

Municipal Development Fund of Georgia

Sustainable Urban Transport Investment Program,
Tranche 3
Loan No. 3063-GEO

Special Purpose Project Financial Statements

For the Year Ended 31 December 2016

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Independent Auditors' Report on Special Purpose Project Financial Statement

To the management of the Municipal Development Fund of Georgia

Opinion

We have audited the accompanying special purpose project financial statements of the Sustainable Urban Transport Investment Program, Tranche 3 (the "Project"), implemented by Municipal Development Fund of Georgia (the "Fund"), which comprise the statement of financial position as of 31 December 2016, the statement of Project sources and uses of funds, the imprest account statements and the government co-financing account statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The special purpose project financial statements have been prepared by management of the Fund based on the financial reporting provisions of Section 4.03 of the Loan Agreement No. 3063 - GEO dated 19 December 2013 (the "Loan Agreement").

In our opinion, the special purpose project financial statements for the year ended 31 December 2016 are prepared, in all material respects, in accordance with the financial reporting provisions of Section 4.03 of the Loan Agreement.

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 Auditors' Responsibilities for the Audit of the Special Purpose Project Financial Statements section of our report. We are independent of the Center in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

Data included on pages 5 to 14 of the accompanying special purpose project financial statements that are marked as "*Unaudited*" have not been audited.

Emphasis of Matter-Basis of Accounting and Restriction on Use and Distribution

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 have been prepared for providing information to the Government of Georgia and the Asian Development Bank to assist them in evaluating the Project implementation. As a result, the special purpose project financial statements may not be suitable for another purpose. This report is intended solely for the Fund, the Government of Georgia and the Asian Development Bank and should not be used by, or distributed to, other parties. Our opinion is not modified in respect of this matter.

Other Matters on which we are required to report

Pursuant to Section 3 of the Terms of Reference for the audit of the special purpose project financial statements of the Project dated 3 June 2016 we have audited the utilization of proceeds of the loan withdrawn from the Asian Development Bank. For the year ended 31 December 2016 no proceeds of the loan have been withdrawn from the Asian Development Bank for the purpose of the Project in accordance with the Loan Agreement No. 3063-GEO dated 19 December 2013.

Responsibilities of Management and Those Charged with Governance for the Special Purpose Project Financial Statements

Management is responsible for the preparation of these special purpose project financial statements in accordance with the financial reporting provisions of Section 4.03 of the Loan Agreement, for determining the acceptability of the basis of accounting, 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.

Auditors' Responsibilities for the Audit of the Special Purpose Project 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 auditors' 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 special purpose project financial statements.

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

- Identify and assess the risks of material misstatement of the special purpose project financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Evaluate the overall presentation, structure and content of the special purpose project financial statements, including the disclosures, and whether the special purpose project 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.

The engagement partner on the audit resulting in this independent auditors' report is:

Karen Safaryan

KPMG Georgia LLC
Tbilisi, Georgia
30 June 2017



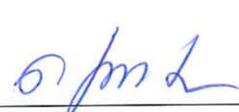
Sustainable Urban Transport Investment Program, Tranche 3
 Statement of financial position as of and for the year ended December 31, 2016
 (in US Dollars)

	<u>Note</u>	<u>As of December 31, 2016</u>	<u>As of December 31, 2015</u>
Assets			
<i>Non-current assets</i>			
Accumulated Project expenses		13,513,169	9,604,646
		<u>13,513,169</u>	<u>9,604,646</u>
<i>Current assets</i>			
Advances and receivables	4	8,995,742	847,932
Bank balances		6,122,749	14,527,823
		<u>15,118,491</u>	<u>15,375,755</u>
Total assets		<u><u>28,631,660</u></u>	<u><u>24,980,401</u></u>
Funds and liabilities			
<i>Funds</i>			
Accumulated Project financing		29,009,437	25,209,480
Foreign exchange rate differences		(377,777)	(335,884)
		<u>28,631,660</u>	<u>24,873,596</u>
<i>Liabilities</i>			
Accounts payable	5	-	106,805
		-	<u>106,805</u>
Total funds and liabilities		<u><u>28,631,660</u></u>	<u><u>24,980,401</u></u>

The special purpose project financial statements were approved on June 30, 2017 by:



Galaktion Buadze
 Executive Director



Natalie Godziashvili
 Head of Financial Management and
 Investment Unit

This statement of financial position is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 10 to 14.

