

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

**Special Purpose Project Financial Statements and
Independent Auditor's Report
For the Year Ended 31 December 2015**

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-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 2015

Management of the Second Regional Development Project (the "Project"), financed under the Credit Agreement No. 5178-GE dated 9 November 2012, implemented by the Municipal Development Fund of Georgia ("MDF") is responsible for the preparation of the special purpose project financial statements that present fairly the financial position of the Project as at 31 December 2015, and the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure ("SOE"), designated account statements in compliance with the basis of accounting described in Note 2 accompanying these special purpose project financial statements and in conformity 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:

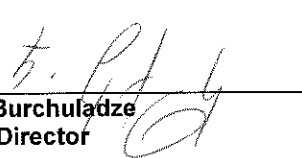
- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures that enable users to understand the impact of particular transactions, other events and conditions on the Project, financial position and its sources and uses of funds and movements in designated accounts;
- Making an assessment of the Projects ability to continue as a going concern.

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 2015 were authorised for issue on 6 June 2016 by the Management.

On behalf of Management:



Juansher Burchuladze
Executive Director

6 June 2016



Natalie Godziashvili
Head of Financial Management and
Investments Unit

6 June 2016



Deloitte & Touche LLC
36 a Lado Asatiani Street
Tbilisi, 0105
Georgia

Tel: +995 32 224 45 66
Fax: +995 32 224 45 69
www.deloitte.ge

INDEPENDENT AUDITOR'S REPORT

To the management of the Municipal Development Fund of Georgia:

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, implemented by the Municipal Development Fund of Georgia, which comprise the Project's statement of financial position as at 31 December 2015, the summary of sources and uses of funds, summary of expenditures by activity, statement of expenditure ("SOE") and designated account statements for the year ended 31 December 2015 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements"). The special purpose project financial statements are prepared by management of the Municipal Development Fund of Georgia 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.

Management's responsibility for the special purpose project 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 the special purpose project financial statements that are free from material misstatement, whether due to fraud or error.

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 International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the special purpose project financial statements are free from material misstatement.

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

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Deloitte

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 accompanying special purpose financial statements of the Project for the year ended 31 December 2015 are prepared, in all material respects, in accordance with the basis of accounting described in Note 2 and in conformity with the World Bank's Guidelines.

Emphasis of matter

We draw attention to Note 3 to the special purpose project financial statements which describes the restatement of corresponding figures for the year ended 31 December 2014. Our audit opinion is not qualified in that respect.

Basis of accounting and restriction on distribution and use

Without modifying our opinion, we draw attention to Note 2 to the special purpose project financial statements which describe the basis of accounting. The special purpose project financial statements are prepared to assist the Project to comply with the requirements of International Development Association. As a result, the special purpose project financial statements may not be suitable for another purpose. Our report is intended solely for use by the management of the Project, the Government of Georgia and International Development Association and should not be distributed or used by anyone other than these specified parties.

Other matter

These special purpose financial statements for the year ended 31 December 2014 were audited by another auditor who expressed an unmodified opinion on those statements on 30 June 2015.

As part of our audit of the 2015 special purpose financial statements, we also audited the adjustments described in Note 3 that were applied to amend the 2014 corresponding figures. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2014 special purpose project financial statements other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2014 special purpose project financial statements taken as a whole.

Deloitte & Touche


6 June 2016
Tbilisi, Georgia

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

**SUMMARY OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2015
(in US Dollars)**

	Actual		Planned	Variance		PAD Life of the project
	Year ended 31.12.2015	Cumulative as at 31.12.2015 Restated		Year ended 31.12.2015	Cumulative as at 31.12.2015	
OPENING WORKING CAPITAL						
Cash	1,724,472	-				
Prepayments	1,008,596	-				
Payables	(863,687)	-				
	1,869,381					
SOURCES OF FUNDS						
IDA Credit	6,275,528	23,928,935				30,000,000
Government of Georgia	1,486,757	6,639,868				7,500,000
TOTAL	7,762,285	30,568,803				37,500,000
EXPENDITURE						
1. Consulting services and training	7,479,604	28,275,773	7,650,000	28,446,169	170,396	37,121,212
Works and goods	6,342,317	24,339,361	6,550,000	24,547,044	207,683	
Consulting services and training	1,137,287	3,936,412	1,100,000	3,899,125	(37,287)	
2. Operating costs	1,508	205,543	15,000	219,035	13,492	378,788
3. Resettlement costs	75,993	75,993	80,000	80,000	4,007	
TOTAL	7,557,105	28,557,309	7,745,000	28,745,204	187,895	37,500,000
Foreign exchange gain&loss	(60,146)	2,921				
CLOSING WORKING CAPITAL						
Cash	2,305,012	2,305,012				
Prepayments	232,175	232,175				
Payables	(522,772)	(522,772)				
TOTAL	2,014,415	2,014,415				

