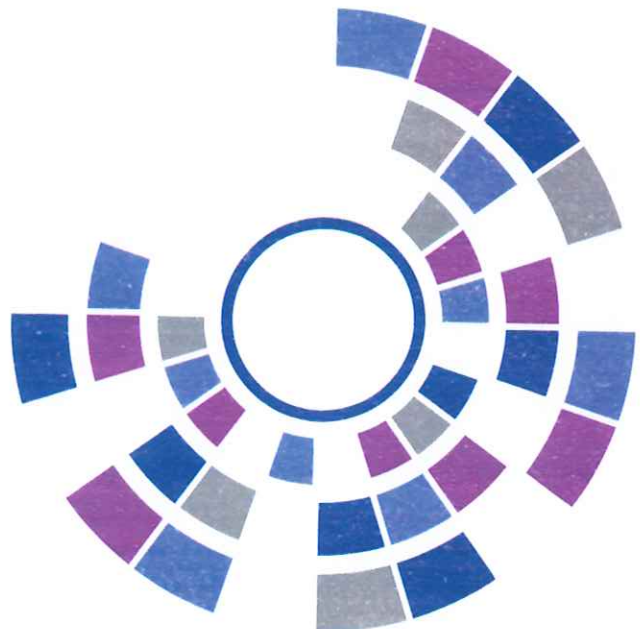


Project Financial Statements and
Independent Auditor's Report

Municipal Development Fund of Georgia

Sustainable Urban Transport Investment Program,
Project 1
Loan No. 2655-GEO(SF)

As of and for the year ended December 31, 2016



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Independent auditor's report

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To the management of the Municipal Development Fund of Georgia

Opinion

We have audited the accompanying project financial statements of the Sustainable Urban Transport Investment Program, Project 1 (the “Project”), financed by the Asian Development Bank (the “ADB”) Loan No. 2655-GEO(SF), and implemented by the Municipality Development Fund of Georgia (the “MDF”) which comprise the statement of financial position as of December 31, 2016, the statement of Project sources and uses of funds, the imprest account statements and the government co-financing account statement as of and for the year ended December 31, 2016, the statement of expenditures (“SOEs”) submitted to the ADB for the year ended December 31, 2016 in support of the Loan Agreement 2655-GEO (SF) withdrawals, and a summary of significant accounting policies and other explanatory information.

In our opinion,

- the aforementioned project financial statements and appended notes that were also the subject of the audit, present fairly, in all material respects, the financial position of the Sustainable Urban Transport Investment Program, Project 1 as of December 31, 2016 and the results of its operations for the year then ended, in conformity with the accrual basis of accounting, applied on a basis consistent in all material respects with that of the previous year, as explained in the note 2, the ADB guidelines and the relevant points of the Loan Agreement No. 2655-GEO(SF);
- the MDF has utilized all proceeds of the loan withdrawn from the ADB only for purposes of the Project as agreed between the ADB and Georgia, in accordance with the loan agreement; and no proceeds of the loan have been utilized for other purposes;
- As of the reporting dates the MDF was in compliance with all financial covenants of the Loan Agreement No. 2655-GEO (SF).

In addition:

- (i) (a) with respect to the statements of expenditures, adequate supporting documentation has been maintained to support claims to the ADB for reimbursements of expenditures incurred; and (b) expenditures are eligible for financing under Loan Agreement No. 2655-GEO (SF).

- (ii) (a) the Imprest accounts and the government co-financing account give a true and fair view of the receipts collected and payments made during the year ended December 31, 2016; and (b) these receipts and payments support Imprest accounts liquidations/replenishments during the year ended December 31, 2016.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (“ISAs”). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (the “IESBA Code”) together with the ethical requirements that are relevant to our audit of the financial statements in the Georgia, and we have fulfilled our other ethical responsibilities in accordance with those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matters

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 MDF of Georgia to meet the requirements of the financial reporting of the ADB. As a result, the project financial statements may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Management’s Responsibility for the Project Financial Statements

