

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**Financial Statements and
Independent Auditor's Report
For the Period Ended 31 December 2016**

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

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MUNICIPAL DEVELOPMENT FUND OF GEORGIA

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER, 2016

Management is responsible for the preparation of the financial statements that present fairly the financial position of Municipal Development Fund of Georgia (the "Fund") as at 31 December 2016, and the results of its operations, changes in reserves and cash flows for the year ended 31 December 2016, in compliance with International Financial Reporting Standards ("IFRS").

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 when compliance with the specific requirements in International Financial Reporting Standards ("IFRS") are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the fund's financial position and financial performance;
- Making an assessment of the Fund's 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 fund;
- Maintaining adequate accounting records that are sufficient to show and explain the fund's transactions and disclose with reasonable accuracy at any time the financial position of the fund, and which enable them to ensure that the financial statements of the fund comply with IFRS;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards;
- Taking such steps as are reasonably available to them to safeguard the assets of the fund; and
- Detecting and preventing fraud and other irregularities.

The financial statements of the fund for the year ended 31 December 2016 were approved by management on June 30 2017.

On behalf of the Management:



Galaktion Buaize
Executive Director

30 June 2017





Natalie Godziashvili
Head of Financial Management
and Investments Unit

30 June 2017

INDEPENDENT AUDITOR'S REPORT

To the management of the Municipal Development Fund of Georgia Opinion

We have audited the financial statements of Municipal Development Fund of Georgia (the "Fund"), which comprise the statement of financial position as at December 31, 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

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 consolidated Financial Statements* section of our report. We are independent of the Fund 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 Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note 5 to the financial statements which describes the restatement of corresponding figures for the year ended 31 December 2016. Our opinion is not modified in respect of this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance 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.

Deloitte & Touche

30 June 2017
Tbilisi, Georgia

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016
(in GEL)**

	Notes	Year ended 31 December 2016	Year ended 31 December 2015 Restated
Income from loans to municipalities	6	3,446,998	3,775,908
Bank Interest Income		3,840,723	3,750,390
Other Interest Income		1,907,323	718,293
Other income/(expense)	7	5,290,772	(2,246,062)
Gain from exchange rate differences		6,309,470	13,164,530
Administrative expenses	8	<u>(4,758,997)</u>	<u>(7,130,061)</u>
Profit before Income Tax		<u>16,036,288</u>	<u>12,032,998</u>
Income tax expense	9	(959,066)	(360,044)
Net profit for the period		<u>15,077,222</u>	<u>11,672,954</u>

On behalf of the Management:


Galaktion Buadze
Executive Director

June 30, 2017


Natalie Godziashvili
Head of Financial Management and
Investments Unit

June 30, 2017

The notes on pages 8-33 form an integral part of these financial statements.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016
(in GEL)**

	Notes	31 December 2016	31 December 2015 Restated	1 January 2015 Restated
ASSETS				
NON-CURRENT ASSETS				
Property, plant and equipment	10	2,495,049	2,864,974	3,172,706
Intangible assets		281,942	158,534	69,842
Deferred tax asset	9	-	68,986	112,925
Loans to municipalities	11	25,485,644	23,463,217	22,765,213
Other loans disbursed	12	<u>30,608,993</u>	<u>20,697,240</u>	<u>5,839,462</u>
TOTAL NON-CURRENT ASSETS		<u>58,871,628</u>	<u>47,252,951</u>	<u>31,960,148</u>
CURRENT ASSETS				
Loans to municipalities	11	6,016,231	5,527,733	10,302,245
Other loans disbursed	12	5,558,628	8,457,676	1,888,670
Other current assets	14	3,445,948	21,165	54,412
Current income tax assets		42,139	379,150	303,259
Receivables and advances	13	94,056,012	59,319,231	65,817,860
Deposits in banks	16	30,000,000	22,600,000	30,000,000
Cash and cash equivalents	15	<u>139,608,316</u>	<u>142,308,107</u>	<u>90,318,804</u>
TOTAL CURRENT ASSETS		<u>278,727,274</u>	<u>238,613,062</u>	<u>198,685,250</u>
TOTAL ASSETS		<u>337,598,902</u>	<u>285,866,013</u>	<u>230,645,398</u>
RESERVES AND LIABILITIES				
RESTRICTED RESERVES				
Sources of financing	19	211,878,375	195,387,832	149,504,665
Loan revolving fund		31,013,647	27,566,775	32,139,454
UNRESTRICTED RESERVES				
Retained earnings		<u>58,550,247</u>	<u>43,473,025</u>	<u>31,800,071</u>
TOTAL RESERVES		<u>301,442,269</u>	<u>266,427,632</u>	<u>213,444,190</u>
LIABILITIES				
NON-CURRENT LIABILITIES				
Grants related to assets	17	2,072,538	2,177,966	2,155,220
Long-term Trade payable	18	3,420,699	-	-
Deferred income tax liability	9	349,892	-	-
Long-term debt	12	<u>14,693,589</u>	<u>-</u>	<u>-</u>
TOTAL NON-CURRENT LIABILITIES		<u>20,536,718</u>	<u>2,177,966</u>	<u>2,155,220</u>
CURRENT LIABILITIES				
Trade payables	18	<u>15,199,915</u>	<u>17,260,415</u>	<u>15,045,988</u>
TOTAL CURRENT LIABILITIES		<u>15,199,915</u>	<u>17,260,415</u>	<u>15,045,988</u>
TOTAL RESERVES AND LIABILITIES		<u>337,598,902</u>	<u>285,866,013</u>	<u>230,645,398</u>

On behalf of the Management:

Galaktion Buadze
Executive Director

June 30 2017

Natalie Godziasivili
Head of Financial Management and
Investments Unit

June 30 2017

The notes on pages 8-33 form an integral part of these financial statements.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

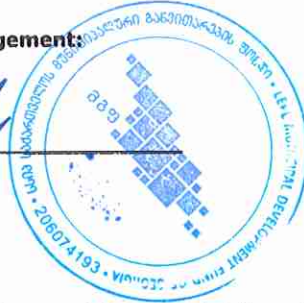
**STATEMENT OF CHANGES IN RESERVES
FOR THE YEAR ENDED 31 DECEMBER 2016
(in GEL)**

	Note	Sources of financing	Loan revolving fund	Retained Earnings	Total reserves
1 January 2015 restated		149,504,665	32,139,454	31,800,071	213,444,190
Profit for the year		-	-	11,672,954	11,672,954
Decrease in loan revolving fund		-	(4,572,679)	-	(4,572,679)
Net financing of implemented projects	19	45,883,167	-	-	45,883,167
31 December 2015 restated		195,387,832	27,566,775	43,473,025	266,427,632
Profit for the year		-	-	15,077,222	15,077,222
Increase in loan revolving fund		-	3,446,872	-	3,446,872
Net financing of implemented projects	19	16,490,543	-	-	16,490,543
31 December 2016		211,878,375	31,013,647	58,550,247	301,442,269

On behalf of the Management:


Galaktion Buaдзе
Executive Director

June 30 2017




Natalie Godziashvili
Head of Financial Management and
Investments Unit

June 30 2017

The notes on pages 8-33 form an integral part of these financial statements.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2016
(in GEL)**