Sustainable Urban Transport Investment Program, Tranche 3
Statement of Project sources and uses of funds as of and for the year ended December 31, 2016
(in US Dollars)

	Actual as at 31 December 2016		Planned as at 31 December 2016		Variance	
	Year to date	Cumulative to date	Year to date	Cumulative to date	Year to date	Cumulative to date
<i>Funds received by sources</i>						
			<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>
Asian Development Bank (ADB) funds (note 6)	265,765	17,974,483				
Government of Georgia (GoG) co-financing	3,534,192	11,034,953				
Total funds received	3,799,957	29,009,436				
Foreign exchange rate differences	(41,894)	(377,777)				
<i>Less: Project expenditures</i>						
ADB loan No 3063 - GEO (note 7.1)	379,525	2,471,608	8,985,765	11,658,237	(8,606,239)	(9,186,629)
Government co-financing (note 7.2)	3,528,997	11,041,561	4,253,227	10,703,227	(724,229)	338,334
Total Project expenditures	3,908,522	13,513,169	13,238,992	22,361,464	(9,330,468)	(8,848,295)
Net flows of funds (note 8)	(150,459)	15,118,490				

This statement of Project sources and uses of funds is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 10 to 14.

Sustainable Urban Transport Investment Program, Tranche 3
 Imprest account statement (USD) as of and for the year ended December 31, 2016
 (in US Dollars)

Opening balance as of January 1, 2016	<u>14,527,823</u>
<i>Add:</i>	
ADB loan replenishment during the year	<u>-</u>
Total inflow	<u>-</u>
<i>Less:</i>	
Transfer to GEL imprest account	<u>(8,405,074)</u>
Total outflow	<u>(8,405,074)</u>
Closing balance as of December 31, 2016	<u><u>6,122,749</u></u>

This Imprest account statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 10 to 14.

Sustainable Urban Transport Investment Program, Tranche 3
 Imprest account statement (GEL) as of and for the year ended December 31, 2016
 (in US Dollars)

Opening balance as of January 1, 2016	<u>38,438</u>
<i>Add:</i>	
Transfer from the USD imprest account	8,405,074
Advances received back	<u>765,949</u>
Total inflow	<u>9,171,023</u>
<i>Less:</i>	
Works	113,824
Consulting services	50,232
Advances paid (note 4)	<u>8,959,333</u>
Total outflow	<u>9,123,389</u>
Foreign exchange rate difference	86,072
Closing balance as of December 31, 2016	<u><u>-</u></u>

This statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 10 to 14.

Sustainable Urban Transport Investment Program, Tranche 3
 Government co-financing account (GEL) statement as of and for the year ended December 31, 2016
 (in US Dollars)

Opening balance as of January 1, 2016	-
<i>Add:</i>	
Government co-financing	3,534,192
Total inflow	3,534,192
<i>Less:</i>	
Works	15,351
Consulting services	61,687
Resettlement expenses	3,451,960
Total outflow	3,528,998
Foreign exchange rate difference	5,194
Closing balance as of December 31, 2016	-

This Government co-financing account statement is to be read in conjunction with the notes to and forming part of the special purpose project financial statements set out on pages 10 to 14.

1 Background

In accordance with the Loan Agreement No. 3063-GEO signed between Georgia and the Asian Development Bank (the "ADB") on December 19, 2013 (the "Loan Agreement"), Georgia has received a loan in a total amount of USD 73,000,000 for the Sustainable Urban Transport Investment Program, Tranche 3 (the "Project").

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

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

The objective of the Project is to improve efficiency, reliability and affordability of urban transport and services. As a part of the Investment Program, the Project aims to improve efficiency, reliability and affordability of urban transport infrastructure and services in the cities of Anaklia, Rustavi and Tbilisi.

The Project includes the following main components:

- a. construction of an approximately 6.8 kilometers 4-lane urban road link between the cities of Rustavi and Tbilisi, including a 2 kilometers urban boulevard and recreational areas;
- b. construction of an approximately 1.2 kilometers coastal protection structure in the city of Anaklia;
- c. project implementation support through financial audit and independent safeguards monitoring.

The financing of Loan Agreement No. 3063-GEO is implemented through the following categories:

Category	Total Amount Allocated for ADB Financing (in USD)	Basis for Withdrawal from the Loan Account
1 Works	62,123,000	100% of total expenditure claimed (*)
2 Consulting services	934,000	100% of total expenditure claimed (*)
3 Interest and commitment charges	2,377,000	100% of amounts due
4 Unallocated	7,566,000	
TOTAL	73,000,000	

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

2 Significant accounting policies

2.1 Statement of compliance

These special purpose project financial statements have been prepared in accordance with the accrual basis of accounting and the Loan Agreement, to the extent applicable to these special purpose project financial statements and as agreed by the Company, Government of Georgia and Asian Development Bank.