Management of the MDF is responsible for the preparation and fair presentation of these project financial statements in accordance with the accounting policies described in the note 2 to these project financial statements, the ADB guidelines and the financial covenants of the Loan Agreement No. 2655-GEO(SF), and for such internal control as management determines is necessary to enable the preparation of project financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibilities for the Audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the project financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these project financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the project financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies and the reasonableness of accounting estimates and related disclosures made by management.
- Evaluate the overall presentation, structure and content of the project financial statements, including the disclosures, and whether the project financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

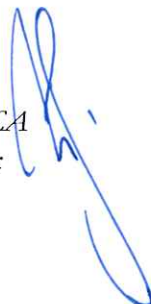
We communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

June 28, 2017

Gagik Gyulbudaghyan
Managing Partner



Emil Vassilyan, FCCA
Engagement Partner

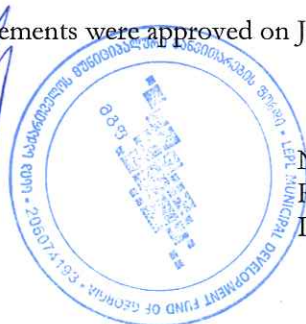


Statement of financial position

In US dollars	Note	As of December 31, 2016	As of December 31, 2015
Assets			
<i>Non-current assets</i>			
Accumulated Project expenses		66,678,840	48,897,501
		<u>66,678,840</u>	<u>48,897,501</u>
<i>Current assets</i>			
Advances to contractors	4	9,593,523	7,934,620
Bank balances	5	5,075,803	8,160,016
		<u>14,669,326</u>	<u>16,094,636</u>
Total assets		<u><u>81,348,166</u></u>	<u><u>64,992,137</u></u>
Funds and liabilities			
<i>Funds</i>			
Accumulated Project financing		82,479,315	65,015,204
Foreign exchange rate differences		(3,251,438)	(417,279)
		<u>79,227,877</u>	<u>64,597,925</u>
<i>Liabilities</i>			
Accounts payable	6	2,120,289	394,212
		<u>2,120,289</u>	<u>394,212</u>
Total funds and liabilities		<u><u>81,348,166</u></u>	<u><u>64,992,137</u></u>

The project financial statements were approved on June 28, 2017 by:

Gagi Buadze
 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 project financial statements set out on pages 10 to 15.

Statement of Project sources and uses of funds

As of and for the year ended December 31, 2016
 In US dollars

	Actual		Planned		Variance	
	For the year	As of December 31, 2016	For the year	As of December 31, 2016	For the year	As of December 31, 2016
<i>Sources of funds</i>						
ADB funds (note 7)	13,737,430	61,688,691				
Government co-financing	3,726,681	20,790,624				
	<u>17,464,111</u>	<u>82,479,315</u>				
Foreign exchange rate differences	(2,834,159)	(3,251,438)				
<i>Less: Project expenses</i>						
ADB loan number 2655 - GEO(SF) (note 8.1)	15,116,326	48,352,347	16,100,000	49,336,021	(983,674)	(983,674)
Government co-financing (note 8.2)	2,665,013	18,326,493	2,898,000	18,559,480	(232,987)	(232,987)
Total	<u>17,781,339</u>	<u>66,678,840</u>	<u>18,998,000</u>	<u>67,895,501</u>	<u>(1,216,661)</u>	<u>(1,216,661)</u>
Net increase/(decrease) in working capital (note 9)	<u>(3,151,387)</u>	<u>12,549,037</u>				

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 10 to 15.

SOE withdrawal schedule

*For the year ended December 31, 2016
Loan Agreement No. 2655-GEO
In US dollars*

Application No.	Category	Total	ADB percentage of financing	Eligible expense
ADB38	Works and Goods	2,706,163	100%	2,706,163
	Consulting Services and Incremental Administration	1,600,835	100%	1,600,835
				<u>4,306,998</u>

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 10 to 15.