	<u>31 December 2016</u>	<u>31 December 2015 Restated</u>
Cash flow from operating activities:		
Income after income tax	15,077,222	11,672,954
Adjustments for:		
Depreciation and amortisation expense	513,181	808,959
Provision for impairment losses on interest-bearing assets	-	(593,568)
Write-off of other loans disbursed	-	1,678,407
Recovery of assets previously written-off	(1,104,133)	-
Income from grants related to assets	(196,947)	(191,702)
Interest income	(9,195,044)	(8,244,590)
Income tax expense	959,066	360,044
Foreign exchange gain	(5,534,384)	(13,164,530)
Operating loss/(gain) before working capital changes	518,961	(7,674,026)
Change in receivables and advances	(34,736,781)	6,882,859
Change in other current assets	(3,424,783)	33,247
Change in loans to banks	(7,400,000)	7,400,000
Change in payables	1,183,320	(2,833,495)
Cash inflow /(outflow) from operating activities before taxation	(43,859,283)	3,808,585
Income tax paid	(316,106)	(391,996)
Net cash inflow /(outflow) from operating activities	<u>(44,175,389)</u>	<u>3,416,589</u>
Cash flows from investing activities		
Purchase of equipment and intangible assets	(248,205)	(706,913)
Interest received from municipalities and banks	8,994,679	7,022,703
Net cash flows used in investing activities	<u>8,746,474</u>	<u>6,315,790</u>
Cash flows from financing activities		
Cash receipt for project financing	16,490,543	45,883,168
Issuance of other loans, net	(7,012,705)	(17,130,547)
Loans repaid by/(provided to) municipalities ,net	(3,446,872)	(4,572,679)
Receipt of other loans	14,693,589	
Net cash from financing activities	<u>20,724,554</u>	<u>24,179,942</u>
Effect of foreign exchange rate changes on cash and cash equivalents	12,004,569	18,076,982
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(14,704,360)	33,912,321
CASH AND CASH EQUIVALENTS, at beginning of the period	142,308,107	90,318,804
CASH AND CASH EQUIVALENTS, at end of the period	<u>139,608,316</u>	<u>142,308,107</u>

On behalf of the Management:

Galaktion Buadze
Executive Director


Natalie Godziashvili
Head of Financial Management and
Investments Unit

June 30 2017

June 30 2017

The notes on pages 8-33 form an integral part of these financial statements.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (in GEL)

1. GENERAL INFORMATION

Municipal Development Fund of Georgia (the "Fund" or "MDF") was established on 7 June 1997 by the Presidential Decree N° 294 "On management of funds for the development of municipal sector in Georgia. The Fund is a legal entity of public law, the objective of which is to support strengthening institutional and financial capacity of local government units, investing financial resources in local infrastructure and services, improving on sustainable basis the primary economic and social services for the local population and the provision of low-interest loans to legal entities and physical persons of Georgia in the framework of the Government Program. The founder and governing body of the fund is the government of Georgia. The Fund is cooperating with all large investment banks and financial institutions operating in Georgia.

2. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

2.1 Basis of preparation

These financial statements have been prepared on the assumption that the Fund is a going concern and will continue in operation for the foreseeable future.

These financial statements are presented in GEL ("GEL"), unless otherwise indicated.

The financial statements are prepared on a historical cost basis. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that prices are directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Fund takes into account the characteristics of the asset and liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/ or disclosure purposes in these financial statements is determined on such a basis.

Functional currency. Items included in the financial statements are measured using the currency of the primary of the economic environment in which the entity operates ("the functional currency"). The functional currency of the Fund is the Georgian Lari ("GEL"). The presentational currency of the consolidated financial statements of the Fund is the GEL.

Offsetting. Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the consolidated statement of profit or loss unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

2.2 Interest income

Interest income on loans to municipalities is allocated to accounting periods so as to reflect a constant periodic rate of return on the Fund's net investment outstanding in respect of the loans. Interest income is recognized based on an accrual basis.

2.3 Financial instruments

Financial assets and financial liabilities are recognised when a Fund becomes a party to the contractual provisions of the instrument.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Financial assets

Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL), 'held-to-maturity' investments, 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. The principal financial assets of the Fund are cash and cash equivalents and loans disbursed to municipalities, which are classified as loans and receivables.

Loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables (including cash and cash equivalents and loans disbursed to municipalities) are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the effect of discounting is immaterial.

The Fund derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. The difference between the carrying amount of the financial asset derecognised and the consideration received and receivable is recognised in statement of comprehensive income.

Impairment of financial assets - Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after

the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For Fund's financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments;
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Fund's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit

or loss to the extent that the carrying amount of the investment at the date the impairment does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial liabilities

Financial liabilities are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The Fund derecognises financial liabilities when, and only when, the Fund's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in statement of comprehensive income.

2.4 Foreign currencies

In preparing the financial statements, transactions in currencies other than the Fund's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are recognized in profit or loss in the period in which they arise.

2.5 Corporate Income tax

Corporate Income tax includes current and deferred taxes. Current Corporate Income tax is applied at the rate of 15% on taxable income generated by the Fund during the taxation period. Deferred Corporate Income tax arising from temporary differences in the timing of the recognition of items in the tax returns and these financial statements is calculated using the liability method. The Deferred Corporate Income tax asset and liability are determined on the basis of the tax rates that are expected to apply when the timing differences reverse. The principal temporary timing differences arise from differing rates of accounting and tax amortization and depreciation on the Fund's non-current assets, the treatment of temporary provisions and accruals.

2.6 Property Plant and Equipment

Equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is recognised so as to write off the cost less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Equipment and machinery	- 5 years
Motor vehicles	- 5 -10 years
Furniture and other	- 5 -10 years
Leasehold improvement	- 20 years

Depreciation is calculated starting with the following month after the asset is put into operation or engaged in commercial activity. The carrying values of equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount.

The recoverable amount of equipment is the higher of an asset's net selling price and its value in use. In assessing the value in use, the estimated future cash flows are discounted to their present

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the income statement in the impairment caption.

An item of equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognized.

2.7 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, unrestricted balances on corresponded and term deposits with the commercial banks and state treasury with original maturity of less or equal to 90 days and amounts due from credit institutions with original maturity of less or equal to 90 days and are free from contractual encumbrances.

2.8 Grants related to assets

Grants related to assets are recognised as deferred income when they are received. Recognition in Profit and Loss is done on systematic basis over the periods in which the entity recognises expenses for the related costs for which grants are intended to compensate.

Government grants are recognised at fair value when there is reasonable assurance that the entity will comply with the conditions attaching to them and the grants will be received. Assets received for indefinite use by way of government grants are capitalised at fair value at the point of the transfer of the asset. Grants related to the transfer of assets are treated as deferred income and allocated to the income statement over the useful lives of the related assets.

2.9 Reserves

Reserves are restricted if the related funds are restricted by the donors for implementation of specific projects. In the statement of changes in reserves the restricted reserves are composed of the sources of financing and the loan revolving fund.

Sources of financing - Sources of financing represent the net cumulative financing received and the respective expenditures incurred for the implementation of the projects. 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 is recognised on an accruals basis as a use of project funds when liabilities are incurred.

