

MUNICIPAL DEVELOPMENT FUND OF GEORGIA

LOAN NO.8494-GE
(THIRD REGIONAL DEVELOPMENT PROJECT)

Special Purpose Project Financial Statements and
Independent Auditor's Report
For the Year Ended 31 December 2019

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

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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 2019

Management of the Third Regional Development Project (the "Project") 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 financial position of the Project as at 31 December 2019, and the summary of sources and uses of funds, summary of expenditure by activity, statement of expenditure (SOE), statement of designated account, in compliance with the basis of accounting described in Note 2 the accompanying special purpose project financial statements.

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; and
- 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.

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;
- 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 2019 were authorised for issue on 29 June 2020 by the Management.

On behalf of Management:


Giorgi Shengelia
Executive Director



29 June 2020


Levan Sharvadze
Deputy Director – Chief Financial Officer

29 June 2020

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 the Third Regional Development Project (the "Project") financed under the Loan Agreement No. 8494-GE dated 7 August 2015 (the "Agreement"), implemented by the Municipal Development Fund of Georgia, which comprise the Project's summary of sources and uses of funds for the year ended 31 December 2019, statement of financial position as at 31 December 2019, summary of expenditure by activity, statement of expenditure ("SOE") and statement of designated account for the year ended 31 December 2019 and a summary of significant accounting policies and other explanatory notes (collectively referred to as the "special purpose project financial statements").

In our opinion, the accompanying special purpose project financial statements for the year ended 31 December 2019 are prepared, in all material respects, in accordance with the Loan Agreement No. 8494-GE dated 7 August 2015, as further detailed in Note 2.

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.

Other matter

Data included on pages 4 to 13 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 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. 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 in reporting the information to 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 Special Purpose Project 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 financial reporting provisions of the Agreement 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.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

Auditor's 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 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 special purpose project financial statements.

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

- Identify and access the risks of material misstatement of the special purposes 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.

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.


Stuart Leighton
On behalf of Deloitte and Touche LLC


29 June 2020
Tbilisi, Georgia

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

**SUMMARY OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in US Dollars)**

	Actual		Planned**		Variance		Project appraisal document
	Year ended 31.12.2019	Cumulative as at 31.12.2019	Year ended 31.12.2019	Cumulative as at 31.12.2019	Year ended 31.12.2019	Cumulative as at 31.12.2019	
OPENING WORKING CAPITAL							
Cash	2,810,639	-					
Prepayments	1,725,296	-					
Payables	(269,360)	-					
	4,266,575						
SOURCES OF FUNDS							
IBRD loan	6,437,183	21,514,341					60,000,000
Government of Georgia	1,360,057	4,838,953					15,000,000
Other income*	-	64,784					-
TOTAL	7,797,240	26,418,077					75,000,000
EXPENDITURES							
Works and goods, consulting service, training	7,717,384	21,512,104	8,865,000	22,659,720	1,147,616	1,147,616	73,812,500
Operating costs	351,076	821,061	530,000	999,985	178,924	178,924	1,000,000
Front-end fee	-	150,000	-	150,000	-	-	150,000
TOTAL	8,068,460	22,483,165	9,395,000	23,809,705	1,326,540	1,326,540	74,962,500
Foreign exchange loss, net	(94,763)	(34,321)					
CLOSING WORKING CAPITAL							
Cash	4,002,316	4,002,316					
Prepayments	567,135	567,135					
Other receivables	29,403	29,403					
Payables	(698,262)	(698,262)					
TOTAL	3,900,592	3,900,592					

*Other income for the year ended 31 December 2019 represent penalty amount paid by the counterparty.

** The initial budgeted figures are updated several times during the year. Planned figures for the year ended 31 December 2019 included in the IFR (interim financial report) represent the final budgeted figures reflected in the State Budget for FY2019 adjusted to the accrual model, which have not been audited.

