Financial Management Assessment

Project Number: 53118-001
October 2021

Georgia: Livable Cities Investment Project for Balanced Development

CURRENCY EQUIVALENTS
(as of 15 December 2020)

Currency unit – Georgian lari (GEL)
GEL 1.00 = US$0.304
US$1.00 = GEL 3.287

ABBREVIATIONS

ADB	Asian Development Bank
APFS	Annual Project Financial Statements
CFO	Chief Financial Officer
CHU	Central Harmonization Unit
CPS	Country Partnership Strategy
CSB	Civil Service Board
EA	Executing Agency
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
FMA	Financial Management Assessment
FMICRA	Financial Management, Internal Control and Risk Assessment
GOG	Government of Georgia
IA	Implementing Agency
IAD	Internal Audit Department
IAMS	Internal Audit and Monitoring Service
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISSAI	International Standards of Supreme Audit Institutions
LCIP	Livable Cities Investment Project for Balanced Development
MDF	Municipal Development Fund
MFF	Multi-tranche Financing Facility
MIS	Management Information System
MOF	Ministry of Finance
MRDI	Ministry of Regional Development and Infrastructure
MSDA	Municipal Service Development Agency
PEFA	Public Expenditure and Financial Accountability
PIE	Public Interest Entity
PFM	Public Financial Management
SAO	State Audit Office
SOE	Statement of Expenditure
SUTIP	Sustainable Urban Transport Investment Program
TCM	Tbilisi City Municipality
TDF	Tbilisi Development Fund

NOTE

(i) In this report, “$” refers to US dollars.

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I. EXECUTIVE SUMMARY

1. The Asian Development Bank (ADB) is processing the Livable Cities Investment for Balanced Development (LCIP, the Project) upon request from the Government of Georgia (GOG). The Project, financed by a sector loan, involves the rehabilitation of building and supporting infrastructure in villages and towns, the development of urban infrastructure to promote tourism, the construction of libraries, youth centers and kindergartens, and the construction of roads to link villages to major highways. This report provides findings and conclusions related to the financial management assessment (FMA) carried out on the Ministry of Regional Development and Infrastructure (MRDI) and Tbilisi City Municipality (TCM), the two Executing Agencies (EAs) for the Project, and the Municipal Development Fund (MDF) and the Tbilisi Development Fund (TDF), the two Implementing Agencies (IAs).

2. MRDI has significant experience in executing projects for ADB and other International Financial Institutions (IFI). It has well developed financial and reporting structures, and significant experience in coordinating the budget requests, and subsequent implementation, for its operating agencies, including MDF. Its Internal Audit Department (IAD) is responsible for the internal audit of MRDI and all operating agencies, including MDF. The IAD is fully staffed and experienced in the internal audit of projects supported by IFIs including ADB.

3. MDF has demonstrated satisfactory financial management performance during the implementation of its on-going program, including the Sustainable Urban Transport Investment Program (SUTIP) financed by ADB, where it has a dedicated ADB Project Implementation Unit (PMU) that is responsible for all IA responsibilities. The accounting and finance function of MDF is well staffed and is governed by adequately documented policies and procedures, tools and templates. Finance staff dedicated to the SUTIP program have been with MDF for more than 5 years, with good knowledge of ADB procedures in the accounting and finance department. Financial reporting at entity level is performed using International Financial Reporting Standards (IFRS), while internal reporting is also undertaken under national standards to meet the reporting requirements of MRDI. The external audit process has operated timely with no major issues raised at the Entity level. Several budgetary safeguards are built into the planning and budget drawdown process, with adequate segregation of duties. MDF as an Entity is largely self-funded, with most non-project expenditure financed from interest income earned on bank accounts and some loans to municipalities and related bodies. It has limited long term loans, and based on the current funding mode, it is financially stable.

4. TCM has no experience in executing projects for ADB and limited experience with other IFIs. Its financial accounts are prepared under national standards, with its policies largely based on orders prepared by the Tbilisi City Council and regulations prepared by Ministry of Finance. From 2021, TCM and other municipalities are to develop financial statements under the International Public Sector Accounting Standards (IPSAS) cash modified basis. This change will require TCM to prepare a detailed policy manual to support its internal processes. Budgetary processes appear effective and allow TCM to support and coordinate the budgetary needs of TDF. Its Internal Audit department is well established and is involved in the internal audit of TDF. However, the Internal Audit department does not have any experience in the audit of projects supported by ADB and other IFIs, and hence will need training in this area.

5. Financial management risks are most acute for TDF due to it not having previous experience with ADB or related projects. Its accounts are prepared under national standards, with delays experienced in financial audits performed by the State Audit Office (SAO). A recent

compliance audit by SAO highlighted weak project and financial management practices. TDF has presented an Action Plan to SAO to address these weaknesses and has already implemented two of the proposed measures. Like TCM, accounts are prepared under national standards with accounting policies determined by internal orders. The introduction of the IPSAS cash modified approach is expected to be introduced consistent with the timeframe for TCM. ADB is already supporting TDF through the set-up of a PIU, which is essential to enhance financial management and procurement practices. Recently appointed PIU staff have experience of ADB and IFI implementation procedures. The PIU will assist TDF in preparing annual project financial statements (APFS) for 2020 under existing Project Readiness Financing.

6. The overall project pre-mitigation financial management risk is assessed as "substantial" because of identified TCM and TDF risks. Identified actions to mitigate these risks include extensive training on ADB procedures for relevant financial staff in TCM and TDF, support to the Internal Audit division in TCM, the introduction of financial accounts based on IPSAS cash-modified by 2021 in TCM and TDF and requiring timely presentation of external audits in both entities. For MDF and MRDI there is an ongoing need for training on ADB procedures, including for MRDI's IAD.

II. INTRODUCTION

7. This Financial Management Assessment (FMA) was conducted in accordance with ADB's Guidelines for the Financial Management Technical Guidance Note for the Financial Management Assessment (May 2015). The FMA was prepared during the second half of 2020 and examines the financial management capacity of the project EAs and IAs. Financial management questionnaires were filled in for each EA and IA as part of this process.

8. The principal objective of the FMA was to evaluate the suitability of the EA's and IA's systems and capacities to effectively managing risks to ADB's project funds and to ensure that the Project funds are used economically and efficiently for the purposes intended. For the EA's the FMA focused on governance and accountability. For the IA's the FMA focused at assessing the design and effectiveness of the IA's financial management and related governance systems including planning, budgeting, accounting, internal control, corporate governance, financial reporting, internal audit, and external audit. The FMA also assessed the financial management capacity of the IA's with reference to the proposed funds flow arrangement for the Project.

9. This assessment is based on: (i) the results of the FMA questionnaire; (ii) discussions with financial management and other staff of MRDI, TCM, MDF and TDF; (iii) information available through various reports, manuals, regulations, annual financial statements and audit reports; and (iv) ADB's prior and current experience with the EAs and IAs in terms of compliance with financial management requirements of projects.

III. BRIEF PROJECT DESCRIPTION

10. The ADB plans to support the urban development in Georgia through its Livable Cities Investment Project for Balanced Development. The project involves the rehabilitation of building and supporting infrastructure in villages and towns, the development of urban infrastructure to promote tourism, the construction of libraries, youth centers and kindergartens, and the construction of roads to link villages to major highways.

IV. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

A. Country Partnership Strategy

11. ADB's *Country Partnership Strategy* (CPS) 2014–2018 aimed to support improved public financial management.[1] The CPS (2019-2023) noted significant improvements in public financial management systems, however, it also noted residual challenges within the systems and capacities resulting in potential fiduciary risks including weak project appraisal and selection procedures for public investments, inadequate institutional and regulatory setup for monitoring state-owned enterprise performance and limited analysis of expenditure and revenue implications of policy changes. Over the short to medium term, the CPS (2019-2023) aims at helping the GOG in strengthening the public financial management systems through a series of capacity building events for project executing and implementing agencies, while continuing to support Georgia's private auditor quality assurance program. For the long term, the CPS (2019-2023) mentions ADBs' participation in discussions with donors and the government to outline a roadmap strategy for public financial management strengthening.

B. Public Financial Management

12. Georgia's public financial management (PFM) systems have significantly improved over the last decade. The public expenditure and financial accountability (PEFA) assessment report – 2018. The country embarked on a PFM Reform Action Plan in 2007 and has made significant improvements by successfully implementing short-term PFM reform strategies in the areas of fiscal governance, transparency, budget reliability and execution, and external scrutiny and audit.[2]

13. Georgia underwent a PEFA Performance Assessment during 2018. The assessment concluded that public financial management systems in Georgia are strong and have improved since 2016. Aggregate fiscal discipline is achieved through control over spending as well as realistic revenue forecasts. Strong revenue administration ensures that revenues are collected efficiently. The Chart of Accounts caters for a multi-dimensional analysis of expenditure. Expenditures perform according to plan. Treasury operations and cash management enables expenditures to be managed within available resources. Control of contractual commitments is effective, as demonstrated by limited expenditure arrears. The strong external audit function enhances fiscal discipline, but only at the individual budgetary units because the consolidated financial statement is not yet audited. A debt management strategy is being developed. The PEFA also noted steady progress towards a comprehensive medium-term expenditure framework. Georgia was assessed to have an effective budget calendar.

14. The GOG makes extensive use of information technology (IT) for budget preparation and execution, personnel and payroll, revenue services, and procurement. IT solutions have largely been developed in-country, which allows wide dissemination of budgetary information to relevant stakeholders. External audit was assessed as effective. The internal audit function is improving though its coverage does not yet reach all budgetary units. Consolidated financial reports for central government budgetary units can readily be compared with approved budgets. The financial statements of individual budgetary units are audited however a consolidated audited financial statement is not generated within existing reporting framework. Finally, weaknesses in investment management impact resource allocation and efficiency.

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[1] Page 12 (Results Framework – Government Sector Objectives #4. Public Sector Management).