Loan revolving fund - Loan revolving fund represents donor financing received for the purposes of providing loan financing to municipalities. In the statement of changes in reserves increases or decreases of the loan revolving fund are presented net.

3. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSS)

Amendments to IFRSs affecting amounts reported in the financial statements

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these financial statements:

Amendments to IFRS 10, IFRS 12 and IAS 28 *Investment Entities: Applying the Consolidation Exception*;

Amendments to IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*;

Amendments to IAS 1 *Disclosure Initiative*;

Amendments to IAS 16 and IAS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation*;

Amendments to IAS 16 and IAS 41 *Agriculture: Bearer Plants*;

IFRS 14 *Regulatory Deferral Accounts*;

Amendments to IAS 27 – *Equity Method in Separate Financial Statements*;

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)
(in GEL)**

Annual Improvements to IFRSs 2012-2014 Cycle

Amendments to IAS 1 Disclosure Initiative

The Company has applied these amendments for the first time in the current year. The amendments clarify that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, and give guidance on the bases of aggregating and disaggregating information for disclosure purposes. However, the amendments reiterate that an entity should consider providing additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance.

In addition, the amendments clarify that an entity's share of the other comprehensive income of associates and joint ventures accounted for using the equity method should be presented separately from those arising from the Group, and should be separated into the share of items that, in accordance with other IFRSs: (i) will not be reclassified subsequently to profit or loss; and (ii) will be reclassified subsequently to profit or loss when specific conditions are met.

As regards the structure of the financial statements, the amendments provide examples of systematic ordering or grouping of the notes.

The application of these amendments has not resulted in any impact on the financial performance or financial position of the Company.

Annual Improvements to IFRSs - 2012-2014 Cycle

The Company has applied these amendments for the first time in the current year. The Annual Improvements to IFRSs 2012-2014 Cycle include a number of amendments to various IFRSs, which are summarised below.

The amendments to IFRS 5 introduce specific guidance in IFRS 5 for when an entity reclassifies an asset (or disposal group) from held for sale to held for distribution to owners (or vice versa). The amendments clarify that such a change should be considered as a continuation of the original plan of disposal and hence requirements set out in IFRS 5 regarding the change of sale plan do not apply. The amendments also clarifies the guidance for when held-for-distribution accounting is discontinued.

The amendments to IFRS 7 provide additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purpose of the disclosures required in relation to transferred assets.

The amendments to IAS 19 clarify that the rate used to discount post-employment benefit obligations should be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. The assessment of the depth of a market for high quality corporate bonds should be at the currency level (i.e. the same currency as the benefits are to be paid). For currencies for which there is no deep market in such high quality corporate bonds, the market yields at the end of the reporting period on government bonds denominated in that currency should be used instead.

The application of these amendments has had no effect on the Company's financial statements.

New and revised IFRSs in issue but not yet effective

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 9 *Financial Instruments*²;
- IFRS 15 *Revenue from Contracts with Customers (and the related Clarifications)*²;
- IFRS 16 *Leases*³
- Amendments to IFRS 2 – *Classification and Measurement of Share-based Payment Transactions*²;

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

- Amendments to IFRS 10 and IAS 28 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*¹;
- Amendments to IAS 7 – *Disclosure Initiative*¹;
- Amendments to IAS 12 – *Recognition of Deferred Tax Assets for Unrealised Losses*¹;
- Amendments to IFRS 4 – *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*²;
- IFRIC 22 *Foreign Currency Transactions and Advance Consideration*²;
- Amendments to IAS 40 – *Transfers of Investment Property*²;
- Annual Improvements to IFRSs 2014-2016 Cycle.

¹ Effective for annual periods beginning on or after 1 January 2017, with earlier application permitted.

² Effective for annual periods beginning on or after 1 January 2018, with earlier application permitted.

³ Effective for annual periods beginning on or after 1 January 2019, with earlier application permitted.

⁴ Effective for annual periods beginning on or after a date to be determined. Earlier application is permitted.

IFRS 9 Financial Instruments

IFRS 9 issued in November 2009 introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments.

The key requirements of IFRS 9 are:

- **Classification and measurement of financial assets.** All recognised financial assets that are within the scope of IFRS 9 are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are generally measured at FVTOCI. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies) in other comprehensive income, with only dividend income generally recognised in profit or loss.
- **Classification and measurement of financial liabilities.** With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of a financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of such changes in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.
- **Impairment.** In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model, as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

- **Hedge accounting.** The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contracts;
- Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises revenue when or as a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

In April 2016, the IASB issued *Clarifications to IFRS 15* in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

IFRS 16 Leases

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 *Leases* and the related interpretations when it becomes effective.

IFRS 16 distinguishes leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions of operating leases (off balance sheet) and finance leases (on balance sheet) are removed for lessee accounting, and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees (i.e. all on balance sheet) except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at cost (subject to certain exceptions) less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst others. Furthermore, the classification of cash flows will also be affected as operating lease payments under IAS 17 are presented as operating cash flows; whereas under the IFRS 16 model, the lease payments will be split into a principal and an interest portion which will be presented as financing and operating cash flows respectively.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, and continues to require a lessor to classify a lease either as an operating lease or a finance lease.

Furthermore, extensive disclosures are required by IFRS 16.

Amendments to IAS 7 Disclosure Initiative

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

The amendments apply prospectively for annual periods beginning on or after 1 January 2017 with earlier application permitted. The management of the Company does not anticipate that the application of these amendments will have a material impact on the Company's financial statements

IFRIC 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that when an entity pays or receives consideration in advance in a foreign currency, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income is the date of the advance consideration, i.e. when the prepayment or liability in respect of the income received in advance was recognised. If there is more than one advance payment or receipt the date of the transaction for each payment or receipt of advance consideration should be determined. The amendments apply to annual periods beginning on or after 1 January 2018 with earlier application permitted. Entities may elect to apply amendments either retrospectively or prospectively. The management of the Company does not anticipate that the application of this IFRIC will have a material impact on the Company's financial statements as the Company currently uses the approach prescribed in IFRIC 22.

Amendments to IAS 40 Transfers of Investment Property

The amendments are intended to clarify that an entity can only reclassify a property to/ from investment property when, and only when, there is evidence that a change in the use of the property has occurred. The amendments emphasise that a change in management's intentions alone would not be enough to support a transfer of property. The standard has a list of circumstances that evidence a change in use, which is perceived by some as being exhaustive, the amendments make it clear that they are only examples. The amendments apply to annual periods beginning on or after 1 January 2018 with earlier application permitted. Entities may elect to apply them either retrospectively (if it is possible without the use of hindsight) or prospectively. The management of the Company does not anticipate that the application of these amendments will have a material impact on the Company's financial statements as the Company does not hold any investment property.

Annual Improvements to IFRSs 2014-2016 Cycle

This annual improvements package amended three standards:

The Amendments to IFRS 1 delete the short-term exemptions that related to disclosures about financial instruments, employee benefits and investment entities as the reporting period to which the exemptions applied have already passed and as such, these exemptions are no longer applicable. The amendments are effective for annual periods beginning on or after 1 January 2018.

