

**MUNICIPAL DEVELOPMENT  
FUND OF GEORGIA**

LOAN NO.8380-GE  
GRANT NO.TF018090  
(SECOND REGIONAL AND MUNICIPAL  
INFRASTRUCTURE DEVELOPMENT PROJECT)

Special Purpose Project Financial Statements and  
Independent Auditor's Report  
For the Year Ended 31 December 2016

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA**  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE  
DEVELOPMENT PROJECT  
LOAN NO.8380-GE  
GRANT NO.TF018090

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## MUNICIPAL DEVELOPMENT FUND OF GEORGIA

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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Management of the Second Regional and Municipal Infrastructure Development Project (the "Project"), financed under the Loan Agreement No. 8380-GE dated 18 August 2014 and Grant Agreement No. TF018090 dated 1 May 2015, implemented by the Municipal Development Fund of Georgia ("MDF") is responsible for the preparation of the special purpose project financial statements that present fairly the project's statement of financial position as at 31 December 2016, the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure ("SOE") and designated account statements, in compliance with the basis of accounting described in Note 2 of accompanying these special purpose project financial statements and in conformity with the World Bank's Financial Management Sector Board's "Guidelines: Annual Financial Reporting and Auditing for World Bank Financed Activities" (the "World Bank Guidelines").

In preparing the special purpose project financial statements, management is responsible for:

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

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Project;
- Maintaining adequate accounting records that are sufficient to show and explain the Project's transactions and disclose with reasonable accuracy at any time the financial position of the Project, and which enable them to ensure that the special purpose project financial statements of the Project comply with the Guidelines on Annual Financial Reporting and Auditing for World Bank – Financed Activities issued by the World Bank's Financial Management Sector Board;
- Maintaining statutory accounting records in compliance with Georgian legislation;
- Taking such steps that are reasonably available to them to safeguard the assets of the Project; and
- Preventing and detecting fraud and other irregularities.

The special purpose project financial statements for the year ended 31 December 2016 were authorised for issue on 31 May 2017 by the Management.

**On behalf of Management:**



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**Galaktion Buadze**  
Executive Director

31 May 2017



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**Natalie Godziashvili**  
Head of Financial Management  
and Investments Unit

31 May 2017



## INDEPENDENT AUDITOR'S REPORT

### To the management of the Municipal Development Fund of Georgia:

#### Opinion

We have audited the accompanying special purpose project financial statements of Second Regional and Municipal Infrastructure Development Project (the "Project") financed under the Loan Agreement No. 8380-GE dated 18 August 2014 and Grant Agreement No. TF018090 dated 1 May 2015, implemented by the Municipal Development Fund of Georgia, which comprise the Project's statement of financial position as at 31 December 2016, the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure ("SOE") and designated account statements for the year ended 31 December 2016 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements"). The special purpose project financial statements are prepared by management of the Municipal Development Fund of Georgia in accordance with the basis of accounting described in Note 2 and in conformity with the World Bank's Financial Management Manual for World Bank Financed Investment Operations.

In our opinion, the accompanying special purpose financial statements of the Project for the year ended 31 December 2016 are prepared, in all material respects, in accordance with the basis of accounting described in Note 2 and in conformity with the World Bank's Guidelines.

#### Basis for Opinion

We conducted our audit in accordance with International Standards of 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 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 – Basis of Accounting and Restriction on Distribution and Use

We draw attention to Note 2 to the special purpose project financial statements, which describes the basis of accounting. The special purpose project financial statements are prepared to assist the Project's management to comply with the financial reporting provisions of the Agreement referred to above. As a result, the special purpose project financial statements may not be suitable for another purpose.

This report is intended solely for use by the Project's management, the Government of Georgia and International Bank for Reconstruction and Development. This report is not intended for the benefit of any other third parties and we accept no responsibility or liability to any party other than the Project's management in respect of the report. Should any third party take decisions based on the contents of the report, the responsibility for such decisions shall remain with those third parties. Our opinion is not modified in respect of this matter.

## **Responsibility of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation of these special purpose project financial statements in accordance with the basis of accounting described in Note 2 and in conformity with the World Bank's Financial Management Manual for World Bank Financed Investment Operations and for such internal control as management determines is necessary to enable the preparation of special purpose project 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 Organisation's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless management either intends to liquidate the Organisation 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 special purpose 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 financial statements.