On behalf of Management:


Giorgi Shergelidze
Executive Director


Levan Shavadze
Deputy Director – Chief Financial Officer

29 June 2020

29 June 2020

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

**STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2019
(in US Dollars)**

	Note	31 December 2019	31 December 2018
ASSETS			
IBRD designated account	3,9	4,002,316	2,810,639
Prepayments	7	567,135	1,725,296
Other receivables		29,403	-
TOTAL ASSETS		4,598,854	4,535,935
LIABILITIES			
Payables		698,262	269,360
TOTAL LIABILITIES		698,262	269,360
NET (LIABILITIES)/ASSETS		3,900,592	4,266,575
Funds received:			
IBRD loan		21,514,340	15,077,158
Government of Georgia		4,838,953	3,478,896
Other income		64,784	64,784
Total funds received		26,418,077	18,620,838
Expenditure:			
Project expenditure	8	22,483,165	14,414,705
Total expenditures		22,483,165	14,414,705
Foreign exchange (loss)/gain, net		(34,321)	60,442
TOTAL NET ASSETS		3,900,592	4,266,575

On behalf of Management:


Giorgi Shengelia
Executive Director

29 June 2020


Levan Sharvadze
Deputy Director – Chief Financial
Officer

29 June 2020

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.


**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

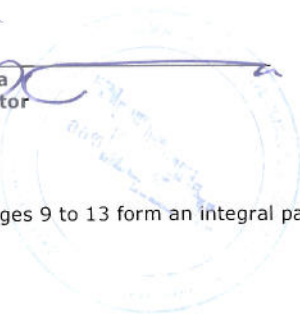
**SUMMARY OF EXPENDITURE BY ACTIVITY
FOR THE YEAR ENDED 31 DECEMBER 2019
(in US Dollars)**

Project activities	Actual		Planned*		Variance	
	Year ended 31.12.2019	Cumulative as at 31.12.2019	Year ended 31.12.2019 <i>Unaudited</i>	Cumulative as at 31.12.2019 <i>Unaudited</i>	Year ended 31.12.2019 <i>Unaudited</i>	Cumulative as at 31.12.2019 <i>Unaudited</i>
Component 1: Infrastructure investment	6,492,503	16,552,878	8,865,000	22,659,720	2,372,497	6,106,842
Component 2: Institutional development	1,575,957	5,780,287	530,000	999,985	(1,045,957)	(4,780,302)
Front end fee	-	150,000	-	150,000	-	-
TOTAL EXPENDITURES	8,068,460	22,483,165	9,395,000	23,809,705	1,326,540	1,326,540

* The initial budgeted figures are updated several times during the year. Planned figures for the year ended 31 December 2019 included in the IFR (interim financial report) represent the final budgeted figures reflected in the State Budget for FY2019 adjusted to the accrual model, which have not been audited.

On behalf of Management:


Giorgi Shengelia
Executive Director



29 June 2020


Levan Sharvadze
Deputy Director – Chief Financial Officer

29 June 2020

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

**STATEMENT OF EXPENDITURE ("SOE")
FOR THE YEAR ENDED 31 DECEMBER 2019
(in US Dollars)**

Withdrawal No.	Withdrawal application date	Total SOE	Works, Goods, Consulting services and training	Operating costs
9	14.01.2019	2,189,361	2,175,867	13,494
10	20.06.2019	1,250,665	1,209,099	41,566
12	20.10.2019	1,783,921	1,602,364	181,557
14	13.12.2019	999,936	954,019	45,917
		6,223,883	5,941,349	282,534

On behalf of Management:



Giorgi Shengelia
 Executive Director

29 June 2020



Levan Sharvadze
 Deputy Director – Chief Financial Officer

29 June 2020

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
LOAN NO.8494-GE**

**STATEMENT OF DESIGNATED ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2019
(in US Dollars)**

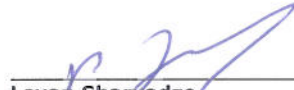
Account No.	202255093
Depository Bank	State Treasury
Address	16 V. Gorgasali street Tbilisi, 0114 Georgia

Opening Balance		<u>2,810,639</u>
Funds received from IBRD		6,223,883
Present outstanding amount advanced to Designated Account (DA)		<u>9,034,522</u>
Designated Account (DA) closing balance as at 31 December 2019		4,002,316
Add: Amount of eligible expenditures paid	9	<u>5,032,206</u>
Total advance accounted for		<u>9,304,522</u>

On behalf of Management:


Giorgi Shengelia
Executive Director

29 June 2020


Levan Sharvadze
Deputy Director – Chief Financial
Officer

29 June 2020

The notes on pages 9 to 13 form an integral part of these special purpose project financial statements.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)
(in US Dollars)**

1. BACKGROUND

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 Fund 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 majority of large investment banks and financial institutions operating in Georgia.