The amendments to IFRS 12 clarify that concession from the requirement to provide summarised financial information in respect of interests in subsidiaries, associates or joint ventures classified as held for sale or included in a disposal group is the only concession available for such interests. The amendments apply retrospectively and are effective for annual periods beginning on or after 1 January 2017.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

In accordance with IAS 28, a venture capital organisation and other similar entities may elect to measure investments in associates and joint ventures at FVTPL. In addition, an entity that is not an investment entity but has an interest in an associate or joint venture that is an investment entity, may, when applying the equity method, elect to retain the fair value measurement applied by that associate or joint venture to its own interests in subsidiaries. Amendments to IAS 28 clarify that such election should be made separately for each associate or joint venture at initial recognition. The amendments apply retrospectively and are effective for annual periods beginning on or after 1 January 2018. Early application is permitted.

The management does not anticipate that the application of these amendments will have a material impact on the Company's financial statements.

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Fund's accounting policies, which are described in note 4, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment allowance

a) Assets carried at amortized cost

The Fund assesses at each reporting date whether there is objective evidence that a group of financial assets is impaired. A group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the group of financial assets that can be reliably estimated.

The criteria that the Fund uses to determine that there is objective evidence of an impairment loss include:

- (a) adverse changes in the payment status of borrowers in the portfolio of financial assets, i.e. financial assets whose interest and principal payments are past due;
- (b) termination of agreement due to a breach of contract by the borrower, such as a default or delinquency in interest, principal and/or penalty payments.

The Fund assesses whether objective evidence of impairment exists collectively for a group of financial assets with similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Fund and historical loss experience for assets with credit risk characteristics similar to those in the Fund. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, levels of arrears, or other factors indicative of changes in the probability of losses and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the management to reduce any differences between loss estimates and actual loss experience.

When a receivable is uncollectible, it is written off against the related allowance for receivable impairment. Such receivables are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the accounts receivable aging), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement.

b) Renegotiated financial assets

Financial assets that are subject to collective impairment assessment and whose terms have been renegotiated are no longer considered to be past due but are treated as new assets. In subsequent years, the asset is considered to be past due and disclosed only if renegotiated again.

Deferred income tax asset

Deferred income tax is provided in full using the liability method for tax losses carried forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet.

Deferred taxation relates to the future tax consequences of all events that have been recognised in the Fund's financial statements. Deferred income tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Taxation

Georgian tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Fund may be assessed additional taxes, penalties and interest. The Fund believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for six years.

5. RESTATEMENT

According to the Company's accounting policy, government grants received in a form of a free of charge transfer of non-monetary assets are accounted for at fair value at the date of transfer.

Subsequent to the issuance of the Company's 2015 financial statements, the Company's management determined that certain government grant received in the form of a free of charge transfer of an administrative building was not measured and presented in accordance with the Company's accounting policy in the previously issued financial statements. Instead, the transferred asset and the related liability were shown at the nominal amount, which was zero.

As a result of the departure from the accounting policy the Company's property plant and equipment, related grant liability, administrative expenses and other expenses were misstated.

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The effects of the restatement and reclassifications on the financial position as at December 31, 2016 and December 31, 2015 and January 1, 2015 are presented in the table below:

	As Previously reported		Adjustments		As Restated	
	1 January 2015	31 December 2015	1 January 2015	31 December 2015	1 January 2015	31 December 2015
Property, plant and equipment	1,121,672	971,712	2,051,034	1,893,261	3,172,706	2,864,973
Grants related to assets	104,186	284,704	2,051,034	1,893,261	2,155,220	2,177,966

The effect of the restatements and reclassification on the statement of comprehensive income for the year ended 31 December 2015 is as follows:

	As previously reported December 31, 2015	Adjustments	As Restated December 31, 2015
Other income/(expense)	(2,403,834)	157,772	(2,246,062)
Administrative expenses	(6,972,289)	(157,772)	(7,130,061)

Restatements have no effect on the statement of cash flows for the year ended 31 December 2015.

6. INCOME FROM LOANS TO MUNICIPALITIES

	31 December 2016	31 December 2015
Interest income	3,438,546	3,770,715
Penalty income	8,452	5,193
Total	3,446,998	3,775,908

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The breakdown of interest income from loans to municipalities is as follows:

Municipality	For the year ended 31 December 2016	For the year ended 31 December 2015
Rustavi	377,695	457,353
Zugdidi City	333,529	400,781
Kobuleti	313,723	357,402
Kutaisi	200,478	57,674
Gurjaani	195,245	235,221
Gori	180,326	80,534
Sighnaghi	157,351	85,730
Bolnisi	142,722	173,074
Tsalenjikha	130,171	49,673
Telavi City	123,760	144,757
Tetritskaro	123,645	17,525
Dusheti	122,658	153,067
Mestia	95,794	22,017
Mtskheta	90,156	109,490
Kaspi	86,093	27,617
Marneuli	84,656	102,535
Zestafoni	80,151	66,297
Akhalqataqi	73,264	88,835
Batumi	72,274	110,628
Khobi	70,382	84,462
Lagodekhi	69,916	83,923
Poti	68,521	346,663
Martvili	62,429	4,229
Gardabani	51,124	60,956
Telavi	46,171	57,684
Mtskheta City	40,720	50,870
Borjomi	30,227	43,318
Lentekhi	3,024	4,529
Ozurgeti	2,880	4,399
Sagarejo	2,753	4,292
Oni	2,635	4,197
Akhaltsikhe City	2,634	4,203
Gori City	1,057	20,343
Ozurgeti City	382	32,723
Tbilisi	-	223,714
Akhaltsikhe	-	-
Total:	3,438,546	3,770,715

7. OTHER INCOME/(EXPENSE)

	31 December 2016	31 December 2015
Income from grants related to assets	196,947	191,702
Income from bank guarantees	3,735,049	-
Accrual of liability to state budget related to penalties received	-	(1,869,862)
Other	1,358,776	(567,902)
Total	5,290,772	(2,246,062)

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**NOTES TO THE FINANCIAL STATEMENTS
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8. ADMINISTRATIVE EXPENSE

	<u>31 December 2016</u>	<u>31 December 2015</u>
Employee benefits	4,225,165	4,246,244
Depreciation and amortization	513,181	808,958
Office expenses	132,755	134,407
Trips, transportation, advertising and representation expenses	379,897	360,723
Audit and consulting	27,675	35,282
Communication costs	10,984	13,080
Insurance expenses	290,129	177,340
Representative expenses	22,948	11,315
Provision/(reversal) for doubtful receivables	-	(593,568)
(Recovery of assets previously written off)/ write-off of assets	(1,104,134)	1,678,407
Other	260,397	257,873
Total	<u>4,758,997</u>	<u>7,130,061</u>

9. INCOME TAX EXPENSE

The tax rate used for the 2016 and 2015 reconciliations and assessment of deferred taxes below is the corporate tax rate of 15% payable by corporate entities in Georgia on taxable profits under the tax law in Georgia. The main components of the income tax for the year ended 31 December 2016 and period ended 31 December 2015 were as follows:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Current income tax expense	540,188	316,105
Deferred income tax expense (benefit)	418,878	43,939
Corporate income tax charged to the statement of profit or loss and other comprehensive income	<u>959,066</u>	<u>360,044</u>

