Other income | 1,499,715 | 1,499,716 | | | | | - |
| | 10,336,124 | 24,306,234 | | | | | 37,500,000 |
| EXPENDITURES | | | | | | | |
| 1. Goods, works, non-consulting services, consultants' services and training | | | | | | | |
| <i>Works and Goods</i> | 11,040,768 | 20,796,169 | 16,166,250 | 25,921,651 | (5,125,482) | (5,125,482) | 37,121,212 |
| <i>Consulting services and training</i> | 9,961,770 | 17,997,044 | 14,666,250 | 22,701,524 | (4,704,480) | (4,704,480) | |
| 2. Operating costs | 1,078,998 | 2,799,125 | 1,500,000 | 3,220,127 | (421,002) | (421,002) | |
| | 204,035 | 204,035 | 100,000 | 100,000 | 104,035 | 104,035 | 378,788 |
| | 11,244,803 | 21,000,204 | 16,266,250 | 26,021,651 | (5,021,447) | (5,021,447) | 37,500,000 |
| Exchange rate gain/(loss) | (195,624) | (86,449) | | | | | |
| CLOSING WORKING CAPITAL | | | | | | | |
| Cash | 1,724,472 | 1,724,472 | | | | | |
| Prepayments and receivables | 2,358,796 | 2,358,796 | | | | | |
| Payables | (863,687) | (863,687) | | | | | |
| | 3,219,581 | 3,219,581 | | | | | |

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Second Regional Development Project
IDA Credit 5178-GE

Statement of expenditures by activities
For the year ended 31 December 2014
(Amounts are shown in US dollars)

| Parts | Actual | | Planned | | Variance | | PAD Life of Project |
|---|--------------------------|-----------------------------------|--------------------------|-----------------------------------|--------------------------|-----------------------------------|---------------------------|
| | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | Year ended 31.12.2014 | Cumulative as at 31.12.2014 | |
| Part A. Infrastructure investment Works and goods | 9,961,770 | 17,997,044 | 14,666,250 | 22,701,524 | (4,704,480) | (4,704,480) | 34,260,000 |
| Part B. Institutional Development Consultants' services and training | 1,283,033 | 3,003,160 | 1,600,000 | 3,320,127 | (316,967) | (316,967) | 3,240,000 |
| TOTAL EXPENDITURES | 11,244,803 | 21,000,204 | 16,266,250 | 26,021,651 | (5,021,447) | (5,021,447) | 37,500,000 |


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**Second Regional Development Project
IDA Credit 5178-GE**


Statement of Summary Reports and SOEs

For the year ended 31 December 2014

(Amounts are shown in US dollars)

| Withdrawal application No | Withdrawal application value date | Disbursement categories | | Total |
|---------------------------|-----------------------------------|---|-------------------|---------------------|
| | | 1.Goods, works, non-consulting services, consultants' services and training | 2.Operating costs | |
| 6 | 24.03.2014 | 1,975,254.89 | - | 1,975,254.89 |
| 7 | 30.09.2014 | 1,770,148.10 | 52,965.72 | 1,823,113.82 |
| 8 | 12.11.2014 | 3,143,583.38 | 70,905.80 | 3,214,489.18 |
| | | 6,888,986.37 | 123,871.52 | 7,012,857.89 |


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30 June 2015

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**Second Regional Development Project
IDA Credit 5178-GE**


Statement of Designated Account
For the year ended 31 December 2014
(Amounts are shown in US dollars)

| | |
|---------------------|-------------------------------------|
| Bank account number | GE65NB0331100001150207-202250947 |
| Bank | National Bank of Georgia |
| Bank location | 3/5, Leonidze Str. Tbilisi, Georgia |
| Currency | USD |

| | <u>IDA Credit 5178-GE</u> |
|---|---------------------------|
| 1. Opening balance as at 01.01.2014 | 2,024,745 |
| 2. Add: opening discrepancy | - |
| 3. WB advance/replenishment | 7,012,858 |
| 4. Less: Refund to WB from DA | - |
| 5. Present outstanding amount advanced to DA | <u>9,037,603</u> |
| 6. DA closing balance as at 31.12.2014 | 1,724,472 |
| 7. Add: Amount of eligible expenditures paid | 7,313,131 |
| 8. Less: interest earned (if credited to DA) | - |
| 9. Total advance accounted for | <u>9,037,603</u> |
| 10. Closing discrepancy (5)-(9) | - |


Ilia Darchiashvili
Executive Director

30 June 2015


Natalie Godziashvili
Head of Financial Management
and Investments Unit

The notes on pages 11-17 form an integral part of these special purpose project financial statements.

1. General information

1.1. *The Project*

The “Second Regional Development Project” (the Project) is being implemented in accordance with the Financing Agreement IDA Credit 5178-GE in the total amount of 19,800,000 Special Drawing Rights (SDR), signed between the Georgia and International Development Association (IDA) on 9 November 2012.