The International Bank for Reconstruction and Development Loan Agreement No. 8494-GE (the "Agreement") in the amount of 60 million United States Dollars ("USD") was signed between the Government of Georgia ("GoG") and International Bank for Reconstruction and Development ("IBRD") on 7 August 2015 ("inception").

The main objectives of the loan are: providing finance for Investment Subprojects for the urban regeneration of old towns and villages in the Samtskhe-Javakheti and Mtkheta-Mtianeti regions; support Local Self Governments in financing investment subprojects for the creation of public infrastructure to attract private sector investments; enhance the institutional capacity and performance of the Georgia National Tourism Administration, the Agency for Culture Heritage Preservation of Georgia, the National Museum, MDF and other local and regional entities. The closing date of the loan was 31 December 2019. On 22 October 2019 the closing date of the loan has been prolonged up to 31 December 2022.

2. ACCOUNTING POLICIES

Basis of accounting – These special purpose project financial statements have been prepared in accordance with the provisions of the Loan Agreement No. 8494-GE dated 7 August 2015 to the extent applicable to these special purposes financial statements and as agreed by the Fund, Government of Georgia and International Bank for Reconstruction and Development (IBRD).

The special purpose project financial statements have been prepared on the accrual basis of accounting.

These special purpose project financial statements, in accordance with the provisions of the Agreement, are prepared to report the information to the Government of Georgia and International Bank for Reconstruction and Development. As a result these special purpose project financial statements may not be suitable for another purpose.

Sources of funds – 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. The accumulated project financing is disclosed under "Funds" in the statement of financial position. In addition current year funds received is disclosed in the Statement of Sources and Uses of Funds, showing under sources funds and expenditures respectively.

Expenditure - is recognised on an accruals basis as a use of project funds when liabilities are incurred. The accumulated project expenditures is disclosed under "Expenditure" in the statement of financial position.

Functional currency – The functional currency of the project and its presentational currency is United States Dollars ("US Dollar" or "USD").

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)
(in US Dollars)**

Transactions in other currencies – Transactions in currencies other than the reporting currency 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.

Prepayments – Prepayments represent the amounts paid to the contractors for work.

Cash – Cash comprises balances with State Treasury.

3. DESIGNATED ACCOUNT

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.

4. BASIS OF FUNDING

According to the terms of the Agreement, the expenditure is co-financed by proceeds received from IBRD and the Government of Georgia (GoG) at a proportional rate of 80% and 20%, respectively.

	<u>IBRD</u>	<u>GoG</u>	<u>Total</u>
Works and goods, non-consulting service, consulting service, training	59,050,000	14,800,000	73,850,000
Operating costs	800,000	200,000	1,000,000
Front-end fee	150,000	-	150,000
Total:	<u>60,000,000</u>	<u>15,000,000</u>	<u>75,000,000</u>

5. METHODS OF WITHDRAWAL

The methods of withdrawal used from the inception of the loan to 31 December 2019 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 International Bank for Reconstruction and Development (IBRD) with authorised signatures. The replenishment requests and respective documentation are reviewed by IBRD 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 International Bank for Reconstruction and Development directly to third parties. MDF forms withdrawal applications for request of direct payments and sends it to the IBRD, 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
THIRD REGIONAL DEVELOPMENT PROJECT
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (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; and
- (iv) All expenditures for goods and non-consulting services valued at less than USD 300,000;

7. PREPAYMENTS

	<u>31 December 2019</u>	<u>31 December 2018</u>
Advances to contractors	567,135	1,725,296
Total:	<u>567,135</u>	<u>1,725,296</u>

Payments of advances to contractors are made at the beginning of the contract in the amount of 10%-20% of the total contract amount. Recovery of advance is done periodically, upon submission of works completed certificates by contractors.