On behalf of Management:


Juansher Burchuladze
 Executive Director


Natalie Godziashvili
 Head of Financial Management and
 Investments Unit

6 June 2016

6 June 2016

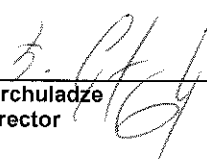
The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

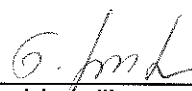
**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
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**STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2015
(in US Dollars)**

	Note	31 December 2015	31 December 2014 Restated
ASSETS			
IDA Special Account		2,305,012	1,724,472
Prepayments	8	232,175	1,008,596
TOTAL ASSETS		2,537,187	2,733,068
LIABILITIES			
Payables		522,772	863,687
TOTAL LIABILITIES		522,772	863,687
NET ASSETS		2,014,415	1,869,381
Funds received:			
IDA Credit		23,928,935	17,653,407
Government of Georgia		6,639,868	5,153,111
Total funds received		30,568,803	22,806,518
Expenditure:			
Project expenditure:	9	28,557,309	21,000,204
		28,557,309	21,000,204
Foreign exchange gain		2,921	63,067
TOTAL NET ASSETS		2,014,415	1,869,381

On behalf of Management:


Juansher Burchuladze
Executive Director


Natalie Godziashvili
Head of Financial Management and
Investments Unit

6 June 2016

6 June 2016

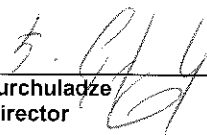
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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
CREDIT NO.5178-GE**

**SUMMARY OF EXPENDITURE BY ACTIVITY
FOR THE YEAR ENDED 31 DECEMBER 2015
(in US Dollars)**

Project activities	Actual		Planned		Variance	
	Year ended 31.12.2015	Cumulative as at 31.12.2015	Year ended 31.12.2015 <i>Unaudited</i>	Cumulative as at 31.12.2015 <i>Unaudited</i>	Year ended 31.12.2015 <i>Unaudited</i>	Cumulative as at 31.12.2015 <i>Unaudited</i>
Part A: Infrastructure investment	6,418,310	24,415,354	6,630,000	24,627,044	211,690	211,690
Part B: Institutional development	1,138,795	4,141,955	1,115,000	4,118,160	(23,795)	(23,795)
TOTAL EXPENDITURES	7,557,105	28,557,309	7,745,000	28,745,204	187,895	187,895

On behalf of Management:



Juansher Burchuladze
Executive Director



Natalie Godziashvili
Head of Financial Management and
Investments Unit

6 June 2016

6 June 2016

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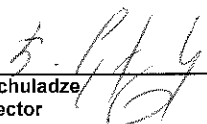
**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPEMENT PROJECT
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**STATEMENT OF EXPENDITURE ("SOE")
FOR THE YEAR ENDED 31 DECEMBER 2015
(in US Dollars)**

Withdrawal No.	Withdrawal application date	Total SOE	Works and Goods and Consulting services	Operating costs
9	15.05.2015	1,738,152	1,712,417	25,735
10	21.09.2015	3,455,926	3,388,311	67,615
		<u>5,194,078</u>	<u>5,100,728</u>	<u>93,350</u>

The total expenditure under withdrawal application No. 9 is attributable to 2014 and recorded as expenditure in the 2014 financial statements respectively. The withdrawal application for these expenses were submitted to International Bank for Reconstruction and Development in 2015.