Actual Corporate Income tax charge, if compared with theoretical calculations:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Profit before tax	16,036,288	12,032,998
Tax at the applicable rate of 15%	(2,405,443)	(1,804,950)
Tax effect of permanent differences	1,446,377	1,444,906
Actual corporate income tax benefit/(expense) for the reporting period	<u>959,066</u>	<u>360,044</u>

Temporary differences as at 31 December 2016 and 31 December 2015 were due to:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Deferred corporate income tax asset		
Property, plant and equipment	83,456	156,989
Intangible assets	1,032	1,032
Receivables and advances	(434,380)	(89,035)
Net deferred corporate income tax asset	<u>(349,892)</u>	<u>68,986</u>

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As at 31 December 2016 and 2015, deferred tax asset was as follows:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Deferred tax asset at the beginning of the period	68,986	112,925
Change in deferred income tax balances recognized in profit or loss	<u>(418,878)</u>	<u>(43,939)</u>
Deferred tax asset as at 31 December	<u><u>(349,892)</u></u>	<u><u>68,986</u></u>

10. PROPERTY PLANT AND EQUIPMENT

	<u>Land</u>	<u>Buildings</u>	<u>Leasehold improvement</u>	<u>Equipment and machinery</u>	<u>Motor Vehicles</u>	<u>Furniture and other</u>	<u>Total</u>
Cost							
As at 1 January 2015	857,519	2,367,127	1,163,652	1,229,125	1,456,593	279,235	7,353,251
Additions	-	-	17,648	235,410	299,327	144,508	696,893
Disposals	-	-	-	<u>(256,646)</u>	<u>(221,648)</u>	<u>(141,950)</u>	<u>(620,244)</u>
31 December 2015	<u>857,519</u>	<u>2,367,127</u>	<u>1,181,300</u>	<u>1,207,889</u>	<u>1,534,272</u>	<u>281,793</u>	<u>7,429,900</u>
Additions	-	-	3,955	86,000	18,460	29,850	138,265
Write-off	-	-	-	<u>(108,382)</u>	-	<u>(99,767)</u>	<u>(208,149)</u>
Disposals	-	-	-	-	-	-	-
31 December 2016	<u>857,519</u>	<u>2,367,127</u>	<u>1,185,255</u>	<u>1,185,507</u>	<u>1,552,732</u>	<u>211,876</u>	<u>7,360,016</u>
Accumulated depreciation							
As at 1 January 2015	275,909	828,494	1,108,304	929,213	825,345	213,280	4,180,545
Charge for the period	39,416	118,356	59,065	156,792	293,695	109,992	777,316
Eliminated on disposal	-	-	-	<u>(223,963)</u>	<u>(82,606)</u>	<u>(86,365)</u>	<u>(392,934)</u>
31 December 2015	<u>315,325</u>	<u>946,850</u>	<u>1,167,369</u>	<u>862,042</u>	<u>1,036,434</u>	<u>236,907</u>	<u>4,564,927</u>
Charge for the period	39,416	118,356	13,931	173,792	88,995	73,700	508,190
Eliminated on disposal	-	-	-	<u>(108,382)</u>	-	<u>(99,769)</u>	<u>(208,150)</u>
31 December 2016	<u>354,741</u>	<u>1,065,206</u>	<u>1,181,300</u>	<u>927,452</u>	<u>1,125,429</u>	<u>210,838</u>	<u>4,864,966</u>
Carrying amount as at							
31 December 2016	<u>502,778</u>	<u>1,301,921</u>	<u>3,954</u>	<u>258,055</u>	<u>427,303</u>	<u>1,038</u>	<u>2,495,049</u>
Carrying amount as at							
31 December 2015	<u>542,194</u>	<u>1,420,277</u>	<u>13,931</u>	<u>345,847</u>	<u>497,838</u>	<u>44,887</u>	<u>2,864,974</u>
Carrying amount as at							
1 January 2015	<u>581,610</u>	<u>1,538,633</u>	<u>1,538,633</u>	<u>3 55,348</u>	<u>299,948</u>	<u>631,248</u>	<u>299,912 65,955</u>

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In the year 2007, MDF received from the Ministry of Economy of Georgia an administrative building and land, located at 150 Agmashenebeli Avenue, Tbilisi, Georgia, under the terms of "usufruct". According to the agreement, MDF can use the building for the whole period of the Fund's existence. The Building together with the attached land was not recognized in entity's financial statements in previous reporting periods. The transfer of the building is the scope of IAS 20. Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. The grants may take various forms, including a transfer of non-monetary resources for the entity's own use.

Under IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors- an entity should select an accounting policy and apply it consistently to all non-monetary grants.

The effect of the restatements and reclassifications on the financial position as at 31 December and 1 January 2015 is presented in note 5 and disclosure note above.

11. LOANS TO MUNICIPALITIES

	<u>31 December 2016</u>	<u>31 December 2015</u>
Current portion	6,016,231	5,527,733
Long-term portion	25,485,644	23,463,217
Total:	<u>31,501,875</u>	<u>28,990,950</u>

Current portion of loans to municipalities include the following:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Principal receivable	5,528,003	5,245,590
Interest receivable	480,676	280,311
Penalties receivable	7,552	1,832
Total:	<u>6,016,231</u>	<u>5,527,733</u>

Municipality	<u>Current Portion</u>	<u>Non-current portion</u>	<u>Total 2016</u>
Kutaisi	317,767	3,716,545	4,034,312
Batumi	140,291	391,643	531,934
Ozurgeti	15,198	1,371	16,569
Rustavi	716,321	2,064,158	2,780,479
Gori	128,308	1,474,362	1,602,670
Poti	126,211	367,627	493,838
Zugdidi City	608,839	1,866,724	2,475,563
Zestafoni	203,539	1,159,744	1,363,283
Telavi	115,266	213,074	328,340
Telavi City	211,227	715,877	927,104
Borjomi	67,568	139,568	207,136
Dusheti	291,063	586,707	877,770
Akhalqalaki	155,892	378,333	534,225
Khobi	140,948	376,587	517,535
Akhalsikhe City	14,270	-	14,270
Marneuli	177,572	440,281	617,853
Mtskheta	195,411	458,697	654,108
Mtskheta City	101,646	187,898	289,544
Oni	14,308	-	14,308
Sagarejo	15,392	-	15,392
Tsalenjikha	124,680	1,061,490	1,186,170
Kaspi	249,597	1,102,381	1,351,979
Bolnisi	303,882	736,725	1,040,607

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Gardabani	98,408	279,482	377,890
Gurjaani	400,257	1,030,721	1,430,978
Lagodekhi	140,243	373,752	513,995
Lentekhi	28,434	2,652	31,086
Sighnaghi	125,275	1,269,668	1,394,942
Kobuleti	437,334	1,962,823	2,400,157
Mestia	198,044	1,260,813	1,458,857
Martvili	69,299	823,338	892,637
Tetritskaro	83,741	1,042,603	1,126,344
Total:	6,016,231	25,485,644	31,501,875