In accordance with Article E.1 of the Financing Agreement, withdrawal up to an aggregate amount not to exceed SDR 5,940,000 equivalent may be made for eligible payments made prior to 9 Nov 2012 but on or after 1 Aug 2012 (retroactive financing).

The payment currency of the credit amounts is United States dollar (USD).

The closing date of the Project is set 30 June 2017.

1.2. *The Project objectives*

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 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 urban landscaping and public parking; (b) the construction of info kiosks, cafes and public toilets; (c) the restoration and refurbishment of the 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 National Museum, the Project Implementing Entity, 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.

Notes to the special purpose financial statements
For the year ended 31 December 2014

1.3. The Project Budget

The Project is being financed by the following sources:

- IDA Credit 5178-GE,
- The Government the Georgia (Government of GE).

The Project budget and percentage of expenditures to be financed by IDA Credit 5178-GE percentage of expenditure category is follows:

| Category | IDA Credit 5178-GE | | | Government of GE | | Total | % of Expenditure to be financed by IDA Credit 5178-GE |
|--|--------------------|----------------|----------------|------------------|-------------|------------|---|
| | Initial | | Updated (a) | Initial | Updated (b) | | |
| | SDR | USD equivalent | USD equivalent | USD | USD | USD | % |
| 1. Goods, works, non-consulting services, Consultants' services and training | 19,600,000 | 29,696,970 | 29,020,555 | 7,424,242 | 7,255,139 | 36,275,693 | 80% |
| 2. Operating costs | 200,000 | 303,030 | 296,128 | 75,758 | 74,032 | 370,160 | 80% |
| | 19,800,000 | 30,000,000 | 29,316,683 | 7,500,000 | 7,329,171 | 36,645,853 | |

(a) Budget USD equivalents for IDA Credit 5178-GE, with underling currency of SDR, are calculated based on cumulative funds received in USD plus, if any, USD equivalent of undisbursed funds in SDR as at reporting date. SDR/USD rate as at 31.12.2014 is set at 1.44881 (31.12.2013: 1.54).

(b) Updated budget of GE cofinancing is calculated based on % of cofinancing.

1.4. Project Implementation

The Project is implemented by Municipal Development Fund of Georgia (MDF) established pursuant to the Republic of Georgia Presidential Decree No. 294 dated 7 June 1997.

The MDF address is: 3rd Floor, #150 D. Aghmashenebeli Ave., 0112, Tbilisi, Georgia.

2. Summary of significant accounting policies

2.1. Preparation and presentation of financial statements

The special purpose financial statements are prepared based on the accrual basis of accounting and presented in accordance with Financial Management Manual for World Bank Financed Investment Operations (March 2010): RM 3 – Financial Reporting and Auditing.

The principal accounting policies applied in the preparation of these special purpose financial statements are set out below. These policies have been consistently applied to all the periods presented.

2.2 Accrual basis of accounting

In accordance with the accrual bases of accounting the expenditure is recognized when the transaction occurs (expense incurred), and not only when cash or its equivalent is received or paid. The transactions are recorded in the accounting records and recognized in the special purpose financial statements of the periods to which they relate.

2.3 Reporting currency

The reporting currency of these special purpose financial statements is United States dollar (USD).

Transactions in currencies other than reporting are converted to US Dollars at the exchange rate prevailing at the date of the transaction.

Transaction in local currency, Georgian Lari (GEL), are recorded in the special purpose financial statements 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.

The effect of exchange rate changes on non-reporting currency transactions and items is reported as separate line item in the statement of financial position.

The exchange rate defined by the NBG as at 31 December 2013 is: USD 1 = 1.7363 GEL.

The exchange rate defined by the NBG as at 31 December 2014 is: USD 1 = 1.8636 GEL.

2.4. Cash

Cash comprises cash at treasure account of the Government of Georgia and bank accounts.

2.5. Budgeting

Expenditure budget is created based on actual accumulated expenditures for the last period plus the updated procurement plans for the period.

**Second Regional Development Project
IDA Credit 5178-GE**

Notes to the special purpose financial statements
For the year ended 31 December 2014

3. Cash

| | As at 31.12.2014 | As at 31.12.2013 |
|---|-------------------------|-------------------------|
| | USD | USD |
| Designated account (in USD) (IDA Credit 5178-GE) | 1,724,472 | 2,024,745 |
| Total | 1,724,472 | 2,024,745 |

4. Prepayments and receivables

| | As at 31.12.2014 | As at 31.12.2013 |
|---------------------------------------|-------------------------|-------------------------|
| | USD | USD |
| Prepayments for civil works* | 1,008,596 | 2,654,825 |
| Receivable for terminated civil works | 1,350,200 | 187,733 |
| Total | 2,358,796 | 2,842,558 |

(*) Under the Civil Works contracts (Works and Goods category expenditures), advances amounting to 10-20% of total contract amount is paid to contractor. Advances are retained by the same percentage from each progress payment made to contractors against presented acceptance acts for executed works.