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

- Identify and access 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 Organisation'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 Company'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 Organisation to cease to continue as a going concern.

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*

31 May 2017  
Tbilisi, Georgia



**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
LOAN NO.8380-GE  
GRANT NO.TF018090**

**STATEMENT OF SOURCES AND USES OF FUNDS  
FOR THE YEAR ENDED 31 DECEMBER  
2016**

*(in US Dollars)*

	Actual		Planned		Variance		PAD Life of the project <i>Unaudited</i>
	Year ended 31.12.2016	Cumulative as at 31.12.2016	Year ended 31.12.2016 <i>Unaudited</i>	Cumulative as at 31.12.2016 <i>Unaudited</i>	Year ended 31.12.2016 <i>Unaudited</i>	Cumulative as at 31.12.2016 <i>Unaudited</i>	
<b>OPENING WORKING CAPITAL</b>							
Cash	1,988,480	-					
Prepayments	1,067,556	-					
Receivables from Municipalities	1,482,812						
Other Assets	328						
Payables	(390,969)	-					
<b>TOTAL</b>	<b>4,148,207</b>	<b>-</b>					
<b>SOURCES OF FUNDS</b>							
IBRD Loan 8380-GE	5,232,323	13,129,227					30,000,000
SDC Funds	142,814	542,814					5,000,000
Government of Georgia	307,755	1,535,487					2,250,000
MDF Funds	2,060,751	4,592,252					12,925,000
Municipal Funds	329,910	2,825,444					8,760,000
Other income	35,258	49,614					
<b>TOTAL</b>	<b>8,108,811</b>	<b>22,674,838</b>					<b>58,935,000</b>
<b>EXPENDITURE</b>							
Works and goods (part A.1(a) & part A1 (b))	8,835,783	17,834,268	10,000,000	18,998,485	1,164,217	1,164,217	47,610,000
Consultants service and training, and IOC under part A.2	881,894	1,793,072	1,200,000	2,111,178	318,106	318,106	2,500,000
Goods, consultants, training under Part B	206,297	206,297	300,000	300,000	93,703	93,703	8,750,000
Front-end fee	-	75,000	-	75,000	-	-	75,000
<b>TOTAL</b>	<b>9,923,974</b>	<b>19,908,637</b>	<b>11,500,000</b>	<b>21,484,663</b>	<b>1,576,026</b>	<b>1,576,026</b>	<b>58,935,000</b>
Foreign exchange loss	(39,801)	(472,958)					

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
 SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
 LOAN NO.8380-GE  
 GRANT NO.TF018090**

**STATEMENT OF SOURCES AND USES OF FUNDS  
 FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**  
*(in US Dollars)*

<b>CLOSING WORKING CAPITAL</b>		
Cash	1,393,771	1,393,771
Prepayments	971,373	971,373
Receivables from Municipalities	463,300	463,300
Other Assets	520	520
Payables	(535,721)	(535,721)
<b>TOTAL</b>	<b>2,293,243</b>	<b>2,293,243</b>

**On behalf of Management:**

**Galaktion Buadze**  
 Executive Director



31 May 2017



**Natalie Godziashvili**  
 Head of Financial Management and  
 Investments Unit

31 May 2017


The notes on pages 1.1 to 1.6 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
LOAN NO.8380-GE  
GRANT NO.TF018090**


**STATEMENT OF FINANCIAL POSITION  
FOR THE YEAR EDNED 31 DECEMBER 2016  
(in US Dollars)**

	Note	31 December 2016	31 December 2015
<b>ASSETS</b>			
Cash	8	1,393,771	1,988,480
Prepayments	7	971,373	1,067,556
Receivables from Municipalities		463,300	1,482,812
Other assets		520	328
<b>TOTAL ASSETS</b>		<b>2,828,964</b>	<b>4,539,176</b>
<b>LIABILITIES</b>			
Payables		(535,721)	(390,969)
<b>Total liabilities</b>		<b>(535,721)</b>	<b>(390,969)</b>
<b>NET ASSETS</b>		<b>2,293,243</b>	<b>4,148,207</b>
<b>Cumulative funds received:</b>			
IBRD Loan 8380-GE		13,129,227	7,896,904
SDC Grant		542,814	400,000
Government of Georgia		1,535,487	1,227,732
MDF Funds		4,592,252	2,531,501
Funds from Municipalities		2,825,444	2,495,533
Other Income		49,614	14,357
<b>Total funds received</b>		<b>22,674,838</b>	<b>14,566,027</b>
<b>Cumulative expenditures:</b>			
Cumulative project expenditures:	9	19,908,637	9,984,663
		<b>19,908,637</b>	<b>9,984,663</b>
Foreign exchange loss		(472,958)	(433,157)
<b>TOTAL NET ASSETS</b>		<b>2,293,243</b>	<b>4,148,207</b>

