

Project Financial Statements and
Independent Auditor's Report

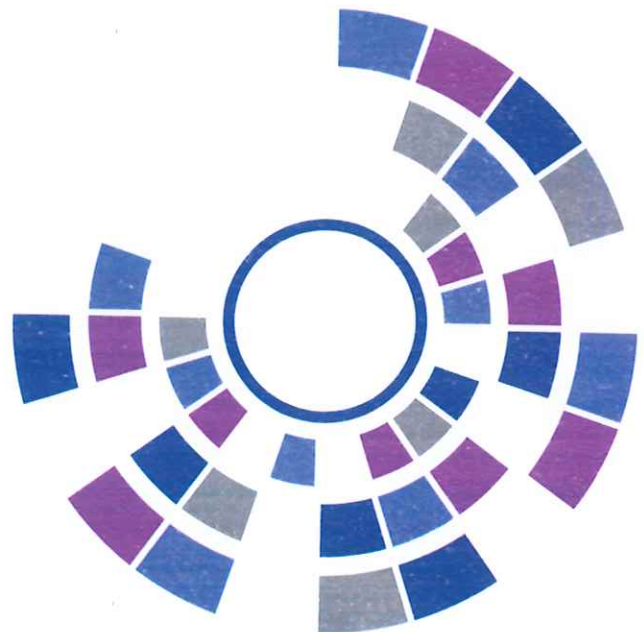
Municipal Development Fund of Georgia

Sustainable Urban Transport Investment Program,
Project 2

Loan No. 2879-GEO

Loan No. 2880-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 2 (the “Project”), financed by the Asian Development Bank (the “ADB”) Loan Agreement No. 2879-GEO and Loan Agreement No. 2880-GEO(SF), and implemented by the Municipal 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 government co-financing account statement as of and for the year ended December 31, 2016, statement of expenditures (“SOEs”) submitted to the ADB for the year ended December 31, 2016 in support of the Loan Agreement No. 2879-GEO and the Loan Agreement No. 2880-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, fairly present in all material respects, the financial position of the Sustainable Urban Transport Investment Program, Project 2 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. 2879-GEO and Loan Agreement No. 2880-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- the MDF has utilized all proceeds of the loan withdrawn from the ADB only for purposes of the Project as agreed between the ADB and Georgia, in accordance with the loan agreement; and no proceeds of the loan have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 date the MDF was in compliance with all financial covenants of the Loan Agreement No. 2879-GEO and Loan Agreement No. 2880-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. 2879-GEO and Loan Agreement No. 2880-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 Loan Agreement No. 2879-GEO and Loan Agreement No. 2880-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		54,574,940	49,589,150
		<u>54,574,940</u>	<u>49,589,150</u>
<i>Current assets</i>			
Advances	4	2,478	-
Bank balances	5	4,658,816	7,977,033
		<u>4,661,294</u>	<u>7,977,033</u>
Total assets		<u><u>59,236,234</u></u>	<u><u>57,566,183</u></u>
Funds and liabilities			
<i>Funds</i>			
Accumulated Project financing		64,777,982	60,493,228
Foreign exchange rate differences		(5,541,748)	(5,027,825)
		<u>59,236,234</u>	<u>55,465,403</u>
<i>Liabilities</i>			
Accounts payable	6	-	2,100,780
		<u>-</u>	<u>2,100,780</u>
Total funds and liabilities		<u><u>59,236,234</u></u>	<u><u>57,566,183</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 12 to 18.

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)	3,575,490	49,832,631				
Government co-financing	709,264	14,945,351				
	<u>4,284,754</u>	<u>64,777,982</u>				
Foreign exchange rate differences	(513,923)	(5,541,748)				
<i>Less: Project expenses</i>						
ADB loan No 2879 - GEO(SF) and loan No 2880-GEO (SF) (note 8.1)	4,279,081	39,631,003	5,800,000	41,151,922	(1,520,919)	(1,520,919)
Government co-financing (note 8.2)	706,709	14,943,937	1,044,000	15,281,228	(337,291)	(337,291)
Total	<u>4,985,790</u>	<u>54,574,940</u>	<u>6,844,000</u>	<u>56,433,150</u>	<u>(1,858,210)</u>	<u>(1,858,210)</u>
Net increase/(decrease) in working capital (note 9)		<u>(1,214,959)</u>		<u>4,661,294</u>		

SOE withdrawal schedule

*For the year ended December 31, 2016
 Loan Agreement No. 2879-GEO
 In US dollars*

Application No.	Category	Total	ADB percentage of financing	Eligible expense
ADB34	Works	986,692	74.58%	735,875
	Consulting Services	192,988	70.82%	136,674
				<u>872,549</u>
ADB37	Works	1,039,708	74.58%	775,414
	Consulting Services	29,439	70.82%	20,849
				<u>796,263</u>
				<u>1,668,812</u>

*For the year ended December 31, 2014
 Loan Agreement No. 2880-GEO (SF)
 In US dollars*

Application No.	Category	Total	ADB percentage of financing	Eligible expense
ADB34	Works	986,688	25.42%	250,816
	Consulting Services	192,988	29.18%	56,314
				<u>307,130</u>
ADB37	Works	1,039,709	25.42%	264,294
	Consulting Services	29,445	29.18%	8,592
				<u>272,886</u>
				<u>580,016</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 12 to 18.