[2] World Bank. 2018. Georgia *Public Expenditure and Financial Accountability Performance Assessment Report*. Washington, D.C.

15. The accounting and auditing professions are regulated under the "Law of Georgia on Accounting, Reporting and Auditing issued in 2016 (the Law). Article 3 of the Law specifies legal framework for accounting and reporting including public interest entities (PIEs). The law requires PIEs to prepare financial statements using the International Financial Reporting Standards (IFRS). Article 14 of the Law provides legal framework for the conduct of audits. The audits of PIEs shall be performed in accordance with International Standards on Auditing (ISA).

V. PROJECT FINANCIAL MANAGEMENT SYSTEM

16. Entity level assessment of financial management systems is carried out for the Executing Agencies and Implementing Agencies involved in this project. According to ADB Project Administration Instructions (October 2020), the executing agency is identified in a financing agreement or Technical Assistance agreement and is responsible for the carrying out of a loan, grant or a TA grant-funded project. An implementing agency is an organization that the EA designates to implement the project and recruit consultants.

A. Ministry of Regional Development and Infrastructure (EA)

Performance under existing ADB projects:

17. MRDI is the EA for the Sustainable Urban Transport Investment Program (SUTIP), financed by the ADB under a Multi-tranche Financing Facility (MFF) with 5 tranches and 6 loans totaling $244 million. The Municipal Development Fund of Georgia (MDF) is the Implementing Agency for the SUTIP project. MRDI is also the EA for the following ADB financed loans in the transport sector, for which the Roads Department of Georgia is the IA, supported by the Eurasian Transport Corridor Investment Center (ETCIC) of MRDI for financial management issues:

- Secondary Road Improvement Project (SRIP) Loan 3524 GEO ($80 million).
- Batumi Bypass Road Project (BBRP) Loan 3520 GEO ($114 million, additional loan from Asian Infrastructure Investment Bank of $114 million).
- East–West Highway (Khevi–Ubisa Section) Improvement Project Loan 3715 GEO ($300 million, additional loan from World Bank of $140 million).
- North–South Corridor (Kvesheti–Kobi) Road Project Loan 3803 GEO ($415 million, additional loan from EBRD of $60 million).
- East–West Highway (Shorapani–Argveta Section) Improvement Project Loan 3861 GEO ($278 million).

18. In addition, for the World Bank funded Transport Reform and Rehabilitation Center Loans Nº 8547-GE and Nº8788-GE (East-West Highway Corridor Improvement Project), ADB has a separate sub-component for MRDI capacity building.

19. Based on interviews and available documents, no major issues with MRDI's role in these projects has been identified.

Legal status and related entities:

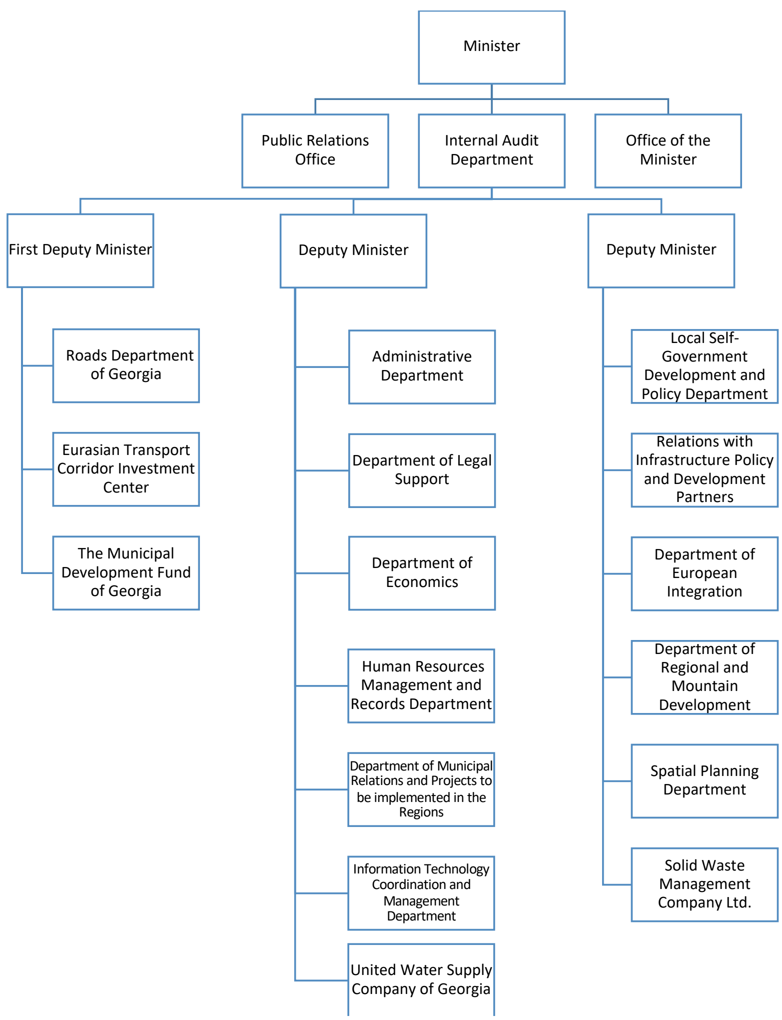
20. MRDI is a Government Ministry, whose jurisdiction includes local and regional development policy, water supply development and the development and design of road networks. It is headed by a Minister and supported by a First Deputy Minister and two Deputy

Ministers. The following four main agencies operate under MRDI:

- Roads Department of Georgia, responsible for road development and integrating road infrastructure with European standards.
- MDF, which has the objective of enhancing the institutional and financial capacities of local self-governmental bodies, making investments in local infrastructure and services, and improving economic and social conditions for the local population.
- United Water Supply Company of Georgia, which provides water and wastewater services throughout the country.
- LTD Solid Waste Management Company of Georgia, responsible for waste disposal.

21. The organizational structure of MRDI, including responsibilities for the key agencies, is set out below.

Figure 1: Organizational Structure of MRDI



22. Key financial activities are carried out under the Department of Economics, which has a Head of Department and Deputy Head and two operating Units: the Economic Analysis Unit, with 3 staff members including the Head of Unit; and the Monitoring and Finance and Budgeting Unit

with 6 staff members including the Head of Unit. Staff are employed on permanent, automatically renewable contracts. At present, all positions are currently filled.

23. Staff in the Financing and Budgeting Unit are not responsible for project/loan financial management and accounting, this being the responsibility of the IA for all key projects where MRDI is the EA. MRDI does not have a formal training policy in place, though staff regularly participate in training. Finance staff are also required to participate in training provided by Finance Academy of the Ministry of Finance.[3]

General policies and procedures

24. MRDI is subject to Ethics and Code of Conduct requirements of the Civil Service Board (CSB). On April 20, 2017, the CSB issued Decree No. 200 'General Code of Ethics and Conduct for the Civil Service", which guides the professional standards of civil servants and implementing fundamental principles and values in the civil service. The CSB has also published a Handbook on Ethics and Code of Conduct in the civil service. Both the Decree and the Handbook apply to MRDI's staff.

Accounting policies and procedures

25. MRDI uses accrual basis accounting for entity-level accounts, following GOG standards based on the IPSAS cash modified approach. A standard Government Chart of Accounts is used to develop these accounts. MRDI is in the process of developing a Financial Management Manual, which will provide policies and procedures for Financial Reporting, Accounting and Internal Control. A private consultant firm has been contracted for this purpose, with a draft final version to be submitted for approval by the end of December 2020.

26. Safeguards against conflicts of interest are outlined and regulated in the Law on Conflict of Interest and Corruption in Public Institutions (2015, as amended). This applies to all staff. Moreover, Chapter VII of the Ministry of Finance's Decree No. 429 of December 31, 2014 'On Accounting and Financial Reporting of Budget Organizations' provides requirements for related party disclosures.

27. Retention of accounting document is undertaken consistent with the Minister of Justice's Order No. 72 of 31 March 2010 on the 'List of Typical Governance Documents Created in the Process of Establishment of the Institutions. The Administrative Department of MRDI is responsible for archive maintenance. After six years, MRDI moves documents to a Central Archive.

28. MRDI does not have bank accounts nor cash operations. A list of expenses is automatically generated by the GOG's e-Treasury system on a daily basis, which is reconciled with accounting records. Where payments are required, these are made via the e-Treasury system: The Head of Finance and Budget Unit and Chief Accountant is responsible for confirming registration of the relevant contract and liabilities, drafting the Payment Orders, Currency Conversion Applications and telexes. The Head of the Economics Department and Line Deputy Minister is responsible for their subsequent approval.

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[3] Finance staff have recently participated in the following courses: General Principles of Financial Reporting for State Funded organizations (2017); Mandatory and Selective review of Inventories in State Funded Organization (2019); General Principles of Accounting in the Public Sector (2019); IPSAS and changes in Accounting for State Funded Entities (2020); Accounting in State Funded Entities by IPSAS (2020).

29. MRDI maintains a fixed asset register. Ministry of Finance’s Decree No. 429 of 31 December 2014 states in Article 151 (Operations and other events with non-financial assets) that the value of assets must be reflected in the financial statements as of the last business day of each reporting year. The MRDI fixed asset register covers furniture, equipment, machinery and any other capital assets. It includes a description of the asset, date received, cost or estimated (market) value, unique serial numbers, location and an indication if it was purchased or donated. All staff are responsible and accountable for fixed assets in their possession. Periodic inventories are carried out, with old or obsolete assets written off at the end of the fiscal year.

Planning and budgeting

30. The Finance and Budget Unit of the Department of Economics is responsible for preparing MRDI’s Budget Application, with support from the Procurement Unit. The Finance and Budget Unit collates information from all Departments and Units within MRDI, following which it prepares a draft of the budget application for MRDI’s administration. The Head of Department of Economics then agrees the budget application, including for all Agencies operating under MRDI, with the Head of relevant Departments and with each Deputy Minister. A final consolidated draft of the budget application for MRDI is then prepared and agreed with Minister. The first draft of the consolidated budget application will be sent to the MOF by August. The MOF may then request changes and corrections, after which a consolidated revised application will sent to MOF for Parliament’s approval.