On behalf of Management:

  
Galaktion Bgadze  
Executive Director

31 May 2017

  
Natalie Godziashvili  
Head of Financial Management and  
Investments Unit

31 May 2017

The notes on pages 11 to 16 form an integral part of these special purpose project financial statements.



**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
LOAN NO.8380-GE  
GRANT NO.TF018090**

**STATEMENT OF EXPENDITURE BY ACTIVITY  
FOR THE YEAR EDNED 31 DECEMBER 2016  
(in US Dollars)**

Project activities	Actual		Planned		Variance	
	Year ended 31.12.2016	Cumulative as at 31.12.2016	Year ended 31.12.2016 <i>Unaudited</i>	Cumulative as at 31.12.2016 <i>Unaudited</i>	Year ended 31.12.2016 <i>Unaudited</i>	Cumulative as at 31.12.2016 <i>Unaudited</i>
<b>Component 1: Infrastructure investment</b>						
A.1(a) Provision of financing on a credit basis	5,987,309	11,775,443	6,781,458	12,569,592	794,149	794,149
A.1(b) Provision of financing on a grant basis	2,848,474	6,058,825	3,218,542	6,428,893	370,068	370,068
A.2.Technical assistance for Investment Subprojects	881,894	1,793,072	1,200,000	2,111,178	318,106	318,106
<b>Component 2: Institutional development</b>						
B.1 Improving the institutional capacity and performance of LSGs	206,297	206,297	300,000	300,000	93,703	93,703
B.2 Improving the institutional capacity and performance of MDF	-	-	-	-	-	-
<b>Front end fee</b>	-	75,000	-	75,000	-	-
<b>TOTAL EXPENDITURES</b>	<b>9,923,974</b>	<b>19,908,637</b>	<b>11,500,000</b>	<b>21,484,663</b>	<b>1,576,026</b>	<b>1,576,026</b>

On behalf of Management:

  
Galaktion Buadze  
Executive Director

31 May 2017

  
Natalie Godziashvili  
Head of Financial Management and  
Investments Unit

31 May 2017

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LOAN NO.8380-GE  
GRANT NO.TF018090**

**STATEMENT OF EXPENDITURE (SOE)  
FOR THE YEAR EDNE 31 DECEMBER 2016  
(in US Dollars)**

Withdrawal applications for Loan:

<b>Withdrawal No.</b>	<b>Withdrawal application date</b>	<b>Total SOE</b>	<b>Category 1a: Works and Goods</b>	<b>Category 1b: Works and Goods</b>	<b>Category 2: Consultants service, training and Incremental operating costs under Part A2</b>
6	04.05.2016	<b>1,211,062</b>	575,791	606,114	29,157
7	05.07.2016	<b>1,750,414</b>	607,493	1,102,239	40,682
8	07.11.2016	<b>1,389,597</b>	802,479	547,960	39,158
9	30.11.2016	<b>282,752</b>	124,691	144,210	13,851
			<b>2,110,454</b>	<b>2,400,523</b>	<b>122,848</b>

USD 490,876 under withdrawal application No. 6 is attributable to 2015 and recorded as expenditure in the 2015 financial statements respectively. The withdrawal application for these expenses were submitted to International Bank for Reconstruction and Development in 2016.

Withdrawal applications for Grant:

<b>Withdrawal No.</b>	<b>Withdrawal application date</b>	<b>Total SOE</b>	<b>Goods, Consulting service, Training under B</b>
2	13.10.2016	<b>3,304</b>	3,304
			<b>3,304</b>

On behalf of Management:

**Galaktion Buadze**  
Executive Director

31 May 2017

  
**Natalie Godziashvili**  
Head of Financial Management and Investments Unit

31 May 2017

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
 SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
 LOAN NO.8380-GE  
 GRANT NO.TF018090**

**STATEMENT OF DESIGNATED ACCOUNT  
 FOR THE YEAR ENDED 31 DECEMBER 2016  
 (in US Dollars)**

<b>Account No.</b>	202250160
<b>Depository Bank</b>	State Treasury
<b>Address</b>	16 V. Gorgasali street Tbilisi, 0114 Georgia