Imprest account statement (USD)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2655-GEO
In US dollars*

Opening balance as of January 1, 2016	8,160,016
<i>Add:</i>	
ADB loan replenishment during the year	<u>4,306,998</u>
Total inflow	<u>4,306,998</u>
<i>Less:</i>	
Transfer to GEL imprest account	<u>(7,391,211)</u>
Total outflow	<u>(7,391,211)</u>
Closing balance as of December 31, 2016	<u>5,075,803</u>

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 10 to 15.

Imprest account statement (GEL)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2655-GEO
In US dollars*

Opening balance as of January 1, 2016	-
<i>Add:</i>	
Transfer from the USD imprest account	7,391,211
Total inflow	<u>7,391,211</u>
Foreign exchange rate differences	9,051
<i>Less:</i>	
Works and Goods	(5,048,931)
Consulting Services and Incremental Administration	<u>(2,351,331)</u>
Total outflow	<u>(7,400,262)</u>
Closing balance as of December 31, 2016	<u>-</u>

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 10 to 15.

Government co-financing account (GEL) statement

As of and for the year ended December 31, 2016
In US dollars

Opening balance as of January 1, 2016	-
<i>Add:</i>	
Government co-financing	3,726,681
Total inflow	<u>3,726,681</u>
<i>Less:</i>	
Works and Goods	(3,266,561)
Consulting Services and Incremental Administration	<u>(460,120)</u>
Total outflow	<u>(3,726,681)</u>
Closing balance as of December 31, 2016	<u>-</u>

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 10 to 15.

Notes to the project financial statements

1 Activity

In accordance with the Loan Agreement No. 2655-GEO(SF) signed between Georgia and the Asian Development Bank (the "ADB") on August 5, 2010, Georgia has received a loan in a total amount of SDR 57,986,000 for the Sustainable Urban Transport Investment Program, Project 1 (the "Project").

The Project is implemented by the Municipal Development Fund of Georgia (the "MDF"). The MDF has been established by the Presidential Decree # 294 dated June 7, 1997.

The legal address of MDF is 150, Aghmashenebeli Avenue, 0112, Tbilisi, Georgia.

During the reporting period the average number of the MDF staff was 138 (2015: 130).

The expected overall impact of the Project is to provide efficient, reliable and affordable urban transport infrastructure and services, thereby increasing economic growth potential and competitiveness of urban communities, improving livelihoods of over 1.5 million people. The Project also aims to: i) improve urban, environment and communities' access to economic opportunities and to public and social services; ii) promote efficient and sustainable urban transportation; and iii) generate income and employment opportunities.

The Project includes the following main components:

- a Urban Transport Infrastructure Improvement, including the following subprojects:
 - i Tbilisi urban environment improvement and Gorgasali road reconstruction;
 - ii Tbilisi metro extension (Vazha Pshavela avenue);
 - iii Kutaisi urban renewal and non-motorize transport facilities development; and
 - iv Road improvement in Mestia.
- b Institutional Capacity Development to strengthen organization, increase coordination, monitoring and financing of urban transport subsector; and
- c Project Management Facility and consulting services for subproject preparation, construction supervision, audit, social and environmental assessments, and institutional capacity development in the urban transport subsector.

The Project financing is implemented through the following categories:

Category	Total Amount Allocated for ADB Financing (in SDR)	ADB Financing Basis
1 Works and Goods	42,920,533	100% of total expenditure claimed (*)
2 Consulting Services and Incremental Administration	9,546,051	100% of total expenditure claimed (*)
3 Interest charge	1,228,000	100% of amounts due
4 Unallocated	4,291,416	
TOTAL	57,986,000	

(*) Exclusive of taxes and duties imposed within territory of Georgia.

2 Significant accounting policies

2.1 Statement of compliance

The MDF's policy is to prepare the accompanying project financial statements on the accrual basis of accounting and the Asian Development Bank guidelines, as well as the relevant points of the Loan Agreement No. 2655-GEO(SF).

2.2 Functional and presentation currency

The national currency of Georgia is Georgian lari (GEL). The project financial statements are presented in US dollar (presentation currency).