31. Financial reporting against the budget is generally done quarterly, although monthly reporting is adopted towards year-end. Any budgetary variations must be approved in advance. Moreover, the e-Treasury system automatically blocks disbursement where there is no remaining balance. For the first two quarters of the year, budget variations could be prepared based on roll-forwarding allocations of the last two quarters of the previous year for relevant items. Starting from Q3, requests for changing the budgetary allocation between projects and programs under MRDI can be mode. From the middle of November, the Ministry can request from MOF additional funds for the Projects from reserved amounts by other Ministries or from any suitable sources via changes in Budget Law. No major deviations from budget allocations have been reported over the past three years.

Internal audit

32. MRDI has an Internal Audit Department (IAD) that reports directly to the Minister. It has 7 positions, all of which are currently filled. The structure involves a Head of Internal Audit; two First Category Senior Specialists; and four Second Category Senior Specialists. Three staff – the two First Category Senior Specialists and one Second Category Senior Specialist - are responsible for the audit of projects financed by IFIs. The Internal Audit program is guided by the International Standards for the Professional Practice of Internal Auditing and Standards of Internal Auditing.

33. The overall staff capacity is considered good. The Internal Auditors are full time employees. The 3 staff responsible for IFIs (two First Category Senior Specialists and one Second Category Senior Specialist), have higher educational qualifications and 41, 23- and 7-years’ experience respectively.[4] All three have audit experience in projects funded by ADB, and have all

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[4] Specifically, as of November 2020: First Category Senior Specialist Ms. Zhana Kotolashvili has a master’s degree in computerized system’s engineering and 23 years of work experience, working specifically in internal audit since 2013

been in the IAD for at least 4.5 years. The IAD includes staff with a background in Information Technology. Furthermore, staff have attended training programs run by USAID and UNDP specifically tailored to the needs of internal audit.

34. The IAD has an annual plan which includes the audit of MRDI, Roads Department, MDF, Sold Waste Management and ETCIC. The IAD can also have unplanned audits if the Minister deems necessary. In general, the plan is developed based on the experience of the previous years, with priority given to entities or Departments considered high risk. The IAD first assesses the risk levels of the organization, considering issues like findings of the previous audit, project delays and cases of contract termination. Based on this assessment, IAD prioritizes organizations for the audit program. However, there are several ongoing activities, including the internal audit of consolidated Financial Statements for budget units and LEPLs under the control of the MRDI.

35. An annual Internal Audit report is sent to the Minister and its recommendations are binding. The monitoring of the implementation of the recommendations given by the IAD is an integral part of its annual program/plan. Twice a year, the IAD sends the company/organization they investigated a follow-up questionnaire to check progress and requests the necessary documentation that demonstrate the recommendations are being implemented. Over recent years, the internal audit process has not reported any issues with reference to availability and completeness of records.

36. The Central Harmonization Unit (CHU) of the Public Internal Control Department of the Ministry of Finance is responsible for coordinating the system of Public Internal Financial Control, including the internal audit system through the Georgian Public Sector. The CHU maintains a close relationship with all interested parties of the system, including all budgetary institutions, the Civil Service Bureau and the State Audit Office. The IAD of MRDI meets regularly with CHU.

External audit

37. MRDI is audit by the State Audit Office (SAO) on annual basis. SAO applies the International Standards of Supreme Audit Institutions (ISSAI).

38. During last 3 years, the major recommendation of SAO has been the need for MRDI to develop a detailed Financial Management Manual setting out its Accounting, Financial Reporting and Monitoring policies and procedures. A draft is being prepared and is due to be presented by December 2020. A key detailed issue raised by the auditors is an inability to split cumulative Works in Progress reported in MRDI's consolidated Financial Statements by Projects and the Roads Sections.

Reporting and monitoring

39. The main reports issued by MRDI are:

- Annual Audit Report issued by SAO.
- Consolidated Annual Financial Report issued to Georgian standards.
- Consolidated Semi-annual Financial Report issued to Georgian standards.

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and in the MRDI IAD from February 2016; First Category Senior Specialist Mr. Tamazi Gurgenidze has a higher education degree in accounting, and has been working in audit positions for the last 27 years, joining the MRDI IAD in 2015; Second Category Senior Specialist Ms. Ani Otarashvili has a master's degree in Business administration and seven years of relevant work experience all in the IAD of MRDI.

- Budget Implementation Report.

40. The above reports incorporate the financial and reporting data of agencies operating under MRDI, including MDF.

Information systems

41. MRDI develops its accounts using the ORIS Manager accounting software. ORIS Manager is an off-the-shelf software that allows users to add specific operations based on Visual Basic. MRDI has 5 licensed units, for which an internal safe network has been created and which is used by the Finance and Budget Unit and Administrative Department.

42. ORIS Manager has two general currencies for reporting purposes - GEL and USD. However, all MRDI reporting is provided in GEL. The updated chart of accounts is prepared in full compliance with Georgian standards and ORIS Manager automatically generates standard versions of General Ledger, Trial Balance and Turnovers. Georgian standard annual Financial Statements are prepared manually based on excel exports from the ORIS Manager.

B. Tbilisi City Municipality (EA)

Legal status and related entities:

43. TCM is a Municipality, which is an independent legal entity under public law. It is subject to self-government according to the Constitution of Georgia and the Organic Law of Georgia on Local Self-Government (2014). Under Article 3 of its Charter (December 2014), it has three layers of governance:

- Tbilisi Mayor - the highest executive body of Tbilisi, which is the head of the Tbilisi City Municipality and the Tbilisi Government.
- The Government of Tbilisi - a collegial executive body consisting of the Mayor of Tbilisi, his First Deputy (Vice-Mayor) and deputies, the heads of the structural units of the Tbilisi City Municipality (except the heads of the structural units supervising the Tbilisi City Municipality) and the district governors of Tbilisi.
- The structural units of Tbilisi City Municipality, which are:
    - Administration,
    - Municipal Finance Service,
    - Supervision Service,
    - Legal Service,
    - Internal Audit and Monitoring Service,
    - Municipal Procurement Service,
    - Economic Policy Municipal Service,
    - Security Service,
    - Ecology and Greenery Municipal Service,
    - Education, Sports and Youth Affairs Municipal Service,
    - Culture Service,
    - Health and Social Services Municipal Service,
    - Transport Service,
    - Improvement Service.

44. Key financial activities are carried out under the Municipal Financial Service, which has a Head who reports directly to the Mayor, two Deputies and four departments, each which report

directly to the Head of Municipal Finance Service. The Deputies are involved in monitoring the departments and sometime participate in daily tasks like budgeting. The four departments are:

- Budgetary – 8 staff
- Treasury – 7 staff
- Analytical – 4 staff
- Accounting – 9 staff

45. Staff in the Municipal Finance Service will not be responsible for project/loan financial management and accounting, this being the responsibility of the IA, though the Treasury department will be involved in project monitoring. Finance staff receive training under programs coordinated by the Municipal Service Development Agency (MSDA) of TCM and participate in courses run by the Finance Academy (MOF). As a minimum, finance staff in the Treasury department will require training in ADB procedures.

General policies and procedures

46. TCM is subject to Ethics and Code of Conduct requirements of the Civil Service Board (CSB). On April 20, 2017, the CSB issued Decree No. 200 'General Code of Ethics and Conduct for the Civil Service", which guides the professional standards of civil servants and implementing fundamental principles and values in the civil service. The CSB has also published a Handbook on Ethics and Code of Conduct in the civil service. Both the Decree and the Handbook apply to TCM's staff.

Accounting policies and procedures

47. TCM uses accrual basis accounting for entity-level accounts, following GOG standards. A standard Government Chart of Accounts is used to develop these accounts. Key financial procedures result from internal orders developed primarily by the Tbilisi City Council. From 2021 TCM is expected to change its financial reporting to IPSAS cash modified, which will strengthen reporting requirements. The adoption of IPSAS based accounting will require TCM to develop supporting internal policies and procedures.

48. Safeguards against conflicts of interest are outlined and regulated in the Law on Conflict of Interest and Corruption in Public Institutions (2015, as amended). This applies to all staff. Moreover, Chapter VII of the Ministry of Finance's Decree No. 429 of December 31, 2014 'On Accounting and Financial Reporting of Budget Organizations' provides requirements for related party disclosures.

49. Retention of accounting document is undertaken consistent with the Minister of Justice's Order No. 72 of 31 March 2010 on the 'List of Typical Governance Documents Created in the Process of Establishment of the Institutions. After six years, TCM moves documents to a Central Archive.

50. TCM does not undertake cash operations. A list of expenses is automatically generated by the GOG's e-Treasury system on a daily basis, which is reconciled with accounting records. The Head of Municipal Finance Service is a dedicated signatory for bank accounts, though these are only used to deposit funds with all payments are made via the e-Treasury system.

51. TCM maintains a fixed asset register. Ministry of Finance's Decree No. 429 of 31 December 2014 states in Article 151 (Operations and other events with non-financial assets) that

the value of assets must be reflected in the financial statements as of the last business day of each reporting year. The TCM fixed asset register covers buildings, furniture, equipment, machinery and any other capital assets. It includes a description of the asset, date received, cost or estimated (market) value, unique serial numbers, location and an indication if it was purchased or donated. All staff are responsible and accountable for fixed assets in their possession. Periodic inventories are carried out, with old or obsolete assets written off at the end of the fiscal year.

Planning and budgeting

52. The Municipal Finance Service is responsible for preparing TCM's Budget Application for approval by its Board. The Municipal Finance Service collates information from all Units within TCM, following which it prepares a draft of the budget application for approval by the Board before presenting to the Ministry of Finance. Budgetary funds include own funds collated through use fees and transfers from central agencies.