Imprest account statement (USD)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2879-GEO
In US dollars*

Opening balance as of January 1, 2016	6,368,620
<i>Add:</i>	
ADB loan replenishment during the year	<u>-</u>
Total inflow	<u>-</u>
<i>Less:</i>	
Transfer to GEL imprest account	<u>(2,466,362)</u>
Total outflow	<u>(2,466,362)</u>
Closing balance as of December 31, 2016	<u>3,902,258</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 12 to 18.

Imprest account statement (GEL)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2879-GEO
In US dollars*

Opening balance as of January 1, 2016	-
<i>Add:</i>	
Transfer from the USD imprest account	<u>2,466,362</u>
Total inflow	<u>2,466,362</u>
Foreign exchange rate difference	8,531
<i>Less:</i>	
Works	<u>(2,344,001)</u>
Consulting Services	<u>(130,892)</u>
Total outflow	<u>(2,474,893)</u>
Closing balance as of December 31, 2016	<u>-</u>

Imprest account statement (USD)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2880-GEO (SF)
In US dollars*

Opening balance as of January 1, 2016	1,608,413
<i>Add:</i>	
ADB loan replenishment during the year	<u>-</u>
Total inflow	<u>-</u>
<i>Less:</i>	
Transfer to GEL imprest account	<u>(851,855)</u>
Total outflow	<u>(851,855)</u>
Closing balance as of December 31, 2016	<u>756,558</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 12 to 18.

Imprest account statement (GEL)

*As of and for the year ended December 31, 2016
Loan Agreement No. 2880-GEO (SF)
In US dollars*

Opening balance as of January 1, 2016	-
<i>Add:</i>	
Transfer from the USD imprest account	851,855
Total inflow	<u>851,855</u>
Foreign exchange rate difference	2,902
<i>Less:</i>	
Works	(800,825)
Consulting Services	<u>(53,932)</u>
Total outflow	<u>(854,757)</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 12 to 18.

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

-

Add:

Government co-financing

709,264

Total inflow

709,264

Less:

Works

(644,605)

Consulting Services

(64,659)

Total outflow

(709,264)

Closing balance as of December 31, 2016

-

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 12 to 18.

Notes to the project financial statements

1 Activity

In accordance with the Loan Agreement No. 2879-GEO signed between Georgia and the Asian Development Bank (the “ADB”) on July 24, 2012, Georgia has received a loan in a total amount of USD 48,886,000 for the Sustainable Urban Transport Investment Program, Project 2 (the “Project”).

In accordance with the Loan Agreement No. 2880-GEO(SF) signed between Georgia and the ADB in July 24, 2012, Georgia has received a loan in a total amount of SDR 10,639,000 for 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 objective of the Investment Program is to improve efficiency, reliability and affordability of urban transport and services. As part of the Investment Program, the Project aims to improve urban transport infrastructure and services in selected municipalities.

The Project includes the following main components:

- a. construction of two section of a four-lane road (of an approximate aggregate length of 10.6 kilometers) between the city of Tbilisi and the city of Rustavi;
- b. construction of 151 meters two-lane bridge over the Aragvi River between the city of Mtskheta and the national east-west highway;
- c. provision of project implantation support (this includes assistance in construction supervision, procurement, financial management and environmental and social safeguards, and provision of financial audits) and capacity development on the bridge construction and maintenance.

The financing of Loan Agreement No. 2879-GEO is implemented through the following categories:

Category	Total Amount Allocated for ADB Financing (in USD)	ADB Financing Basis
1 Works	36,674,000	74.58% of total expenditure claimed (*)
2 Consulting Services	2,761,000	70.82% of total expenditure claimed (*)
3 Interest charge	1,616,400	100% of amounts due
4 Unallocated	7,834,600	
TOTAL	48,886,000	

The financing of Loan Agreement No. 2880-GEO(SF) is implemented through the following categories:

Category	Total Amount Allocated for ADB Financing (in SDR)	ADB Financing Basis
1 Works	8,312,000	25.42% of total expenditure claimed (*)
2 Consulting Services	758,000	29.18% of total expenditure claimed (*)
3 Interest charge	223,000	100% of amounts due
4 Unallocated	1,346,000	
TOTAL	10,639,000	

(*) Exclusive of taxes and duties imposed within the 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. 2879-GEO and Loan Agreement No. 2880-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 and receivables

Advances and receivables 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 by the ADB 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 accounts 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 2879-GEO and the Loan Agreement 2880-GEO (SF), the Project closing date is December 31, 2018.