In preparing the 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.

For direct payments denominated in the currencies other than the USD to the contractor/consultant from the ADB share, the exchange rate set out for the presentation of the operation in the system LFIS (lfis.adb.org) is used.

At each reporting date monetary items denominated in currencies other than the presentation currency are retranslated into US dollar at the rate defined by the NBG prevailing as at the reporting date, which is 2.6468 lari for 1 US dollar as of December 31, 2016 (2.3949 lari for 1 US dollar as of December 31, 2015). Any exchange rate differences are recognized in the statement of Project sources and uses of funds and the accumulated figure of exchange rate difference is disclosed in the statement of financial position under "Funds".

2.3 Bank balances

Bank balances consist of cash amounts in the treasury accounts and in bank accounts.

2.4 Advances

Advances are stated at nominal value. Advances include amounts paid to civil work and consulting service contractors.

2.5 Sources of funds

The ADB Loan and Government co-financing are recognized when earned, which is the date when the funds are received by the MDF or directly paid out to contractors. The accumulated Project financing is disclosed under "Funds" in the Statement of financial position. In addition, the current year funds received are disclosed in the Statement of Project sources and uses of funds, showing the sources of funds.

2.6 Accounts payable

Accounts payable are stated at nominal amount and include outstanding retentions from progress payments against certificates of executed works, for the purpose of liquidation of post-completion faults and defects.

2.7 Project expenses

Project expenses are recognized on the accrual basis of accounting. The accumulated Project expenses are disclosed in the Statement of financial position under non-current assets. In addition, current year expenses are disclosed in the Statement of Project sources and uses of funds.

2.8 The ADB financing

To finance eligible expenses for the Loan Agreement, the ADB disburses proceeds from the Loan amount using one or more of the disbursement methods described below:

- a Direct payment procedure, where ADB, at the borrower's request, pays a designated beneficiary directly;
- b Commitment procedure, where ADB, at the borrower's request, provides an irrevocable undertaking to reimburse a commercial bank for payments made or to be made to a supplier against a Letter of Credit financed from the loan account;
- c Reimbursement procedure, where ADB pays from the loan account to the borrower's account or to the project account for eligible expenditures, which have been incurred and paid for by the project out of its budget allocation or its own resources; and
- d Imprest fund procedure, where ADB makes an advance disbursement from the loan account for deposit to an imprest account to be used exclusively for ADB's share of eligible expenditures.

3 Closing date of the Project

In accordance with the Schedule 1 of the Loan Agreement No. 2655-GEO(SF), the Project closing date is September 30, 2018.

4 Advances to contractors

As of December 31, 2016 advances paid to contractors were as follows: US dollars 448,623 (US dollars 507,281 as of December 31, 2015) to the "Modern business group" Ltd and US dollars 9,144,900 (US dollars 7,427,339 as of December 31, 2015) to the Joint Venture of Cobra Instalaciones Y Servicios, S.A., with Assignia Infraestructuras, S.A. for construction works.

5 Bank balances

In US dollars	As of December 31, 2016	As of December 31, 2015
Imprest account (USD)	5,075,803	8,160,016
	<u>5,075,803</u>	<u>8,160,016</u>

6 Accounts payable

In US dollars	As of December 31, 2016	As of December 31, 2015
Retentions	2,120,289	394,212
	<u>2,120,289</u>	<u>394,212</u>

Retentions comprise amounts retained (5% of total contract price) and to be paid out to the contractor at the expiration of the faults and defects period, as defined in civil works contracts. Amounts are retained from each progress payment made to civil works contractors against presented acceptance acts for executed works.