53. Financial reporting against the budget is generally done quarterly, although monthly reporting is adopted towards year-end. Any budgetary variations must be approved in advance. Moreover, the e-Treasury system automatically blocks disbursement where there is no remaining balance. For the first two quarters of the year, budget variations could be prepared based on roll-forwarding allocations of the last two quarters of the previous year for relevant items. Starting from Q3, requests for changing the budgetary allocation between projects and programs under TCM can be made. From the middle of November, TCM can request from MOF additional funds for the Projects from reserved amounts by other Ministries or from any suitable sources via changes in Budget Law. No major deviations from budget allocations have been reported over the past three years.

Internal audit

54. TCM has an Internal Audit and Monitoring Service (IAMS) unit as required under the Law of Georgia on Public Internal Financial Control (Law of Georgia Nº5447 of 9 December 2011). The IAMS unit consists of 3 divisions: Internal Audit (6 employees); Planning and analysis (7 employees); and Department of Inspection, Labor Safety Organization and Management. (6 employees); It is governed by a Head, who is elected to the position by the Tbilisi Assembly, which is designed to ensure a high degree of independence. The Head reports directly to the Mayor, who sets the work program. The Head of IAMS has two deputies who supervise the Internal audit and Inspection, Labor Safety Organization and Management directions. The Planning and analysis direction is supervised by the Head of IAMS directly.

55. The Internal Audit program is guided by GOG standards[5]. The staff of the Internal Audit division is trained in the national standards and participates in workshops on internal auditing.

56. The Internal Audit program has an annual plan which includes the audit of TCM and other agencies like TDF. The annual plan is designed based on assessment of the risk of the various activities, considering the findings of previous audits, project delays and issues raised in SAO audit reports. Strategic and annual plans of the internal audit are prepared by the Head of IAMS and submitted to the Mayor of Tbilisi for approval. The IAMS meets regularly with the Mayor and unplanned audits can be carried out if the Mayor deems necessary.

[5] These include the *Code of Ethics for Internal Auditors* (Decree 1836 of 14 September 2011), *On Approval of System Audit Manual* (Resolution 592 of 26 December 2016), and *On Approval of Internal Audit Standards* (Ordinance 1015 of 30 July 2010).

57. Recommendations of the internal auditors are submitted to the Mayor and are binding. The monitoring of the implementation of the recommendations given by the Internal Audit division is an integral part of its annual program/plan.

58. The Central Harmonization Unit (CHU) of the Public Internal Control Department of the Ministry of Finance is responsible for coordinating the system of Public Internal Financial Control, including the internal audit system through the Georgian Public Sector. The CHU maintains a close relationship with all interested parties of the system, including all budgetary institutions, the Civil Service Bureau and the State Audit Office.

External audit

59. TCM is audited by the State Audit Office (SAO) on annual basis. SAO applies the International Standards of Supreme Audit Institutions (ISSAI). The most recent financial audit undertaken by SAO was for the 2018 Financial Year. SAO is currently undertaking the audit for the 2019 financial statements. No major recommendations have been made in the most recent audits.

Reporting and monitoring

60. The main reports issued by TCM are:

- Annual Audit Report issued by SAO.
- Consolidated Annual Financial Report issued to Georgian standards.
- Consolidated Semi-annual Financial Report issued to Georgian standards.
- Budget Implementation Report.

61. The above reports incorporate the financial and reporting data of agencies operating under TCM, including TDF.

Information systems

62. TCM develops its accounts using the ERTIGONI accounting software. ERTIGONI is an off-the-shelf software that allows users to add specific operations based on Visual Basic. The software is used in TCM and TDF and can be employed for financial reporting under IPSAS.

C. Municipal Development Fund (IA)

Performance under ADB projects

63. The Municipal Development Fund of Georgia (MDF) is currently implementing the Sustainable Urban Transport Investment Program (SUTIP), under a Multi-tranche Financing Facility (MFF), which consists of five projects and six loans with a total value of $243 million:

Table 1: Projects and Loans under SUTIP MFF

Tranche	Loan	Amount ($ million)
1	2655 GEO	85.0
2	2879 GEO and 2880 GEO	64.0 and 16.0
3	3063 GEO	46.0
4	3273 GEO	20.0

5	3617 GEO	12.0

64. No major issues have been raised by the project auditors over the last 3 years. Minor issues raised in the audit reports for 2019 relate to the inconsistency in application of exchange rates in software and accounting records, the revaluation of monetary reserves due to changes in the exchange rate and the treatment of advances to contractors.

65. MDF has successfully implemented two ADB loans, Municipal Services Development Program (MSDP) 1 and 2. MSDP 1 and MSDP 2 are closed and were rated as successful at the project completion stage.

Performance under other projects

66. MDF also has significant experience in implementing projects for other bilateral agencies in the urban and transport sector, including the following open projects.

Table 2: Projects undertaken by MDF for other bilateral agencies.

Agency	Project	Date
World Bank	Supporting Sustainable Wastewater Management	2013-2020
	Second Regional and Municipal Infrastructure Development Project	2014-2021
	Third Regional Development Project	2015-2022
	Second Regional Development Project	2016-2018
	Georgia I2Q Innovation, Inclusion and Quality	2020-2026
EIB	Water Infrastructure Modernization Project II	2013-2019
	Georgian Urban Reconstruction and Development	2016-2020
	Georgia Upgrade of Municipal Infrastructure Project	2016-2021
EBRD	Kobuleti Wastewater	2018-2020
	Georgia Urban Transport Enhancement Program	2019-2022
CEBD	Rehabilitation of Public Schools in Tbilisi and Increasing Energy Efficiency	2016-2021
NEFC	Energy Efficiency Improvements in Public Buildings in Georgia	2018-2020

EIB – European Investment Bank; EBRD = European Bank for Reconstruction and Development; CEDB – Council of Europe Development Bank; NEFC – Nordic Environment Finance Corporation

Legal and governance structure

67. MDF is a Legal Entity under Public Law (LEPL) established on 7 June 1997 through Presidential Decree Nº 294 “On Management of Funds Designated for the Development of the Municipal Sector in Georgia”.[6] MDF operates as an agency under MRDI and has the objective of enhancing institutional and financial capacities of local governments, investing in local infrastructure and services, and improving socio-economic conditions for the local population.

68. The main tasks of Fund are the:

- Support of the long-term institutional and socio-economic development of

[6] The Chart of MDF was approved on July 23 2005 by Decree of the Government of Georgia (GOG) No. 118 ‘On Approval of the Regulations of the Legal Entity of Public Law – the Municipal Development Fund of Georgia and the Supervisory Board’. Later it was changed by GOG Decree No. 558 of 30 October 2015 ‘On Establishment of a Legal Entity of Public Law – Establishment of the Municipal Development Fund of Georgia, Definition of the Supervisory Board and Approval of its Regulations.’

municipalities,
- Promotion of sustainable improvement of basic economic and social services of the population,
- Promotion of the investment in municipal, state and public infrastructure and services, and
- Ensuring the improvement of municipal, state, and public infrastructure within its functions.

69. MDF is largely self-funded, with the largest part of its annual expenditure based on a revolving fund (restricted reserves) whose funds can only be used for the purpose of project-related expenditure. It also earns income from bank deposits, and loans to municipalities and some other loans, which are used to finance its administrative activities.

70. MDF reports to a Supervisory Board, which is chaired by the Minister of Regional Development and Infrastructure and comprises 15 members including several Ministers and Deputy Ministers.[7] The Supervisory Board should meet at least every 6 months. Its general tasks and responsibilities are to:

- Review and approve long-term action plans,
- Approve annual programs and budget,
- Approve operating guidelines,
- Determine MDF's structure, staffing table, and wages, with MRDI,
- To review and approve the bilateral and multilateral agreements as well as loan terms,
- To review and approve externally funded activities,
- To approve loans to municipalities,
- To review the annual external audit reports.

71. The Governing body for the project, which will oversee Project Implementation and be responsible for inter-ministerial coordination, will be a Steering Committee headed by a Deputy Minister, and will comprise representatives from the Ministry of Finance (MOF), Ministry of Economy and Sustainable Development (MOESD), other MRDI agencies, and private sector representatives.

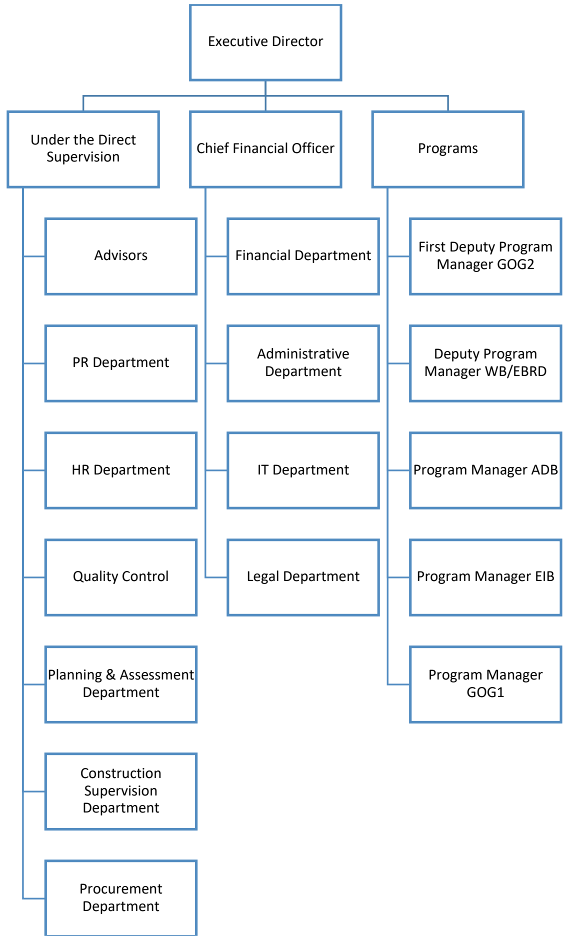
72. An Executive Director of the fund is appointed, whose tasks and responsibilities include managing MDF's day-to-day operations, represent MDF with state agencies, municipalities, and development partners, coordinate MDF's long-term action plan, appoint staff, submit the annual budget to the Supervisory Board for approval, organize and convene meetings of the Supervisory Board, sign on behalf of MDF agreements and contracts, and select the external auditor based on a tender.