4 Advances

In US dollars	As of December 31, 2016	As of December 31, 2015
Advance to a contractor	1,652	-
Advance to the Revenue Service	826	-
	<u>2,478</u>	<u>-</u>

5 Bank balances

In US dollars	As of December 31, 2016	As of December 31, 2015
Imprest account (USD) of Loan Agreement No. 2879-GEO	3,902,258	6,368,620
Imprest account (USD) of Loan Agreement No. 2880-GEO(SF)	756,558	1,608,413
	<u>4,658,816</u>	<u>7,977,033</u>

6 Accounts payable

In US dollars	As of December 31, 2016	As of December 31, 2015
Retentions	-	2,100,780
	<u>-</u>	<u>2,100,780</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
<i>Loan No. 2879-GEO</i>		
SOE procedures	1,668,812	17,865,653
Direct payments	2,288,178	14,211,003
Imprest account advance (redemption), net	(1,668,812)	4,731,188
Interest charge	406,491	835,842
	<u>2,694,669</u>	<u>37,643,686</u>
<i>Loan No. 2880-GEO(SF)</i>		
SOE procedures	580,016	6,120,224
Direct payments	779,908	4,843,710
Imprest account advance (redemption), net	(580,016)	1,039,250
Interest charge	100,913	185,761
	<u>880,821</u>	<u>12,188,945</u>
	<u>3,575,490</u>	<u>49,832,631</u>

8 Project expenses

8.1 From ADB funds

In US dollars <i>Loan No.2879-GEO and Loan No. 2880-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	3,525,163	37,966,894	5,500,000	39,941,731	(1,974,837)	(1,974,837)
Consulting Services	246,514	642,506	300,000	695,992	(53,486)	(53,486)
Interest charge	507,404	1,021,603	-	514,199	507,404	507,404
Total	4,279,081	39,631,003	5,800,000	41,151,922	(1,520,919)	(1,520,919)

8.2 From government co-financing 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
Works	634,529	6,834,040	990,000	7,189,511	(355,471)	(355,471)
Consulting Services	72,180	192,773	54,000	174,593	18,180	18,180
Resettlement expenses	-	7,917,124		7,917,124	-	-
Total	706,709	14,943,937	1,044,000	15,281,228	(337,291)	(337,291)

9 Net increase/(decrease) in working capital

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
Increase/(decrease) in bank balances	(3,318,217)	4,658,816
Increase in advances	2,478	2,478
Decrease in accounts payable	2,100,780	-
	<u>(1,214,959)</u>	<u>4,661,294</u>

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

For the year ended December 31, 2016

*Loan Agreement No. 2879-GEO
 In US dollars*

Category	Appl.	MDF	ADB	Difference
Works	ADB 31	333,687	333,687	-
	ADB 32	179,207	179,207	-
	ADB 33	168,354	168,354	-
	ADB 34	735,875	735,875	-
	ADB 35	432,097	432,097	-
	ADB 36	314,705	314,705	-
	ADB 37	775,414	775,414	-
	ADB 38	860,128	860,128	-
		<u>3,799,467</u>	<u>3,799,467</u>	-
Consulting Services	ADB 34	136,674	136,674	-
	ADB 38	20,849	20,849	-
		<u>157,523</u>	<u>157,523</u>	-
Interest charge	CAP	156,786	156,786	-
	CAP	249,705	249,705	-
		<u>406,491</u>	<u>406,491</u>	-
Imprest account advance redemption	ADB 34	(872,548)	(872,548)	-
	ADB 38	(796,264)	(796,264)	-
		<u>(1,668,812)</u>	<u>(1,668,812)</u>	-
		<u>2,694,669</u>	<u>2,694,669</u>	-

Loan Agreement No. 2880-GEO(SF)
 In US dollars

Category	Appl.	MDF	ADB	Difference
Works	ADB 31	113,735	113,735	-
	ADB 32	61,081	61,081	-
	ADB 33	57,382	57,382	-
	ADB 34	250,816	250,816	-
	ADB 35	147,277	147,277	-
	ADB 36	107,265	107,265	-
	ADB 37	264,294	264,294	-
	ADB 38	293,168	293,168	-
		<u>1,295,018</u>	<u>1,295,018</u>	-
Consulting Services	ADB 34	56,314	56,314	-
	ADB 38	8,592	8,592	-
		<u>64,906</u>	<u>64,906</u>	-
Interest charge	CAP	46,042	46,042	-
	CAP	54,871	54,871	-
		<u>100,913</u>	<u>100,913</u>	-
Imprest account advance redemption	ADB 34	(307,131)	(307,131)	-
	ADB 38	(272,885)	(272,885)	-
		<u>(580,016)</u>	<u>(580,016)</u>	-
		<u>880,821</u>	<u>880,821</u>	-

11 Project implementation

As of December 31, 2016 only 62% of the Project has been implemented in the framework of the Loan Agreement 2879-GEO and the Loan Agreement 2880-GEO (SF). The Project expenses by categories (in percentages) are presented in the table below:

Category	Amounts disbursed in %
Works	78%
Consulting Services	17%
Interest charge	53%
Total	<u>62%</u>