5. Payables

| | As at 31.12.2014 | As at 31.12.2013 |
|----------------------------------|-------------------------|-------------------------|
| | USD | USD |
| Payables for civil works | 167,300 | 6,717 |
| Payables for LDG* | 696,387 | 377,871 |
| Payables for consulting services | - | 158,831 |
| Total | 863,687 | 543,419 |

(*) 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 (usually 1 year). Amounts are retained from each progress payment made to contractors against presented acceptance acts for executed works.

6. Financing

6.1. IDA Credit 5178-GE

| | Year ended | Cumulative as |
|--|-------------------|-----------------------|
| | 31.12.2014 | at 31.12.2014 |
| | USD | USD |
| Advances | - | 4,000,000 |
| SOE and Summary Sheet | 7,012,858 | 13,653,408 |
| Total | 7,012,858 | 17,653,408 |
| Total financing budget | | 29,316,683 |
| Percentage of finance provided as at 31 Dec 2014 | | 60% |

Notes to the special purpose financial statements
For the year ended 31 December 2014

6.2. Government of GE

| | Year ended 31.12.2014 USD | Cumulative as at 31.12.2014 USD |
|--|---------------------------------|---------------------------------------|
| Cash contributions | 1,823,551 | 5,153,111 |
| Total | 1,823,551 | 5,153,111 |
| Total financing budget | | 7,329,171 |
| Percentage of finance provided as at 31 Dec 2014 | | 70% |

6.3. Other income

Consists of fines and penalties to contractors due to failure to meet the works deadlines.

7. Project Expenditures

7.1. Project expenditure financing per funds

| Category | Year ended 31 Dec 2014 | | | |
|--|------------------------|---------------------|------------------|-------------------|
| | IDA Credit 5178-GE | Government of GE | Other income | Total |
| 1. Goods, works, non-consulting services, consultants' services and training | 7,473,328 | 2,067,725 | 1,499,715 | 11,040,768 |
| 2. Operating costs | 163,101 | 40,934 | - | 204,035 |
| Subtotal | 7,636,429 | 2,108,659 | 1,499,715 | 11,244,803 |
| Prepayments/(payables) | (323,298) | (285,108) | - | (608,406) |
| Total | 7,313,131 | 1,823,551 | 1,499,715 | 10,636,397 |

| Category | Cumulative as at 31 Dec 2014 | | | |
|--|------------------------------|---------------------|------------------|-------------------|
| | IDA Credit 5178-GE | Government of GE | Other income | Total |
| 1. Goods, works, non-consulting services, consultants' services and training | 14,578,073 | 4,718,381 | 1,499,715 | 20,796,169 |
| 2. Operating costs | 163,101 | 40,934 | - | 204,035 |
| Subtotal | 14,741,174 | 4,759,315 | 1,499,715 | 21,000,204 |
| Prepayments/(payables) | 1,187,762 | 393,796 | - | 1,581,558 |
| Total | 15,928,936 | 5,153,111 | 1,499,715 | 22,581,762 |

Notes to the special purpose financial statements
For the year ended 31 December 2014

7.2. Budget execution

The progress of the expenditure budget execution is presented below:

| Category | Cumulative Expenditures as at 31.12.2014 | Total budget | Execution |
|---|--|-------------------|------------|
| | USD | USD | % |
| 1. Goods, works, non-consulting services, consultants' services and training | 20,796,169 | 36,275,693 | 57% |
| 2. Operating costs | 204,035 | 370,160 | 55% |
| Total | 21,000,204 | 36,645,853 | 57% |

8. Events after the reporting date

The expenditures regarding to IDA Credit 5178-GE in the amount of USD 2,275,528.37 incurred during the reporting period were included in withdrawal applications number 6 submitted to the World Bank on 16 May 2015 and approved in 18 May 2015.

Second Regional Development Project
IDA Credit 5178-GE

**ANNEX 1. RECONCILIATION BETWEEN THE AMOUNTS SUBMITTED BY THE MDF AND
DISBURSED BY THE WORLD BANK**

For the year ended 31 December 2014

(Amounts are shown in US dollars)

| Expenditure Category | Appl. | MDF | WB | Difference |
|-------------------------------------|--------------|---------------------|---------------------|-------------------|
| 1. Goods, works, non-consulting | 6 | 1,975,254.89 | 1,975,254.89 | - |
| services, consultants' services and | 7 | 1,770,148.10 | 1,770,148.10 | - |
| training | 8 | 3,143,583.38 | 3,143,583.38 | - |
| | | 6,888,986.37 | 6,888,986.37 | |
| 2. Operating costs | 7 | 52,965.72 | 52,965.72 | - |
| | 8 | 70,905.80 | 70,905.80 | - |
| | | 123,871.52 | 123,871.52 | |
| Total | | 7,012,857.89 | 7,012,857.89 | |