	Current Portion	Non-current portion	Total 2015
Municipality			
Tbilisi	885,518	18,301	903,819
Kutaisi	59,964	75,060	135,024
Batumi	140,479	531,933	672,412
Ozurgeti	13,493	16,569	30,062
Ozurgeti City	30,595	-	30,595
Rustavi	663,585	2,780,579	3,444,164
Gori	129,986	1,602,670	1,732,656
Gori City	26,916	-	26,916
Poti	-	-	-
Zugdidi City	563,821	2,475,663	3,039,484
Zestafoni	118,655	366,657	485,312
Telavi	102,293	328,340	430,633
Telavi City	187,452	927,104	1,114,556
Borjomi	94,669	207,136	301,805
Dusheti	263,464	877,770	1,141,234
Akhalkalaki	138,344	534,225	672,569
Khobi	125,092	517,535	642,627
Akhaltikhe City	13,926	14,270	28,196
Marneuli	158,848	617,853	776,701
Mtskheta	173,419	654,107	827,526
Mtskheta City	90,205	289,544	379,749
Oni	13,877	14,308	28,185
Sagarejo	13,687	15,392	29,079
Tsalenjikha	73,971	1,115,126	1,189,097
Kaspi	36,956	545,503	582,459
Bolnisi	269,682	1,040,608	1,310,290
Gardabani	87,332	377,891	465,223
Gurjaani	355,213	1,431,079	1,786,292
Lagodekhi	124,588	513,995	638,583
Lentekhi	18,838	17,760	36,598
Sighnaghi	120,981	1,394,943	1,515,924
Kobuleti	388,114	2,400,257	2,788,371
Mestia	22,017	609,396	631,413
Martvili	4,229	56,035	60,264
Tetritskaro	17,524	1,095,608	1,113,132
Total:	5,527,733	23,463,217	28,990,950

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Municipality	Current Portion	Non-current portion
Tbilisi	1,646,454	903,830
Kutaisi	684,797	61,860
Batumi	434,853	672,415
Ozurgeti	350,538	60,652
Rustavi	685,277	3,444,164
Gori	215,364	26,210
Poti	3,179,545	589,223
Zugdidi City	577,664	3,039,484
Zestafoni	126,823	485,312
Telavi	265,811	1,545,189
Borjomi	107,294	301,805
Dusheti	243,485	1,141,234
Akhalqalaql	122,773	672,569
Khobi	111,005	642,621
Akhaltsikhe City	12,359	28,196
Marneuli	140,969	776,701
Mtskheta	233,974	1,207,276
Oni	12,315	28,185
Sagarejo	12,148	29,079
Tsalenjikha	15,223	30,027
Kaspi	12,088	29,013
Bolnisi	239,330	1,310,289
Gardabani	77,500	465,222
Gurjaani	315,231	1,786,291
Lagodekhi	110,453	638,455
Lentekhi	11,899	31,169
Sighnaghi	12,642	30,371
Kobuleti	344,431	2,788,371
Total:	<u>10,302,245</u>	<u>22,765,213</u>

Loans to municipalities represent loans disbursed by MDF to Local self-governments within the scope of different projects financed by International Financial Institutions and implemented by MDF. Loans are disbursed to municipalities for implementing the sub-projects for the rehabilitation and expansion of priority municipal services and infrastructure needs. Loans carry an interest rate of 12% and are disbursed for an average period of 10 years. Loans issued to municipalities are unsecured.

No provision for impairment of loans balances is made, as the management considers that there is no objective evidence of impairment since loans origination. There are no overdue balances as at the end of 2016 and 2015.

12. OTHER LOANS DISBURSED

	31 December 2016	31 December 2015
Current portion	5,558,628	8,457,676
Long-term portion	<u>30,608,993</u>	<u>20,697,240</u>
Total:	<u>36,167,621</u>	<u>29,154,916</u>

Current portion of other loans disbursed include the following:

	31 December 2016	31 December 2015
Principal receivable	5,558,628	8,015,813
Interest receivable	-	441,863
Total:	<u>5,558,628</u>	<u>8,457,676</u>

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		Interest	31 December 2016	31 December 2015
Loans disbursed to Municipalities under Solid Waste Management Project	A	Refinancing rate +0.5%	14,693,399	-
Loans disbursed to Tbilisi City hall (Principal)	B	10.5%	12,743,813	18,063,692
Loans disbursed to United Water Supply Company of Georgia	C	12%	2,090,519	2,143,361
Loans disbursed to commercial banks	D	3%	6,639,890	8,506,000
Interest receivable from the loans to Tbilisi City hall			-	441,863
Total:			36,167,621	29,154,916

A: During the year 2016 Georgian Government received a long-term loan from the European Bank for Reconstruction and Development (EBRD) for the execution of Solid Waste Management project. Under the subsidiary loan agreement between Georgia and MDF, the loan proceeds were received by MDF, which in its turn transferred the loan to the ultimate beneficiary municipalities. Original currency of the loan from EBRR in Euro. Long-term debt of GEL 14,693,589 is recorded in the financial position of the fund. The loan was received in Euro and further disbursed to Municipalities in Georgian lari therefore causing foreign exchange effect of GEL190.

B: In 2015 MDF disbursed loan to Tbilisi City Hall based on respective government decree. The loans proceeds should be used by the City Hall for capital investments, specifically, for rehabilitation and development of city roads.

C: During the previous years MDF had disbursed loans to the Poti Municipality for the infrastructure projects. The right of use of the related assets, together with the respective liability for the loan disbursed by MDF, was transferred from the municipality to the United Water Supply Company of Georgia by the Government decree.

D: MDF disbursed loans to the commercial banks from the proceeds of the grant received from KfW, a German government-owned development bank. The loans were disbursed to the commercial banks for the purpose of providing financial resources to private and municipal operators of existing small scale hydro power plants and geothermal facilities.

13. RECEIVABLES AND ADVANCES

	31 December 2016	31 December 2015
<i>Financial assets</i>		
Receivables from terminated contracts	3,547,258	2,721,522
Receivables from municipalities	1,171,053	3,303,211
Other receivables	1,358,458	822,450
	6,076,769	6,847,183
<i>Non-financial assets</i>		
Advances to suppliers	88,381,147	52,873,952
	88,381,147	52,873,952
Provision for doubtful receivable	(401,904)	(401,904)
Total:	94,056,012	59,319,231

Advances to contractors are paid within the scope of projects signed between the Government of Georgia and Donor Organizations for which the implementing agency is MDF. Advances to

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contractors include payments to construction companies in the amount of GEL 74,421,566 for the year ended 2016 (GEL 48,537,127 for the year ended 2015) for the construction and rehabilitation of the infrastructure in different regions, GEL 13,595,187 for acquisition of goods (GEL 3,840,345 for the year ended 2015), GEL 336,208 for supervision of construction works (GEL 608,730 for the year ended 2015) and GEL 28,186 for other services (GEL 45,481 for the year ended 2015). Advances are fully redeemed when the performance of works and services is 80-90% complete by the contractor.

Receivables from municipalities represent the share of municipalities co-financing for the municipal projects implemented by MDF.