73. MDF is structured with common management functions directly under the Executive Director, financial functions under a Chief Financial Officer and programs under a First Deputy

[7] The present members are: The Minister of Regional Development and Infrastructure (Chairman); First Deputy Minister of Regional Development and Infrastructure (Deputy Chairman); Minister of Economy and Sustainable Development; Minister of Finance; Minister of Environment Protection and Agriculture; Minister of Internally Displaced Persons from the Occupied Territories, Labor, Health and Social Affairs; Deputy Minister of Regional Development and Infrastructure; Deputy Minister of Regional Development and Infrastructure; Director of the United Water Supply Company of Georgia (UWSCG); Chairman of the Regional Policy and Self-Government Committee of Parliament; Member of the Regional Policy and Self-Government Committee of Parliament; Chairman of Economic Branch and Economic Policy Committee of Parliament; First Deputy Chairman of Financial-Budgetary Committee of Parliament; and Chairman of the Government of the Autonomous Republic of Abkhazia.

with a program manager for each Development partner, including ADB. The organizational structure is set out below.

Figure 2: Organizational Structure of MDF



Source: MDF

74. As of August 2020, MDF had 184 staff, of which 104 were permanent employees and 80 contract staff. In addition, there were 6 vacancies for permanent roles and 8 for contract staff.

General policies and procedures

75. MDF is subject to Ethics and Code of Conduct requirements of the Civil Service Board (CSB). On April 20, 2017, the CSB issued Decree No. 200 ‘General Code of Ethics and Conduct for Civil Service”, which outlines an ethical environment for developing the professional standards of civil servants and implementing fundamental principles and values in the civil service. The CSB has also published a Handbook on Ethics and Code of Conduct in the civil service. Both the Decree and the Handbook apply to MDF’s staff. In addition, Operational Manuals, which are prepared for each project include additional and complementary requirements.

Structure and staffing of accounting and finance function.

76. Key accounting and financial functions are carried out in the Finance Department. MDF's Deputy Director functions as the Chief Financial Officer (CFO). MDF's Financial Department has 15 staff:

- One Financial Manager
- One Chief Accountant
- Eight Accountants, of which:
  - One person is responsible for MDF own funds and administrative expenses,
  - Two persons are responsible for GOG financed programs and inland business trips payments, accounting and disbursement (these are GOG funded),
  - One person is responsible for EIB Projects payments, accounting and disbursement,
  - One person is responsible for EBRD, NESCO, SEB payments, accounting and disbursement,
  - Two persons are responsible for WB Projects payments, accounting and disbursement,
  - One person is responsible for Bank Guarantee administration.
- One Budget Officer, responsible for Budget preparation.
- Two Disbursement Officers, responsible for ADB Project payments, accounting and disbursement. The two Officers are financed by ADB under the existing SUTIP project.
- Two Credit Officers.

77. The Financial Department is supported by an experienced ADB-financed local Financial Management and Reporting consultant.

78. The Financial Department has significant project accounting and finance experience. The Finance Manager has been with MDF for 9 years, with previous work experience as an accountant and financial manager in different private and public organizations, including over 16 years working on projects funded by different donors. The two officers assigned to ADB projects have been with MDF for more than 11 and 5 years respectively, each with more than 10 years additional experience in public and private roles.

79. The Finance Department is adequately staffed to perform its roles, including for the administration of donor-funded projects. Accounting and finance staff possess adequate experience and knowledge of donor funded financial management and disbursement procedures, with those assigned to the SUTIP project having daily exposure to ADB procedures. Based on the current staff assignment to projects, an additional accountant may need to be hired for the proposed project. Due to previous training programs and its importance in MDF's activities, there is reasonable knowledge of ADB procedures in the Finance Department outside the staff working directly on ADB projects.

Accounting and reporting framework

80. Accounting and financial reporting is performed in accordance with IFRS and adopting accrual-based accounting. MDF adopts a standard Chart of Accounts with 4-digit codes. Monthly reconciliation of general and subsidiary ledgers is carried out, with quarterly reconciliation of all transactions. Financial statements for MDF are prepared on an annual and semi-annual basis under IFRS.

81. The format of reporting by project depends on donor requirements.[8] Separate financial statements are prepared for each major project on at least an annual basis depending on the requirement of the donor. Reports to World Bank include a half-yearly and annual financial monitoring report, including balance sheet, sources and uses of funds, a statement on all special accounts, and expenditures by project categories. ADB reporting needs are based on the Chart of Accounts, though reports require export of data and additional manual calculations for funds denominated in foreign currency.

82. MDF has a set of documented policies and procedures to govern its financial management activities. The key document is its Financial Management Manual. Various operating manuals are developed for each donor-assisted project.[9]

83. The updated chart of accounts is prepared in full compliance with Georgian standards. The accounting software, ORIS Manager automatically generates standard versions of the General Ledger, Trial Balance and Turnover. For donor financed projects, ORIS manager is able to separate out the Source of Financing, Trial Balances and Turnovers through the use of special indicators and codes.

84. Adequate retention of documents occurs. The retention of accounting documents is regulated by the Minister of Justice's Order No. 72 of 31 March 2010 on the 'List of Typical Governance Documents Created in the Process of Establishment of the Institutions', which stipulates retaining documents for 10 years. MDF stores documents on site for six years, with these then moved to a Central Archive. In addition, MDF has a dedicated staff for archive-related matters. MDF has archives for finance documents, which are kept separate from archives for procurement, technical and administrative documents.

Budgeting and monitoring

85. Budget requests are developed for each ongoing project using MDF's Management Information System (MIS), its internal system for project control and monitoring. On a daily basis all payments for each contract are automatically exported from the e-Treasury System to the MIS in GEL equivalents. The MIS therefore provides daily updates on project payments and collates information for budget applications. The budget system works automatically for payments in GEL but for multicurrency contracts information has to be introduced manually on issues like the paid amount for each currency. At the start of August Program Managers and staff from relevant Departments like Finance and Procurement etc., estimate funding needs by project. This information is analyzed by the Budget Officer (Finance Department), with a draft of the budget application prepared. This application is reviewed by the Finance Manager, CFO, Consultant and Director. The final version of the draft application will be informal agreed with the Finance

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[8] For World Bank-financed projects, MDF bases its accounting on the accrual model of International Accounting Standards (IAS), as per World Bank's Financial Management Sector Board's 'Guidelines: Annual Financial Reporting and Auditing for World Bank Financed Activities'. For existing ADB-financed projects, MDF bases its accounting on the accrual model of IAS and the 2002 'Guidelines for the Financial Governance and Management of Investment Projects Financed by the Asian Development Bank'.

[9] For example, the Project Operations Manual (POM) for the World Bank-financed 'Georgia I2Q Innovation, Inclusion and Quality' project covers the following financial management aspects: Planning and budgeting; Internal controls; Contract management; Accounting and bookkeeping (Accounting objective and principles, Accounting rules, Specific rules for micro/macro-project accounting, MDF financial resources related to the project, Description of the computerized accounting system, Operational expenditures); Disbursement and funds flow procedures; Disbursement categories and disbursement procedures; Authorized signatories; Advance account procedure; Payment Procedure; Ineligible expenditures paid from the Designated Account; Closure of accounts, refund of unused funds; Interaction between two implementing agencies; Reporting and monitoring; and Auditing.

Department of MRDI and sent for approval by MRDI. MRDI will either approve the application or return for amendment by late August. The Finance Department of MRDI will prepare a consolidated budget application and submit it to MOF. MOF will review and return for corrections if necessary. In September MOF will prepare a consolidated application for the whole Budgetary Sector of Georgia and present it for approval to Parliament.

86. Financial reporting comparing expenditure against the budget is undertaken on a quarterly basis for much of the year, and monthly towards the year-end based largely on information obtained from MDF Management Information System (MIS). Deviations of more than 15% require explanations from the Budgetary Unit to MRDI, who then responds to MOF.

87. Any budget variations must be approval in advance. The e-Treasury system automatically blocks allocations where there is a zero-remaining balance. During Q1 and Q2 budget variations could be prepared based on a roll-forward of allocations of Q3 and Q4 for a particular project for the previous year. Any adjustment would need to be counter-balanced by reductions with other Programs or Projects. Greater freedom in balancing between projects is possible starting from Q3. Towards the end of the fiscal year, MRDI can request additional funds from MOF for Projects from reserved amounts of other Ministries or from any suitable sources via changes in Budget Law.

Segregation of duties

88. Effective segregation of functions is carried out with respect to ordering, receiving, accounting for, and paying for goods and services, with responsibilities split between the User Unit and the Finance Department. For transactions, the following responsibilities are assigned:

- Authorizing the execution of a transaction – Executive Director, CFO, and the Financial Management and Reporting Consultant.
- Recording the transaction in the accounts – Respective Project Disbursement Officer.
- Maintaining custody of assets arising from the transaction – Accountant working on MDF administration matters, including taxes.
- Reconciling of bank/treasury account and Advance Fund Account turnover and Ending Balance – Chief Accountant.