8. PROJECT EXPENDITURE BY FUNDS

Project activities	Actual	
	<u>Year to date</u>	<u>Cumulative to date</u>
Works and goods, non-consulting service, consulting service, training	6,114,751	16,826,521
Operating cost	281,163	630,616
Front end fee	-	150,000
IBRD TOTAL	<u>6,395,914</u>	<u>17,607,137</u>
Works and goods, non-consulting service, consulting service, training	1,602,633	4,686,169
Operating cost	69,913	189,859
GoG TOTAL	<u>1,672,546</u>	<u>4,876,027</u>
TOTAL PROJECT EXPENDITURE	<u>8,068,460</u>	<u>22,483,165</u>

The Project consists of the following main components:

Component 1 – Infrastructure investment

- Urban regeneration of old towns and villages, including restoration of building facades and roofs, public spaces, museums, etc.; and
- Provision of public infrastructure to attract private investments

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
THIRD REGIONAL DEVELOPMENT PROJECT
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)
(in US Dollars)**

Component 2 - Institutional development

- Support institutional capacity and performance of the Georgia National, Tourism Administration (GNTA), National Agency for Culture Heritage Preservation of Georgia (NACHP), National Museum, Project Implementing Entity (MDF), and other local and regional entities.

9. RECONCILIATION OF DESINGATED ACCOUNT

	<u>IBRD</u>	<u>GoG</u>	<u>Total</u>
Expenditures incurred during the year	6,395,914	1,672,546	8,068,460
Direct payment	(213,300)	-	(213,300)
Change in prepayments	(904,814)	(223,944)	(1,128,758)
Change in payables	(324,081)	(104,820)	(428,901)
Foreign exchange	78,487	16,275	94,762
Amount of eligible expenditure paid	<u>5,032,206</u>	<u>1,360,057</u>	<u>6,392,263</u>

10. COMMITMENTS AND CONTINGENCIES

Management is not aware of any commitments and contingencies which would have a material impact on the financial position of the Project and the Special Account Statement as at 31 December 2019 and on the funds received and disbursed during the year then ended.

11. 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.

For the last two years Georgia has experienced a number of legislative changes, which have been largely related to the European Union Association Agreement. Whilst the legislative changes implemented during 2016 and 2017 paved the way, more can be expected as Georgia's action plan for achieving accession to the European Union continues to develop.

In addition to that, starting from early 2020 a new coronavirus disease (COVID-19) has begun rapidly spreading all over the world resulting in announcement of the pandemic status by the World Health Organization in March 2020. Responses put in place by many countries to contain the spread of COVID-19 are resulting in significant operational disruption for many companies and have significant impact on global financial markets. As the situation is rapidly evolving it may have a significant effect on business of many companies across a wide range of sectors, including, but not limited to such impacts as disruption of business operations as a result of interruption of production or closure of facilities, supply chain disruptions, quarantines of personnel, reduced demand and difficulties in raising financing. In addition, the Fund may face the increasingly broad effects of COVID-19 as a result of its negative impact on the global economy and major financial markets. The significance of the effect of COVID-19 on the Fund's operations largely depends on the duration and the incidence of the pandemic effects on the world and Georgian economy.

**MUNICIPAL DEVELOPMENT FUND OF GEORGIA
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**NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)
(in US Dollars)**

The economic shock caused by the coronavirus and the expectations of the future development of pandemic and its impact on the Georgian economy have been reflecting on increased volatility of the foreign exchange market and weakening of Georgian Lari against other currencies

Management is unable to predict all developments which could have an impact on the Georgian economy and consequently what effect, if any, they could have on the future financial position of the Project. Management believes it is taking all the necessary measures to support the sustainability and development of the Project's operations.

12. SUBSEQUENT EVENTS

Subsequent to the year end, no events have occurred that require disclosure in the special purpose project financial statements or adjustment to the reported figures.