As at 31 December 2016 and 2015, movement in the provision for doubtful receivable was as follows:

	<u>31 December 2016</u>	<u>31 December 2015</u>
Provision for doubtful receivable at the beginning of the period	401,904	995,472
Additional provision recognised during the year	-	-
Reversal of provision recognised in prior periods	-	(593,568)
Provision for doubtful receivable at the end of the period	401,904	401,904

14. OTHER CURRENT ASSETS

	<u>31 December 2016</u>	<u>31 December 2015</u>
Bank Guarantee Receivable	3,308,500	-
Other	137,448	21,165
Total	3,445,948	21,165

The supplier has defaulted on its performance obligations, which was secured by the bank guarantee. MDF claimed for the guarantee and recognized sum as other current asset and income in its financial statements. The amount is restricted cash from bank as at the date of signing the financial statements.

15. CASH AND CASH EQUIVALENTS

	<u>31 December 2016</u>	<u>31 December 2015</u>
Commercial bank accounts	300,001	1,907,556
State treasury accounts	139,308,315	140,400,551
Total	139,608,316	142,308,107

16. DEPOSITS IN BANK

	<u>31 December 2016</u>	<u>31 December 2015</u>
Time deposits	15,000,000	12,000,000
Deposit certificates	15,000,000	10,600,000
Total	30,000,000	22,600,000

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17. GRANTS RELATED TO ASSETS

	31 December 2016	31 December 2015	1 January 2015
Balance at the beginning of the period	2,177,966	2,155,219	2,341,701
Received during the year	91,519	214,449	-
Credited to profit and loss	(196,947)	(191,702)	(186,482)
Balance at the end of the period	<u>2,072,538</u>	<u>2,177,966</u>	<u>2,155,219</u>

18. TRADE PAYABLES

	31 December 2016	31 December 2015
<i>Financial liabilities</i>		
Retentions payable to contractors	15,529,704	12,765,988
Trade accounts payable	2,335,204	2,146,160
Other payables	<u>225,602</u>	<u>1,623,221</u>
	18,090,510	16,535,369
<i>Non-financial liabilities</i>		
Advances received from municipalities	950,104	704,041
Taxes other than Income tax	<u>-</u>	<u>21,005</u>
	950,104	725,046
Total	<u>19,040,614</u>	<u>17,260,415</u>

MDF retains 5-10% of the invoice amounts for the construction works in the framework of implemented project expenditures for possible future losses. These amounts are subject to payment to constructors one year after the construction works are completed.

19. SOURCE OF FINANCING

	31 December 2016	31 December 2015
World Bank	741,797	22,777,477
Asian Development Bank	412,677	22,498,364
European Bank for Reconstruction and Development	2,996,002	(538,908)
Government of Georgia	12,110,589	20,746,769
United States Agency for International Development	(959,515)	6,310,631
KfW	938,894	(875,720)
Government of France	(875,581)	-
Government of Netherlands	(328,384)	-
European Investment Bank	(15,464,270)	(28,788,745)
European Union	27,234,598	4,566,362
Swedish International Development Agency	2,096,186	856,452
Municipalities	(3,247,768)	3,601,934
MDF	<u>(9,164,682)</u>	<u>(5,271,449)</u>
Net financing of implemented projects	<u>16,490,543</u>	<u>45,883,167</u>

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

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20. RELATED PARTIES TRANSACTION AND OUTSTANDING BALANCES

Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be effected on the same terms and conditions as transactions between unrelated parties.

The fund is owned by State of Georgia. It has transactions with entities owned by the state of Georgia, referred as government related entities below. These transactions are conducted in the ordinary course of the fund's business on terms comparable to those with other entities that are non-government related entities.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Fund had the following balances and transactions with related parties:

	December 31, 2016		December 31, 2015	
	Related party balances	Total category as per the financial statements caption	Related party balances	Total category as per the financial statements caption
NON-CURRENT ASSETS				
Loans to municipalities	25,485,644	25,485,644	23,463,217	23,463,217
CURRENT ASSETS				
Loans to municipalities	6,016,231	6,016,231	5,527,733	5,527,733
Receivables and advances	4,632,620	94,056,012	6,750,855	59,319,231
Cash and cash equivalents	139,608,316	139,608,316	140,400,551	142,308,107
CURRENT LIABILITIES				
Trade payables	950,104	19,040,614	704,041	17,260,415

The total number of headcount of hirectors and other member of key managment amounted to 14 in both reporting periods December 31,2016 and December 31,2015. The remuneration of directors and other members of key management members were as follows:

	31 December 2016		31 December 2015	
	Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Key management personnel compensation	231,514	4,225,165	287,830	4,246,244

Included in the statement of profit or loss for the years ended December 31, 2016 and 2015 are the following amounts which were recognized in transactions with related parties:

	2016		2015	
	Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Source of financing	67,055,579	16,490,543	62,714,914	45,883,167
Interest income from loans to municipalities	3,446,998	3,446,998	3,775,908	3,775,908
Other interest income	1,875,194	1,907,323	441,863	718,293

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

21. FINANCIAL RISK MANAGEMENT

The Fund's principal financial instruments comprise loans to municipalities, bank balances and accounts payables. The main purpose of these financial instruments is to ensure financing for the fund's operations.

Financial risks

The main financial risks arising from the Fund's financial instruments are foreign currency risk, interest rate risk, liquidity risk, and credit risk.

Foreign currency risk

The currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Fund is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Fund undertakes certain transactions denominated in foreign currencies, including the receipt of financing from International financial institutions for the implementation of projects. The financing is, in most cases, received in USD and EUR. The funds received are converted in GEL on periodic basis and the fluctuation in exchange rates between the date of funds received and converted results in foreign exchange gain/losses. The Fund does not use any derivatives to manage foreign currency risk exposure.

The Fund's exposure to foreign currency exchange rate risk is presented in the table below:

	<u>GEL</u>	<u>USD USD 1 = GEL 2.6468</u>	<u>EUR EUR 1 = GEL 2.7940</u>	<u>31 December 2016 Total</u>
FINANCIAL ASSETS				
Cash and cash equivalents	4,551,074	83,307,633	51,749,609	139,608,316
Loans to banks	30,000,000	-	-	30,000,000
Receivables and advances	5,674,865	-	-	5,674,865
Loans to municipalities	31,501,875	-	-	31,501,875
Other loans disbursed	29,527,731	-	6,639,890	36,167,621
TOTAL FINANCIAL ASSETS	<u>101,255,545</u>	<u>83,307,633</u>	<u>58,389,499</u>	<u>242,952,677</u>
FINANCIAL LIABILITIES				
Trade Payables	18,090,510	-	-	18,090,510
Long-term debt	-	-	14,693,589	14,693,589
TOTAL FINANCIAL LIABILITIES	<u>18,090,510</u>	<u>-</u>	<u>14,693,589</u>	<u>32,784,099</u>
OPEN POSITION	<u>83,165,035</u>	<u>83,307,633</u>	<u>43,695,910</u>	