Payment and cash

89. The invoice-processing procedure within the Finance Department is as follows: (i) Copies of purchase orders and receiving reports are obtained from the issuing unit; (ii) The MDF Project Manager compares the purchase order and actual delivery and the purchase order and invoice; (iii) Accountants check the accuracy of calculations as well as compliance with contract terms and conditions; (iv) The Project Manager and Accountant check the authenticity of invoices. Once checks are made the invoice can be approved by the Executive Director or the CFO. MDF has procedures for document flow and internal control for Civil Works, Consultancy and the Supply of Goods that vary for standard payment, variation orders and price adjustment. For example, for a standard payment the following processes apply:

- Contractor submits its executed Works Statement to MDF,
- Documents are uploaded in e-doc (electronic documents system),
- Once in e-doc, the MIS System generates a standard Interim Payment Certification (IPC) with advance repayment and retention withheld,
- The Procurement and Financial Units check and confirm the IPC,
- After confirmation, the IPC is sent to the Executive Director for signature,

- The signed IPC is returned to the Financial Unit for payment.

90. MDF does not carry cash. All payments are made through electronic bank transactions. The transactions are prepared by accountants, approved and authorized by the CFO and the Executive Director as a first signatories. Authorization is required to execute the transfer. Even small payments like the purchase of bidding documents are made directly to MDF treasury accounts by electronic transfer. Bank reconciliation is carried out on a daily basis or after each payment.

Asset management

91. MDF maintains a fixed asset register that covers furniture, equipment, machinery and any other capital assets. It includes a description of the asset, date received, cost or estimated (market) value, unique serial numbers, location and an indication if it was purchased or donated. All staff are responsible and accountable for fixed assets in their possession. The asset register is maintained by an Accountant of the Financial Department. All assets are reflected in the accounting system, and assets can be tracked by project as well as at the level of MDF. MDF's Executive Director appoints a three-member working group at the end of each year to carry out inventory of MDF's main assets. Old or obsolete assets are written off at the end of each fiscal year on the basis of conducted inventory and drawing up a relevant act. This document, which is prepared and verified by MDF and external advisers, confirms the asset condition and recommends the write-off, which is approved by the Executive Director. Written off assets are transferred to MOEPD, who decide regarding any sale or liquidation.

Internal audit

92. The internal audit of MDF is the responsibility of the Internal Audit Department (IAD) of MRDI. The IAD has 7 staff, reports directly to the Minister and carries out the internal audit of all agencies operating under MRDI, including MDF. The audit of all IFI projects being undertaken by MDF is under its scope. There are three staff responsible for IFIs (two First Category Senior Specialists and one Second Category Senior Specialist), all of whom have higher educational qualifications and 41, 27, and 7-years' experience respectively. All three have audit experience in projects funded by ADB and have been with the IAD for at least 4.5 years.

93. The Internal Audit program is guided by the International Standards for the Professional Practice of Internal Auditing and Standards of Internal Auditing. The latest internal audit mission with MDF was carried out at the end of 2019. In general, the IAD schedules audit missions with entities once every two to three years, though if the IAD is interested in particular activities it can organize a mission at any time. No issues with the availability and completeness of records have been found in internal audits of MDF over the past 10 years. MDF is also subject to financial and performance audits from the State Audit Office (SAO).

External audit

94. MDF is subject to external audit at three levels. First, MDF is audited by SAO as part of its annual financial audit of MRDI. Second, its consolidated annual Financial Statements prepared under IFRS are audited by a private audit firm. Third, project financial statements are subject to external audit. The audits carried out by SAO apply the International Standards of Supreme Audit Institutions (ISSAI), while the audits of the MDF Financial Statements and project financial statements are undertaken under International Standards on Auditing (ISA).

95. Recent audits by SAO and private firms have been timely, with audited Financial Statements published within 6 months of the end of the Financial Year in the past 3 years. An unqualified opinion has been provided by the external auditors over the past 3 years.

96. Different auditors are appointed to audit MDF's financial statements and project financial statements. The auditor of MDF's consolidated Financial Statement is selected from a list of qualified firms, and is appointed for 2 years, with the possibility of contract extension. Currently entity-wide statements are audited by Deloitte and Touche. Project external auditors are chosen through a least cost selection process from a shortlist as stipulated in the procurement section of loan agreements. The current auditors of appointed for ADB projects are Grant Thornton (SUTIP 1 and 2), KPMG (SUTIP 3) and Deloitte and Touche (SUTIP 4 and 5).

Information systems

97. The key information systems used by MDF are:

- e-doc – electronic document management system used in GOG budgetary entities.
- eTreasury – electronic payment system of the State Treasury within the MOF used to manage payments between and by state organizations. This system is used for project-based payment requests and also for payment of payroll and wages.
- A customized Management Information System (MIS), which provides information on project financial progress and other expenditure. Data from eTreasury is imported into the MIS.
- ORIS Manager – key accounting software.

98. ORIS manager allows for the recording of transactions, the allocation of expenditures by components and projects, fixed assets, recognition of income and foreign exchange transactions. ORIS Manager automatically generates standard versions of General Ledger, Trial Balance and Turnover from the Chart of Accounts based on GOG standards. ORIS Manager is able to separate sources of funding and create Trial Balances and Turnover for projects. However, due to the need for currency revaluation, and limitations in the disbursement categories in the Chart of Accounts, Project Financial Statements are prepared manually based on excel exports from ORIS Manager. There are two possible solutions to prepare automated statements: a) create a separate accounting system for ADB and other projects from bilateral agencies; or b) adjust the Chart of Accounts to reflect donor requirements. The first option is considered highly expensive, while the latter creates difficulties for SAO reporting.

99. ORIS Manager has two general currencies for reporting purposes - GEL and USD. An issue has arisen in the case of financing in EUR, where an equivalent value in GEL is included in trial balances, which created reporting issues. Problems with equivalents for EUR transactions were mentioned in Audit Reports for 2018, 2019 fiscal years. MDF and ORIS are working on the inclusion of EUR as a general currency to overcome this problem.

100. ORIS Manager is an off-the-shelf software that allows users to add particular operations based on Visual Basic. It is a stand-alone software, not integrated into company operations and consists of ten licensed units and used only by the Finance Department of MDF. Project financial data will be entered into and stored in the system manually. Entity-level and project-level data are stored in the system. The program automatically backups data and saves it on MDF's server and on a cloud storage system.

D. Tbilisi Development Fund (TDF)

Legal and governance structure

101. TDF is a non-profit (non-commercial) legal entity established by TCM. The charter of the Tbilisi Development Fund was approved by Resolution N20.01.964 of the Government of the City of Tbilisi of July 16, 2010. The aim of the fund is to preserve the historical appearance of the City of Tbilisi and to promote the value of real estate. The priorities of the Fund involve several activities to promote tourism:

- Rehabilitation of large areas in Old Tbilisi.
- Restoration of historical and cultural heritage monuments located on and along the tourist route.
- Restoration of historic entrances,
- Restoration of museums to attract city residents and tourists.
- Development of recreational zones to create a safe and ecologically clean environment for locals and visitors in Tbilisi.

102. TDF is an agency of TCM, who is the key supervisory body of TDF. TDF operates under a system of self-governance according to the Constitution of Georgia and the Organic Law of Georgia on Local Self-Government (2014).

103. TDF is primarily funded from budgetary contributions from TCM. It receives a small amount of interest income, which it allows it to self-fund some items in its budget, including staff bonuses and a small proportion of construction works. To date, TDF has not implemented investment projects from major IFIs.

104. The Board is the governing body of the Fund. The Chairman, who is the First Deputy Mayor of Tbilisi, and members of the Board are appointed by TCM. Board meetings are held at least once every three months or as needed. Key general tasks of the Board are to:

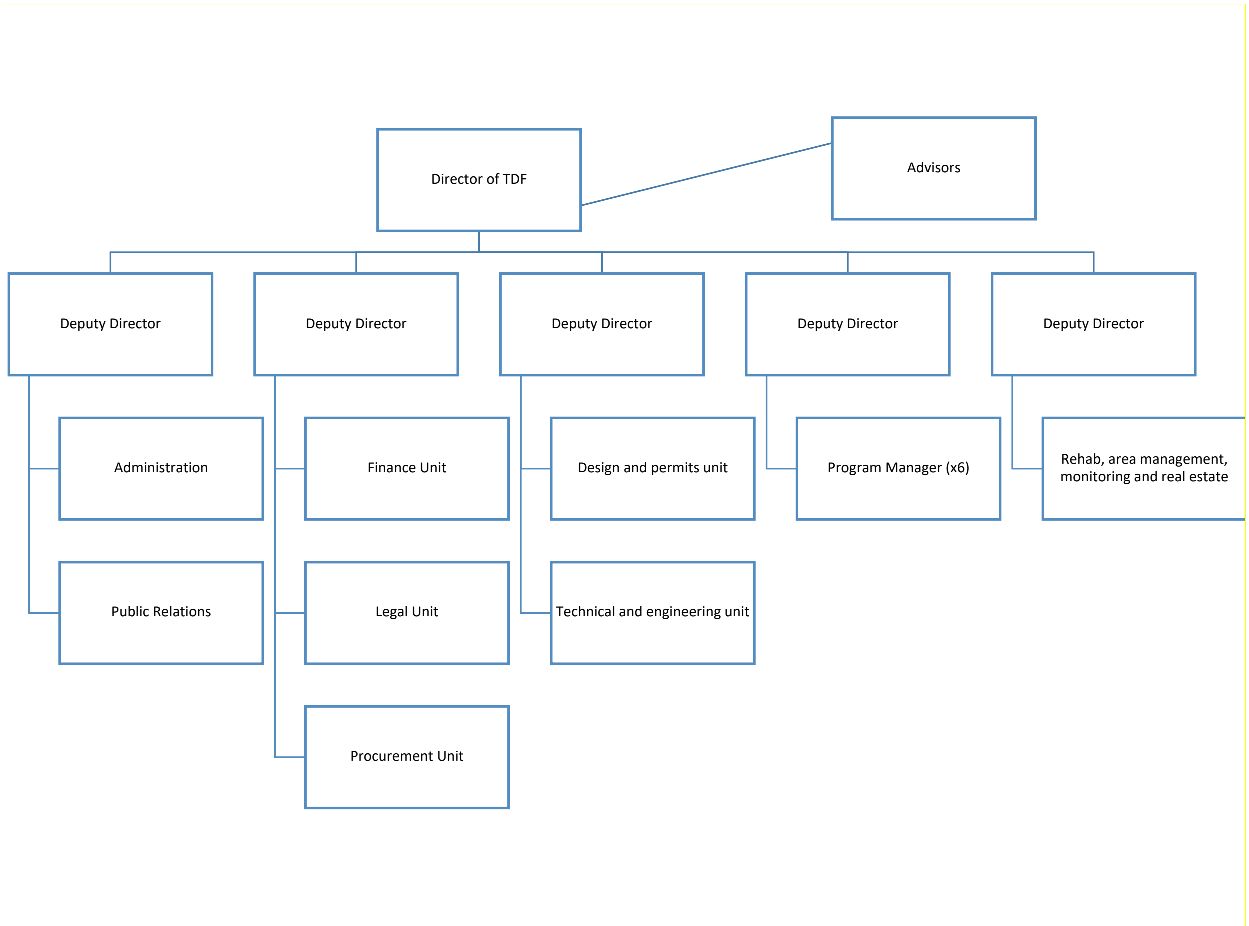
- Approve the strategic directions, plans, target programs, and projects developed by the Director of the fund,
- Approve projects to be financed by the Fund and control their implementation,
- Develop and submit recommendations to the founder on the establishment of branches (representations) of the fund and their liquidation,
- Decide on the establishment of legal entities,
- Appoint and dismiss the heads of legal entities upon the recommendation of the Fund Director,
- Upon the recommendation of the director of the fund, develop the regulations of the fund branches (representations) as necessary,
- Address needs for disciplinary action against members of the Board of the Fund,
- Resolves issues related to membership in the registered organizations of the Fund.