7 ADB funds

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
SOE procedures	4,306,999	37,396,046
Direct payments	8,963,058	14,153,589
Interest charge	467,373	1,639,056
Imprest account advance	-	8,500,000
	<u>13,737,430</u>	<u>61,688,691</u>

8 Project expenses

8.1 From ADB funds

In US dollars	Actual		Planned		Variance	
	For the year	As of December 31, 2016	For the year	As of December 31, 2016	For the year	As of December 31, 2016
<i>Loan number 2655-GEO (SF)</i>						
Works and Goods	12,248,249	34,472,753	14,000,000	36,224,504	(1,751,751)	(1,751,751)
Consulting Services and Incremental Administration	2,400,704	12,240,538	2,100,000	11,939,834	300,704	300,704
Interest charge	467,373	1,639,056	-	1,171,683	467,373	467,373
Total	<u>15,116,326</u>	<u>48,352,347</u>	<u>16,100,000</u>	<u>49,336,021</u>	<u>(983,674)</u>	<u>(983,674)</u>

8.2 From government co-financing amounts

In US dollars <i>Loan number 2655-GEO (SF)</i>	Actual		Planned		Variance	
	For the year	As of December 31, 2016	For the year	As of December 31, 2016	For the year	As of December 31, 2016
Works and Goods	2,210,735	6,296,293	2,520,000	6,605,558	(309,265)	(309,265)
Consulting Services and Incremental Administration	454,278	2,613,392	378,000	2,537,114	76,278	76,278
Resettlement expenses	-	9,416,808	-	9,416,808	-	-
Total	2,665,013	18,326,493	2,898,000	18,559,480	(232,987)	(232,987)

9 Net increase/(decrease) in working capital

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
Decrease in bank balances	(3,084,213)	5,075,803
Increase in advances	1,658,903	9,593,523
Increase in accounts payable	(1,726,077)	(2,120,289)
	(3,151,387)	12,549,037

10 Fixed assets

Fixed assets of the Project include acquisitions for the needs of Project implementation. The cost of fixed assets includes purchase price and other related acquisition costs.

The fixed assets are recognized in the project financial statements as expense. The accounting of fixed assets is made in the inventory registers. Taking into consideration the non-commercial status of the Project, depreciation is not charged.

The following table presents breakdown of fixed assets acquired with ADB financing as of and for the year ended December 31, 2016.

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
Office equipment	-	9,331
Furniture and other equipment	-	1,873
	-	11,204

11 Reconciliation between the amounts received by the MDF and disbursed by the Asian Development Bank

For the year ended December 31, 2016
 In US dollars

Category	Appl.	MDF	ADB	Difference
Work and Goods	ADB26	511,510	511,510	-
	ADB27	285,397	285,397	-
	ADB28	468,975	468,975	-
	ADB29	445,267	445,267	-
	ADB30	76,301	76,301	-
	ADB31	246,461	246,461	-
	ADB32	114,643	114,643	-
	ADB33	818,105	818,105	-
	ADB34	185,395	185,395	-
	ADB35	129,405	129,405	-
	ADB36	545,486	545,486	-
	ADB37	472,658	472,658	-
	ADB38	2,706,163	2,706,163	-
	ADB39	288,560	288,560	-
	ADB40	806,764	806,764	-
	ADB41	1,358,585	1,358,585	-
	ADB42	85,763	85,763	-
	ADB43	808,689	808,689	-
	ADB44	248,205	248,205	-
	ADB46	125,340	125,340	-
ADB47	941,550	941,550	-	
		<u>11,669,222</u>	<u>11,669,222</u>	-
Consulting Services and Incremental Administration	ADB19	1,600,835	1,600,835	-
		<u>1,600,835</u>	<u>1,600,835</u>	-
Interest charge	CAP	222,619	222,619	-
	CAP	<u>244,754</u>	<u>244,754</u>	-
		<u>467,373</u>	<u>467,373</u>	-
		<u>13,737,430</u>	<u>13,737,430</u>	-

12 Project implementation

As of December 31, 2016 only 58% of the Project has been implemented in the framework of the Loan Agreement No. 2655-GEO (SF). The Project expenses by categories (in percentages) are presented in the table below:

Category	Amounts disbursed in %
Works and Goods	56%
Consulting Services and Incremental Administration	87%
Interest charge	92%
Total	<u>58%</u>