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	<u>GEL</u>	<u>USD USD 1 = GEL 2.3949</u>	<u>EUR EUR 1 = GEL 2.6169</u>	<u>31 December 2015 Total</u>
FINANCIAL ASSETS				
Cash and cash equivalents	1,748,624	113,744,626	26,814,857	142,308,107
Loans to banks	22,600,000	-	-	22,600,000
Receivables and advances	6,847,183	-	-	6,847,183
Loans to municipalities	28,990,950	-	-	28,990,950
Other loans disbursed	20,648,916	-	8,506,000	29,154,916
TOTAL FINANCIAL ASSETS	<u>80,835,673</u>	<u>113,744,626</u>	<u>35,320,857</u>	<u>229,901,156</u>
FINANCIAL LIABILITIES				
Trade Payables	16,535,368	-	-	16,535,368
TOTAL FINANCIAL LIABILITIES	<u>16,535,368</u>	<u>-</u>	<u>-</u>	<u>16,535,368</u>
OPEN POSITION	<u>64,300,305</u>	<u>113,744,626</u>	<u>35,320,857</u>	<u>213,365,788</u>

The table below details the Fund's sensitivity to strengthening/weakening of functional currency against foreign currencies by 15 per cent as at 31 December 2016 and 31 December 2015. The analysis was applied to monetary items at the balance sheet date denominated in EUR.

	As at 31 December 2016		As at 31 December 2016	
	USD/GEL + 15%	USD/GEL - 15%	EUR/GEL +15%	EUR/GEL - 15%
Profit/(loss) before tax	12,496,145	(12,496,145)	6,554,387	(6,554,387)
Impact of equity	10,621,723	(10,621,723)	5,571,229	(5,571,229)
	As at 31 December 2015		As at 31 December 2015	
	USD/GEL + 15%	USD/GEL - 15%	EUR/GEL +15%	EUR/GEL - 15%
Profit/(loss) before tax	17,061,694	(17,061,694)	4,022,228	(4,022,228)
Impact of equity	14,502,440	(14,502,440)	3,418,894	(3,418,894)

Interest rate risk

Interest-bearing financial assets and liabilities of the Fund have fixed interest rate. Therefore, Fund is not exposed to any interest rate risk.

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to enable repayment of borrowings and other financial commitments as they actually fall due.

The table below presents the cash flows payable by the Fund and to the Fund under non-derivative financial liabilities and assets held for managing liquidity risk by remaining contractual maturities at the date of the statement of financial position. The amounts disclosed in the table are the contractual undiscounted cash flow.

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As at 31 December 2016	Carrying value	Contractual cash flows				Total
		On demand	Up to 1 year	1-5 years	More than 5 years	
Financial Assets						
Loans to banks	30,000,000	-	7,383,717	31,161,425	-	38,545,142
Loans to municipalities	31,501,875	488,228	9,558,223	25,986,047	10,227,760	46,260,259
Other loans disbursed	36,167,621	-	8,039,330	23,306,636	13,681,489	45,027,455
Bank balances	139,608,316	139,608,316	-	-	-	139,608,316
Receivables and advances	6,076,769	6,076,769	-	-	-	6,076,769
Total financial assets	243,354,581	146,173,313	24,981,270	80,454,108	23,909,249	275,517,940
Financial Liabilities						
Accounts payable	18,090,510	5,805,158	8,864,653	3,420,699	-	18,090,510
Long-term debt	14,693,589	-	73,677	5,542,351	9,635,512	15,251,540
Total financial liabilities	32,784,099	5,805,158	8,938,330	8,963,050	9,635,512	33,342,050
Liquidity gap		140,368,155	16,042,940	71,491,058	14,273,737	
Cumulative liquidity gap		140,368,155	156,411,095	227,902,153	242,175,890	

As at 31 December 2015	Carrying value	Contractual cash flows				Total
		On demand	Up to 1 year	1-5 years	More than 5 years	
Financial Assets						
Loans to banks	22,600,000	-	13,557,986	17,167,603	-	30,725,589
Loans to municipalities	28,990,950	282,142	12,009,025	25,276,516	5,082,407	42,650,090
Other loans disbursed	29,154,916	441,863	8,671,780	19,721,874	109,375	28,944,892
Bank balances	142,308,107	142,308,107	-	-	-	142,308,107
Receivables and advances	6,847,183	6,847,183	-	-	-	6,847,183
Total financial assets	229,901,156	149,879,295	34,238,791	62,165,993	5,191,782	251,475,861
Financial Liabilities						
Accounts payable	16,535,369	16,535,369	-	-	-	16,535,369
Total financial liabilities	16,535,368	16,535,369	-	-	-	16,535,369
Liquidity gap	215,044,194	133,343,927	34,238,791	62,165,993	5,191,782	
Cumulative liquidity gap	215,044,194	346,709,714	380,948,505	443,114,498	448,306,280	

Credit risk

The Fund is exposed to credit risk through its receivables and advances, loans to municipalities and other loans disbursed.

The Fund operates by applying a clear set of loan granting criteria to the municipalities. Each municipality is assessed for creditworthiness using the data provided by the Ministry of Finance. The Fund takes into consideration both quantitative and qualitative factors when assessing the creditworthiness of the borrower. Based on this analysis, the Fund sets the credit limit for each and every borrower.

When the loan agreement has been signed, the Fund monitors the loan and borrower's solvency. The Fund has developed loan monitoring process so that it helps to quickly spot any possible non-compliance with the provisions of the agreement. The receivable balances are monitored on an

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED) (in GEL)

ongoing basis to ensure that the Fund's exposure to bad debts is minimized, and, where appropriate, provisions are being made.

Fair value

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. The estimated fair values of financial instruments have been determined by the Fund using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Georgia continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Financial assets carried at amortised cost - The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty.

Liabilities carried at amortised cost - The estimated fair value of fixed interest rate instruments with stated maturity was estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Management of the Fund considers that the carrying amounts of financial liabilities recorded in the financial statements approximate to their fair values.

22. COMMITMENTS AND CONTINGENCIES

Commitments - The Fund receives financing from donors for the completion of different projects. The fund is committed to use the proceeds received for the purposes defined in loan, credit or grant agreements. Total amount of the commitment for the year ended 2016 amounts to the balance of Source of Financing in entity's financial statements.

Legal proceedings - As at 31 December 2016 the Fund was not engaged in any significant litigation proceedings. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

Taxes - Georgian tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Fund may be assessed additional taxes, penalties and interest. The Fund believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for six years.

Operating environment - The entity's principal business activities are within Georgia. Since laws and regulations affecting the business environment in Georgia are subject to rapid changes, the entity's assets and operations could be at risk due to negative changes in the political and business 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. Tax, currency and customs legislation within Georgia are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in Georgia. 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.

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)
(in GEL)**

In 2015 and 2016, economies of the CIS countries experienced political and economic turmoil which significantly affected Georgian economy as well. Currency exchange market was unstable and the Georgian Lari depreciated by 11%, substantially against the United States of Dollar.

Economic situation in Georgia depends, to a large extent, upon success of the Georgian government's efforts, future condition of the Georgian economy and political developments in the CIS. Outcome of these efforts and developments is at this stage difficult to determine.

23. EVENTS AFTER THE REPORTING PERIOD

There were no significant events subsequent to the balance sheet date that require adjustment to, or disclosure in, these special purpose financial statements.

24. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors and authorized for issue on 30 June 2017.