105. The representation of the Fund is exercised by a Fund Director, who is supported by five Deputy Directors responsible for various administrative, financial and project functions. The Director of the Fund is elected and dismissed by its founder (TCM)[10]. The Director is appointed

[10] The responsibilities of the Director include: Acts on behalf of the Fund and represents it in relations with third parties, both within the country and abroad; Attends board meetings and receives relevant assignments from the board; Enters into contracts, transactions, negotiates and issues power of attorney on behalf of the Fund; Supervises the

for life. The organizational structure is set out below.

Figure 3: Organizational Structure of TDF



Source: TDF

General policies and procedures

106. TDF is subject to Ethics and Code of Conduct requirements of the Civil Service Board (CSB). On April 20, 2017, the CSB issued Decree No. 200 'General Code of Ethics and Conduct

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management of the Fund's financial resources and other tangible assets together with the Board; Opens and closes accounts in banking institutions, in national and foreign currencies, signs all financial and other official documents of the Fund; Ensures the implementation of the decisions of the founder and the board of the Fund; Reports on the activities performed to the board or the founder; Submits draft programs to the Board; Enters into relevant agreements with third parties on behalf of the Fund for projects approved by the Board; Appoints and dismisses the heads and other employees of the structural units of the Fund upon the conclusion and termination of the employment contract, determines the terms of remuneration, decides on their issuance or other incentives or disciplinary liability of the employee; Determines the staff list of the fund, salaries and the amount of allowances with the consent of the founder; Defines the service regulations of the structural units, job descriptions of the employees and the internal regulations of the labor; Submits annual reports to the founders on the status of the Fund's activities and the work done; Carries out other activities within the framework of the rights granted by the Board; In agreement with the founder, makes decisions regarding the purchase, management and / or legal encumbrance of real estate by the Fund in accordance with the legislation of Georgia; Decides independently on the acquisition, disposal and / or legal encumbrance of movable property by the Fund.

for Civil Service", which outlines an ethical environment for developing the professional standards of civil servants and implementing fundamental principles and values in the civil service. The CSB has also published a Handbook on Ethics and Code of Conduct in the civil service. Both the Decree and the Handbook apply to TDF's staff.

Structure and staffing of accounting and finance function.

107. Key accounting and financial functions are carried out in the Finance Unit, which is staffed with four employees: A Head of the Finance Unit, a Chief Accountant, an Accountant; and a support person. There has not been any staff turnover over the past four years. The Unit is adequately staffed and trained to perform the required tasks as a state-owned budgetary entity. Staff training at TDF, including for finance staff is coordinated under the MSDA of TCM. MSDA is responsible for developing and implementing an annual training program for staff of TCM and all its agencies. Over the last four years TDF finance staff have participated in courses run by MSDA and the Ministry of Finance Academy.[11]

108. While proficient on local requirements, the Finance Unit has low capacity to administer any loan-financed project. To address this gap, TDF appointed a Financial Manager in agreement with ADB to train the finance unit and lead the administration of the project finances under this loan. The Finance Manager commenced work in TDF in December 2020. The Finance Manager is part of a Project Implementation Unit (PIU) for which a Procurement Specialist and Project Manager have also been appointed. The Finance Manager has extensive experience with ADB and IFI implementation procedures. Under the conditions of Project Readiness Financing for this sector loan, the PIU will assist TDF in preparing APFS for 2020, which are due in June 2021. ADB support will be required in training relevant Finance Unit and PIU staff on ADB procedures and procurement under IFI rules in general. In addition, the PIU may require an accountant to be hired to support project disbursement and reporting.

Accounting and reporting framework

109. Accounting and financial reporting is performed on an accrual basis in accordance with national standards. TDF adopts a standard Chart of Accounts in compliance with Georgian standards. TDFs financial policies and procedures are implemented by means of internal orders primarily issued by the Tbilisi City Council. In line with plans for TCM, TDF will be introducing financial reporting under the IPSAS cash modified approach.

110. TDF's accounting system (ERTIGONI) has a direct link with Government's e-Treasury System, which allows payment information to be uploaded directly into the accounting program. The program is able to generate General Ledger, Trial Balance and Turnover report and a full set of financial reports in the IPSAS format as required. All transactions in the e-Treasury system are documented and based on approvals, while costs are able to be allocated according to funding sources.

111. Adequate retention of documents occurs. Retention of accounting document is regulated by the Minister of Justice's Order No. 72 of 31 March 2010 on the 'List of Typical Governance Documents Created in the Process of Establishment of the Institutions (Indicating the Terms of their Retention). After six years, documents are moved to a Central Archive.

[11] Finance Unit staff have attended the following MSDA and MOF Academy courses: Program Budgeting (MSDA, 2017), E-Treasury Program and integrated modules (MSDA, 2017), Accounting and Financial Reporting (MSDA, 2018), Treasury Procedures and e-Treasury System (MOF Academy, 2017), Inventory for Budget Entities (MOF Academy, 2019).

112. Adequate functional segregation is carried out with the following responsibilities assigned:

- Authorizing to execute a transaction – Head of Financial Unit and Deputy Director.
- Recording the transaction in the accounts – Accountant and Chief Accountant.
- Reconciling of bank/treasury account and Advance Fund Account turnover and Closing Balance – Chief Accountant.

113. The responsibilities for ordering, receiving, accounting for, and paying for goods and services are split between the User Unit and the Finance Unit.[12]

Budgeting and monitoring

114. Budget requests are managed by the Finance Unit. All units of TDF submit information to the Finance Unit for the following year based on actual budgetary allowances and expenditures The Finance Unit consolidates all information, makes any relevant price adjustments and prepares the budget application for the next fiscal year, which is submitted to TCM after approval from the Director and the Board of TDF.

115. Financial reporting comparing expenditure against the budget is undertaken on a quarterly basis for much of the year, and monthly towards the year-end. Deviations of more than 15% require explanations from the Relevant Unit to the Finance Unit, who then responds to TCM if necessary.

116. Any budget variations must be approved in advance. The e-Treasury system automatically blocks allocations where there is a zero-remaining balance. During Q1 and Q2 budget variations could be prepared based on a roll-forward of allocations of Q3 and Q4 for a particular project for the previous year. Any adjustment would need to be counter-balanced by reductions with other Programs or Projects. Greater freedom in balancing between projects is possible starting from Q3. Towards the end of the fiscal year, TCM on behalf of TDF can request additional funds from MOF for Projects from reserved amounts of other Ministries or from any suitable sources via changes in Budget Law.

Payment and cash

117. The invoice-processing procedure varies for civil works contracts and consultancy/goods supply. All contracts for civil works are uploaded on State Procurement Agencies server, after which the contractor then presents weekly Executive Works Statements to the Municipal Laboratory (entity under TCM control) to allow for checking of works volumes, unit prices and compliance with design documents. Documents are then forwarded to TDF and uploaded in the e-doc system and sent to the relevant Technical Unit. The Technical Unit then reviews the Statement, which is then signed by the appropriate TDF Deputy Director and Contractor before being submitted to the Finance Unit. Finance Unit staff double check the documents, with the Chief Accountant preparing the payment which is approved by the Deputy Director.

118. For Consultancy and Goods supply, the same contract registration process applies, after which the Consultant or Supplier presents a full set of documents directly to TDF. These documents are uploaded via e-doc and forwarded to the relevant Unit in TDF. Authorized staff

[12] Specifically, the following responsibilities are assigned: (i) Ordering – User entity (who prepares a purchase order that describes the order and is approved by eligible signatories), (ii) Receiving – User entity (who prepares a delivery acceptance note), (iii) Accounting for the payment – Financial Unit (based on the invoice); (iv) Paying for goods and services – Financial Unit. Payments are only processed based on receipt of appropriate documentation that is approved by eligible signatories.

check invoices, packing lists or reports against the contractual provisions, agreed unit prices and quantities, and then prepare delivery acceptance acts, which are signed by the Consultant/Supplier and TDF's Deputy Director. These acts are then submitted to the Finance Unit for double checking and approval of the payment. As for civil works, the Chief Accountant prepares the payment, which is approved by the Deputy Director.