<b>Opening balance</b>		<u>1,458,745</u>
Funds received from IBRD (Loan)		5,232,323
<b>Present outstanding amount advanced to Designated Account ("DA")</b>		<u><b>6,691,068</b></u>
DA closing balance as at 31 December 2016	8	1,125,913
Add: Amount of eligible expenditures paid	10	<u>5,565,155</u>
<b>Total advance accounted for</b>		<u><u><b>6,691,068</b></u></u>

**On behalf of Management:**

**Galaktion Buadze**  
**Executive Director**

31 May 2017



**Natalie Godziashvili**  
**Head of Financial Management and**  
**Investments Unit**

31 May 2017

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**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
 SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
 LOAN NO.8380-GE  
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**STATEMENT OF DESIGNATED ACCOUNT  
 FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)  
 (in US Dollars)**

<b>Account No.</b>	202230160	
<b>Depository Bank</b>	State Treasury	
<b>Address</b>	16 V. Gorgasali street Tbilisi, 0114 Georgia	
<hr/>		
<b>Opening balance</b>		<u>382,281</u>
Funds received from IBRD (Grant)		142,814
<b>Present outstanding amount advanced to DA</b>		<u><b>525,095</b></u>
DA closing balance as at 31 December 2016	8	175,107
Add: Amount of eligible expenditures paid	10	<u>349,988</u>
<b>Total advance accounted for</b>		<u><u><b>525,095</b></u></u>

**On behalf of Management:**

**Galaktion Buadze  
 Executive Director**

31 May 2017



**Natalie Godziashvili  
 Head of Financial Management and  
 Investments Unit**

31 May 2017

The notes on pages 11 to 16 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
LOAN NO.8380-GE  
GRANT NO.TF018090**

**NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2016  
(in US Dollars)**

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**1. BACKGROUND**

Municipal Development Fund ("MDF") was established by the Government of Georgia by Presidential Decree # 294 of June 7, 1997 to manage allocated credits/loans received from the International Development Association ("IDA"), the International Bank for Reconstruction and Development ("IBRD"), the Asian Development Bank ("ADB") and the European Investment Bank ("EIB") and monitor the implementation of infrastructure sector projects.

The International Bank for Reconstruction and Development Loan Agreement No. 8380-GE (the "Agreement") in the amount of 30 million United States Dollars ("USD") was signed between the Government of Georgia ("GoG") and International Bank for Reconstruction and Development ("IBRD") on 18 August 2014 ("inception"). Swiss Grant Agreement No. TF018090 (the "Agreement") in the amount of 5 million United States Dollars ("USD") was signed between the Government of Georgia ("GoG") and International Bank for Reconstruction and Development ("IBRD") on 1 May 2015.

The main objectives of the loan are: providing finance on the credit and grant basis to selected Local self governments ("LSG") to finance investment sub-projects related to municipal services; preparation of feasibility studies, construction supervision, monitoring and evaluation activities for investment subprojects; enhancing the institutional capacity and performance of LSGs and MDF. The closing date of the loan is 30 June 2019.

**2. ACCOUNTING POLICIES**

**Basis of accounting** – These special purpose project financial statements have been prepared in accordance with the *Modified Accrual Basis of Accounting* and incorporate the following principal accounting policies, which have been consistently followed in all material respects and comply with the Guidelines on Annual Financial Reporting and Auditing for World Bank – Financed Activities issued by the World Bank's Financial Management Sector Board.

**Funds received** – Project financing is recognised as sources of funds in the period when the cash inflow can be reasonably estimated and they become available and measurable.

**Expenditure** - Expenditure is recognised on an accruals basis as a use of project funds when liabilities are incurred.

**Functional currency** – These special purpose project financial statements are expressed in United States Dollars ("US Dollar" or "USD").

**Transactions in other currencies** – Transactions in currencies other than reporting currencies are converted to US Dollars at the exchange rate prevailing at the date of the transaction. Monetary items are translated into US Dollars at the National Bank of Georgia ("NBG") official exchange rate at the reporting date.