2.2 Presentation currency

The national currency of Georgia is Georgian Lari (GEL). The special purpose project financial statements are presented in US dollar. All financial information presented in USD has been rounded to the nearest USD.

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

2.3 Bank balances

Bank balances consist of cash amounts in the accounts of the State Treasury of Georgia.

2.4 Advances and receivables

Advances are stated at nominal value. Advances include amounts paid to the contractor for works.

2.5 Sources of funds

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

2.6 Accounts payable

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

2.7 Project expenses

Project expenses are recognized on the accrual basis of accounting. The Project expenses financed by Government of Georgia are recognized when the funds are available for those expenditures. The accumulated Project expenses are disclosed in the statement of financial position under non-current assets.

2.8 The ADB financing

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

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

3 Closing date of the Project

In accordance with the Schedule 1 of the Loan Agreement the Project is expected to be completed by June 30, 2018.

4 Advances and receivables

As at December 31, 2016 advances and receivables comprises of advances made to a construction company (Seza Insaat San. Ve Tic. Ltd STI (Turkey)) of USD 8,995 thousand.

5 Accounts payable

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

6 Asian Development Bank funds

In US dollars

Loan No. 3063-GEO

	<u>For the year ended December 31, 2016</u>	<u>Cumulative as of December 31, 2016</u>
Direct payments	-	637,342
Reimbursement procedure	-	2,298,904
Imprest account advance	-	14,600,000
Interest and commitment charge	265,765	438,237
	<u>265,765</u>	<u>17,974,483</u>

Sustainable Urban Transport Investment Program, Tranche 3
Notes to the Special Purpose Project Financial Statements
as of and for the year ended December 31, 2016
(in US Dollars)

7 Project expenditures

7.1 From ADB funds

<i>In US dollars</i> <i>Loan No. 3603-GEO</i>	Actual as at		Planned s at		Variance	
	31 December 2016		31 December 2016		Year to date	Cumulative to date
	Year to date	Cumulative to date	Year to date	Cumulative to date		
			<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>
Works	63,529	1,969,226	8,620,000	11,120,000	(8,556,471)	(9,150,774)
Consulting services	50,231	64,145	100,000	100,000	(49,768)	(35,855)
Interest and commitment charge	265,765	438,237	265,765	438,237	-	-
Total	379,525	2,471,608	8,985,765	11,658,237	(8,606,239)	(9,186,629)

7.2 From government co-financing funds

<i>In US dollars</i>	Actual as at		Planned s at		Variance	
	31 December 2016		31 December 2016		Cumulative to date	Year to date
	Year to date	Cumulative to date	Year to date	Year to date		
			<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>	<i>Unaudited</i>
Works	15,350	358,376	783,267	1,233,267	(767,916)	(874,891)
Consulting services	61,687	83,693	18,000	18,000	43,687	65,693
Resettlement expenses	3,451,960	10,599,492	3,451,960	9,451,960	-	1,147,532
Total	3,528,997	11,041,561	4,253,227	10,703,227	(724,229)	338,334

8 Net flows of funds

<i>In US dollars</i>	For the year ended	As of
	December 31, 2016	December 31, 2016
Decrease in bank balances	(8,405,074)	6,122,749
Increase in advances	8,147,810	8,995,742
Decrease in accounts payable	106,805	-
	(150,459)	15,118,491

9 Reconciliation between the amounts received by the Fund and disbursed by the Asian Development Bank

For the year ended December 31, 2016

Loan Agreement No. 3063-GEO

In US dollars

Category	Appl.	The Fund	ADB	Difference
Interest and commitment charge	CAP	104,283	104,283	-
	CAP	161,482	161,482	-
		<u>265,765</u>	<u>265,765</u>	<u>-</u>

10 Project implementation

As of December 31, 2016 only 3,39 % of the Project has been implemented in the framework of the Loan Agreement. The Project expenses by categories (in percentages) are presented in the table below:

Category	Amounts disbursed in %
Works	3.17%
Consulting Services	6.87%
Interest and commitment charge	18.44%
Total	3.39%

11 Commitments and contingencies

Management is not aware of any commitments and contingencies which would have a material impact on this special purpose project financial statements as of December 31, 2016 for the year then ended.

12 Georgian operating environment

The Fund's operations are located in Georgia. Consequently, the Fund is exposed to the economic and financial markets of Georgia, which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The special purpose project financial statements reflect management's assessment of the impact of the Georgian operating environment on the operations of the Fund. The future operating environment may differ from management's assessment.

13 Events subsequent to the balance sheet date

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