On behalf of Management:



Juansher Burchuladze
Executive Director



Natalie Godziashvili
Head of Financial Management and Investments Unit

6 June 2016

6 June 2016

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

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
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**STATEMENT OF DESIGNATED ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2015
(in US Dollars)**

Account No.	202250947
Depository Bank	State Treasury
Address	16 V. Gorgasali street Tbilisi, 0114 Georgia
<hr/>	
Opening Balance	<u>1,724,472</u>
Funds received from IDA	6,275,528
Present outstanding amount advanced to DA	<u>8,000,000</u>
DA closing balance as at 31 December 2015	2,305,012
Add: Amount of eligible expenditure paid	<u>5,694,988</u>
Total advance accounted for	<u><u>8,000,000</u></u>

On behalf of Management:



Juansher Burchuladze
Executive Director

6 June 2016



Natalie Godziashvili
Head of Financial Management and
Investments Unit

6 June 2016

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

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015
(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").

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 closing date of the loan is 30 June 2017.

2. ACCOUNTING POLICIES

Basis of accounting – These special purpose project financial statements have been prepared in accordance with the *Accrual Basis of Accounting* and incorporate the following principal accounting policies, which have been consistently followed in all material respects and 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.

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.

3. RESTATEMENT

In 2015 management determined that receivable balance was not appropriately presented in the special purpose project financial statement for the year ended 31 December 2014. These special purpose project financial statements have been restated as detailed in the following paragraph.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
SECOND REGIONAL DEVELOPMENT PROJECT
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015 (CONTINUED)
(in US Dollars)**

Penalty receivable is from the counterparty Sani LLC. The counterparty did not agree with the penalty and filed a case against MDF in the court. The process is still ongoing; however, Sani LLC paid all penalty amounts to MDF in 2014. Income from penalties, cash and related payments are not part of this project financial statements. Therefore management is of the opinion that the penalty income should not be recorded in these special purpose project financial statement due to not meeting the criteria of ownership.

The effect of the adjustments made to the special purpose project financial statements for the year ended 31 December 2014 is as follows:

Statement of financial position	As previously reported 31 December 2014	Adjustment 31 December 2014	As restated 31 December 2014	Description
Receivable for terminated civil works	2,358,796	(1,350,200)	1,008,596	Receivable from Penalties not meeting the criteria of an asset.
Other income	1,499,716	(1,499,716)	-	Related accrued income from penalties recorded as other income is also derecognised
Foreign exchange gain/(loss)	(86,449)	149,516	63,067	Related accrued income from penalties recorded as other income is also derecognised

4. 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 in accordance with the Agreement.

5. BASIS OF FUNDING

According to the terms of the Agreement, the expenditures 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, goods, non-consulting services, Consulting services and training	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

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

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015 (CONTINUED)
(in US Dollars)**

6. METHODS OF WITHDRAWAL

The methods of withdrawal used from the inception of the loan to 31 December 2015 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.

7. 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
- (iv) All expenditures for goods valued at less than USD 300,000;

8. PREPAYMENTS

	<u>31 December 2015</u>	<u>31 December 2014 Restated</u>
Prepayments to contractors	232,175	1,008,596
Total:	<u>232,175</u>	<u>1,008,596</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
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015 (CONTINUED)
(in US Dollars)**

9. PROJECT EXPENDITURE BY FUND

Project activities	Actual	
	Year to date	Cumulative to date
Works and goods, non-consulting services, Consulting services and training	5,981,385	20,559,458
Operating costs	-	163,101
IDA TOTAL	5,981,385	20,722,559
Works and goods, non-consulting services, Consulting services and training	1,498,219	6,216,600
Operating costs	1,508	42,442
Resettlement costs	75,993	75,993
GoG TOTAL	1,575,720	6,335,035
Works and goods, non-consulting services, Consulting services and training	-	1,499,715
OTHER SOURCES TOTAL	-	1,499,715
TOTAL PROJECT EXPENDITURE	7,557,105	28,557,309

The Project consists of the following main components:

Component 1

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

Component 2

- 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

10. COMMITMENTS AND CONTINGENCIES

Management is not aware of any 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 2015 and on the funds received and disbursed during the year then ended.

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

**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015 (CONTINUED)**
(in US Dollars)

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 and 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.

Throughout 2015 Georgia's neighbouring countries, which are large trading partners of Georgia, have experienced significant political and economic turmoil which has had a knock-on effect on the Georgian economy. This has resulted in a significant devaluation of the Georgian Lari against the US dollar and other major currencies.

12. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

There were no significant events subsequent to the balance sheet date.

13. APPROVAL OF SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS

These special purpose financial statements were authorised for issue by the Management of MDF on 6 June 2016.