**Cash** – Cash comprises balances with State Treasury.

**3. DESIGNATED ACCOUNT**

The designated account is a special disbursement account of the Project maintained in US Dollars at the State Treasury to ensure the payment of eligible expenditures, within defined limits, which do not require individual authorisation from IBRD in accordance with the Agreement.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
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**NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)  
(in US Dollars)**

**4. BASIS OF FUNDING**

According to the terms of the Agreement, expenditure is co-financed by proceeds received from IBRD, Swiss Grant, the Government of Georgia ("GoG"), MDF and Municipalities.

The financing is provided from the following sources:

Goods and Works under part A.1 (a) - IBRD, MDF and Municipalities: 40%, 40% and 20%, respectively;

Goods and Works under part A.1 (b) - IBRD and Municipalities: 85% and 15%, respectively;

Consultants' services, training under Part A.2 of the Project and Incremental Operating Costs - IBRD and GoG: 80% and 20%, respectively;

Goods, consultants' services and training under Part B of the Project - IBRD, Swiss Grant and GoG: 22.8%, 57.2% and 20%, respectively.

	<u>IBRD</u>	<u>Swiss Grant</u>	<u>GoG</u>	<u>MDF</u>	<u>Municipalities</u>	<u>Total</u>
Goods and Works under part A.1 (a)	12,925,000	-	-	12,925,000	6,465,000	<b>32,315,000</b>
Goods and Works under part A.1 (b)	13,000,000	-	-	-	2,295,000	<b>15,295,000</b>
Consultants' services, training and Incremental Operating Costs under Part A.2 of the Project	2,000,000	-	500,000	-	-	<b>2,500,000</b>
Goods, consultants' services and training under Part B of the Project	2,000,000	5,000,000	1,750,000	-	-	<b>8,750,000</b>
Front-end fee	75,000	-	-	-	-	<b>75,000</b>
<b>Total:</b>	<b><u>30,000,000</u></b>	<b><u>5,000,000</u></b>	<b><u>2,250,000</u></b>	<b><u>12,925,000</u></b>	<b><u>8,760,000</u></b>	<b><u>58,935,000</u></b>

**5. METHODS OF WITHDRAWAL**

The methods of withdrawal used from the inception of the loan to 31 December 2016 were as follows:

**(a) Designated Account**

Municipal Development Fund withdraws the eligible amounts from the designated account and prepares and sends replenishment requests to the World Bank with authorised signatures. The replenishment requests and respective documentation are reviewed by the World Bank and an approved amount is transferred to the designated account.

**(b) Direct Payment**

Available amounts are drawn from time to time within limits determined under the loan agreement for direct payments of eligible expenditures for sub-projects. Direct payments are made by the World Bank directly to third parties. MDF forms withdrawal applications for request of direct payments and sends it to the World Bank, for settlement.

**(c) GoG Current Account**

The Project maintains a separate account where funds from the Government of Georgia are accumulated. The funds are further disbursed to sub-contractors based on the share of expenditures to be incurred.



**MUNICIPAL DEVELOPMENT FUND OF GEORGIA  
 SECOND REGIONAL AND MUNICIPAL INFRASTRUCTURE DEVELOPMENT PROJECT  
 LOAN NO.8380-GE  
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**NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENTS  
 FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)  
 (in US Dollars)**

**6. STATEMENT OF EXPENDITURE**

Withdrawals are to be made on the basis of SOEs for expenses on contracts within the following contractual limits:

- (i) All expenditures for works valued at less than USD 4,000,000;
- (ii) Consultant services contracts (firms) valued at less than USD 200,000;
- (iii) Consultant services contracts (individuals) valued at less than USD 50,000;
- (iv) All expenditures for goods valued at less than USD 300,000;

**7. PREPAYMENTS**

	<u>31 December 2016</u>	<u>31 December 2015</u>
Advances to contractors	971,373	1,067,556
<b>Total:</b>	<u><b>971,373</b></u>	<u><b>1,067,556</b></u>

Payments of advances to contractors are made at the beginning of the contract in amount of 10%-30% of total contract amount. Retention of advance is done periodically upon submission of works completed certificates by contractors.

**8. CASH**

	<u>31 December 2016</u>	<u>31 December 2015</u>
Balance on designated account (Loan)	1,125,913	1,458,745
Balance on designated account (Grant)	175,107	382,281
Local account	92,751	147,454
<b>Total:</b>	<u><b>1,393,771</b></u>	<u><b>1,988,480</b></u>

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**9. PROJECT EXPENDITURE BY FUND**

<b>Project activities</b>	<b>Actual</b>	
	<b>Year to date</b>	<b>Cumulative to date</b>
Works and Goods under Part A.1 (a)	2,390,651	4,794,602
Works and Goods under Part A.1 (b)	2,421,203	5,149,748
Consulting services and training under Part A.2	708,374	1,421,260
Goods, consultants and training under Part B	47,036	47,036
Front-end fee	-	75,000
<b>IBRD TOTAL</b>	<b>5,567,264</b>	<b>11,487,646</b>
Works and Goods under Part A.1 (a)	-	-
Works and Goods under Part A.1 (b)	-	-
Consulting services and training under Part A.2	3,375	21,147
Goods, consultants and training under Part B	118,002	118,002
<b>GRANT TOTAL</b>	<b>121,377</b>	<b>139,149</b>
Works and Goods under Part A.1 (a)	-	568,188
Works and Goods under Part A.1 (b)	-	70,283
Consulting services and training under Part A.2	170,145	350,665
Goods, consultants and training under Part B	41,259	41,259
<b>GoG TOTAL</b>	<b>211,404</b>	<b>1,030,395</b>
Works and Goods under Part A.1 (a)	2,400,691	4,646,027
Works and Goods under Part A.1 (b)	-	-
Consulting services and training under Part A.2	-	-
Goods, consultants and training under Part B	-	-
<b>MDF TOTAL</b>	<b>2,400,691</b>	<b>4,646,027</b>
Works and Goods under Part A.1 (a)	1,195,967	1,781,044
Works and Goods under Part A.1 (b)	427,271	838,795
Consulting services and training under Part A.2	-	-
Goods, consultants and training under Part B	-	-
<b>MUNICIPALITIES TOTAL</b>	<b>1,623,238</b>	<b>2,619,839</b>
<b>TOTAL PROJECT EXPENDITURES</b>	<b>9,923,974</b>	<b>19,923,056</b>

The Project consists of the following parts:

Part A: Infrastructure Investment

1. Provision of financing:

- a) on a credit basis, to selected LSGs to finance Investment Subprojects for the rehabilitation and expansion of priority municipal services and infrastructure needs on a sustainable basis; through the carrying out of works and provision of goods; and
- b) on a grant basis, to selected LSGs to finance Investment Subprojects for selected municipal services and infrastructure projects, through the carrying out of works and provision of goods.

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2. Preparation of feasibility studies, engineering designs, construction supervision, monitoring and evaluation activities for Investment Subprojects, through the provision of consultants' services and Training.

Part B: Institutional Development

1. Improving the institutional capacity and performance of LSGs in: (a) asset management planning; (b) project cycle management; and (c) fiscal discipline and accounting, through the provision of goods, consultants' services and Training.
2. Improving the institutional capacity and performance of the Project Implementing Entity in: (a) technical appraisal; (b) credit risk management; and (c) fiduciary functions, through the provision of consultants' services and Training.

**10. RECONCILIATION OF DESIGNATED ACCOUNT**

	<u>WB (Loan)</u>	<u>WB (Grant)</u>	<u>Other (GoG, MDF, Municipalities)</u>	<u>Total</u>
Expenditures incurred during the year	5,567,264	121,377	4,235,333	<b>9,923,974</b>
Change in prepayments	(10,488)	219,191	(112,520)	<b>96,183</b>
Change in payables	(43,129)	-	(101,623)	<b>(144,752)</b>
Change in other assets	153	-	39	<b>192</b>
Foreign exchange	51,355	9,420	(20,975)	<b>39,800</b>
Add: Amount of eligible expenditure paid	<u>5,565,155</u>	<u>349,988</u>	<u>4,000,254</u>	

**11. COMMITMENTS AND CONTINGENCIES**

Management is not aware of any commitments and contingencies which would have a material impact on the special purpose project financial statements as at 31 December 2016 and on the funds received and disbursed during the year then ended.

**12. OPERATING ENVIRONMENT**

Emerging markets such as Georgia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Georgia continue to change rapidly and tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Georgia is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

Throughout 2016 Georgia's neighbouring countries, which are large trading partners of Georgia, have experienced significant political and economic turmoil which has had a knock-on effect on the Georgian economy. This has resulted in a significant devaluation of the Georgian Lari against the US dollar and other major currencies.



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**13. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE**

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

**14. APPROVAL OF FINANCIAL STATEMENTS**

These special purpose projects financial statements were authorised for issue by the Management of MDF on 31 May 2017.