119. TDF does not carry cash. All payments are made through the e-Treasury system by electronic bank transfer. Bank reconciliation is carried out on a monthly basis.

Asset management

120. MOF Decree No. 429 of 31 December 2014 requires that the value of assets must be reflected in the financial statements as of the last business day of each reporting year. To meet this requirement, TDF maintains a fixed asset register that covers furniture, equipment, machinery and any other capital assets. It includes a description of the asset, date received, cost or estimated (market) value, unique serial numbers, location and an indication if it was purchased or donated. All staff are responsible and accountable for fixed assets in their possession. TDF's Director appoints a five-member special committee to carry out and end-of-year inventory of TDF's main assets. It will check the name, model, unit price, quantity, condition and place of each asset as well as the name and position of the responsible person. An Act for the write-off of old assets is signed by all members of the committee. Assets on the list with an initial unit price of less than GEL2,000 are disposed of by TDF. Assets with an initial unit price of more than GEL2,000 are moved to a separate stock. The Director of MDF will send an official letter with the inventory results to TCM who will decide regarding any subsequent sale or liquidation. All assets are insured whilst in service.

Internal audit

121. The internal audit of TDF is covered under the internal audit program developed by the Internal Audit and Monitoring Service (IAMS) of TCM. The Internal Audit program is developed under standards of the GOG and reports directly to the Mayor. The audit of any new IFI projects falls within its scope.

122. The annual internal audit plan is designed based on assessment of the risk of the various activities, considering the findings of previous audits, project delays and issues raised in SAO audit reports. Strategic and annual plans of the internal audit are prepared by the Head of IAMS and submitted to the Mayor of Tbilisi for approval. The IAMS meets regularly with the Mayor and unplanned audits can be carried out if the Mayor deems necessary. The IAMS has no experience with projects undertaken using ADB finance or that of other IFI and will require training in ADB procedures.

External audit

123. TDF is subject to external audit by SAO. SAO undertakes three types of public audits: financial audits, compliance audits and performance audits. Its Board also undertakes a compliance audit under national standards. TDF does not contract any private external auditors, though project financial statements will be subject to external audit under a process to be stipulated in the loan agreement. The audits carried out by SAO apply the International Standards of Supreme Audit Institutions (ISSAI).

124. There have been delays with TDF's financial audit with those for 2015-2018 recently completed. SAO is currently carrying out the audit for 2019. The two most recent compliance reports presented are the SAO compliance audit report of May 25, 2020 and TDF Board's compliance audit recommendations letter issued on May 23, 2019 for the period 1 January 2016 to 1 July 2018. These audits set out several recommendations, including that:

- TDF should create a contract monitoring and control system, and procedures for returning overpaid amounts,
- Before the contract signing, detailed plan of works and work programs should be prepared,
- Civil Works Contracts' terms should be added to insurance policies for third parties, for fire safety for equipment and property,
- Unconditional bank guarantees should be required from contractors as performance securities to cover damages from delays,
- TDF shall decrease the number of amendments and avoid drastic changes with design, works duration and price,
- TDF shall prepare new qualification criteria for RFPs for Civil Works tenders, and
- TDF shall keep all acts and documents received from the Municipal Laboratory.

125. TDF has developed an Action Plan to address these issues, which it has submitted to SAO. To date, in response to these recommendations it has developed standard contracting forms to promote efficiency in spending during project implementation, revised procedures for procurement of design services and construction works, and enhanced planning procedures to capture the costs to the public from project delays. A dispute strategy is being developed to address issues regarding overpayment.

Information systems

126. The key information systems used by TDF are:

- e-doc – electronic document management system used in GOG budgetary entities.
- eTreasury – electronic payment system of the State Treasury within the MOF used to manage payments between and by state organizations. This system is used for project-based payment requests and also for payment of payroll and wages.
- ERTIGONI – key accounting software.

127. ERTIGONI is an off-the-shelf accounting software that allows users to add particular operations based on Visual Basic. It is a stand-alone computerized software, for which TDF has two licensed units. It is used only by the Finance Unit of TDF, with an internal safe network created. The same software is also used by TCM. There is good knowledge of the software within the Finance Unit. TDF will need to agree with the software developers necessary customizing to meet project accounting and reporting requirements. Currently the software is only able to record entries for payments in local currency.

128. Project financial data will be entered into and stored in the system manually, with the system able to store entity-level and project-level data. Backups are prepared on a weekly basis, with these saved on TDF's server.

VI. FUNDS FLOW MECHANISM

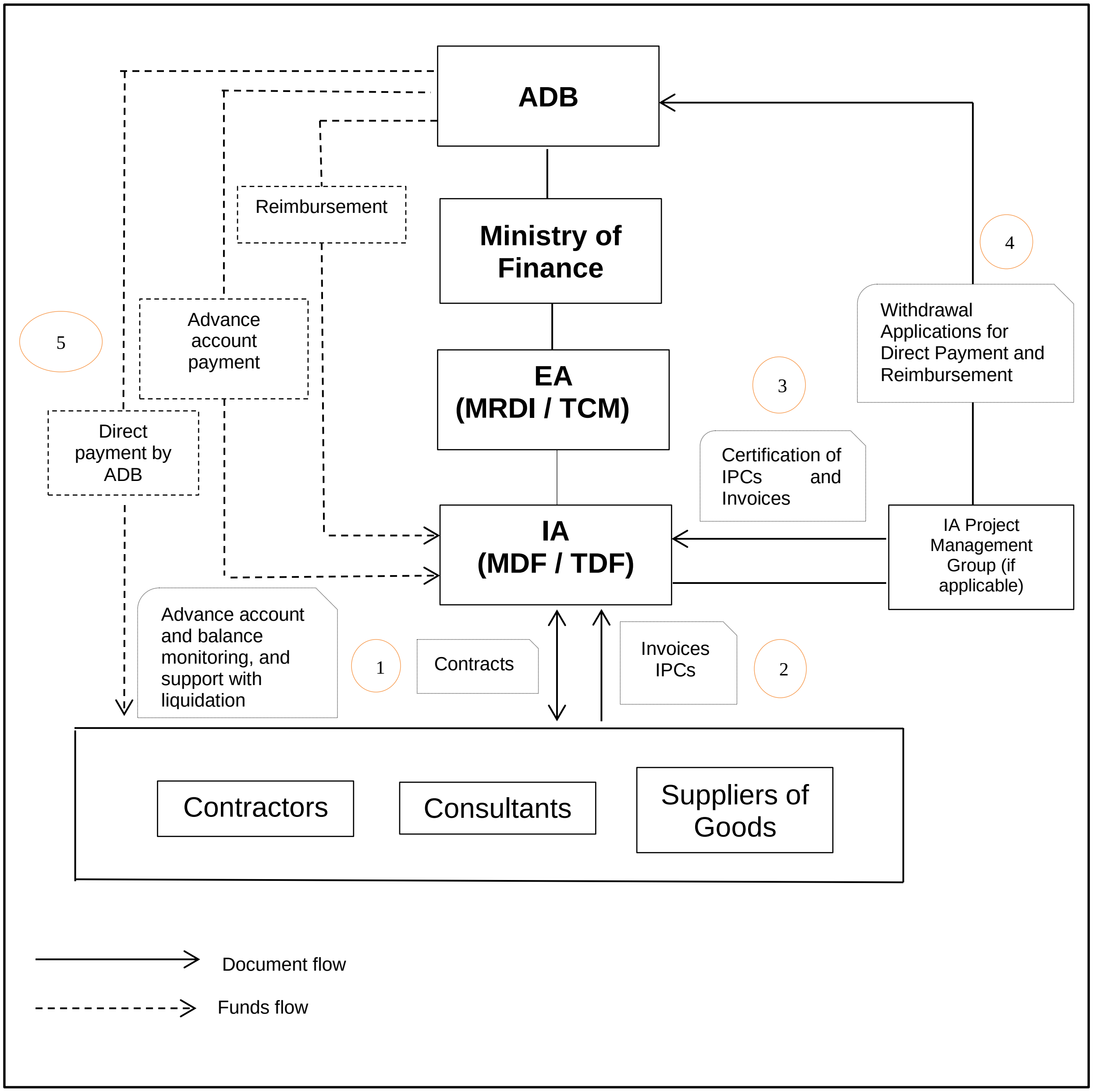
129. The respective IA's (MDF and TDF) will be responsible for implementing the project in accordance with the legal agreements and other implementation arrangements described in the Project Administration Manual (PAM). ADB will monitor the project and review its progress to ensure that the loan proceeds are spent as agreed upon. Upon effectiveness, a loan account under the Ministry of Finance name will be opened in ADB's books where the loan proceeds will be credited, and further on-lent to MDF and TDF. All disbursements will be carried out in accordance with ADB's Loan Disbursement Handbook.

130. The project will primarily use direct payment and commitment procedures (Figure 3). Under the direct payment procedure, ADB loan proceeds will be directly credited to a nominated bank account of a supplier at the IA's request, once an independent Lender's Engineer has verified that works conform to technical specifications in the tender documentation. Under the commitment procedure, the IA will open a letter of credit in the name of the contractor and/or supplier which will be confirmed by ADB through a commitment letter. Payments under the commitment letter will be made by ADB (up to the ceiling amount) directly to the negotiating bank by withdrawal of equivalent amount from the loan proceeds. The minimum size of a withdrawal application shall be $100,000. All claims shall be processed and consolidated by the IA prior to submission of withdrawal application to ADB to ensure efficient disbursement administration. Withdrawal applications will be prepared by MDF and signed by person(s) who is authorized by the Ministry of Finance to sign on behalf of the government. Proper books and records are to be maintained by the IA and supporting documents should be readily made available for review by ADB's disbursement and review missions, upon ADB's request for submission on a sampling basis, and for independent audit.

131. The Statement of Expenditure (SOE) procedure is a simplified procedure wherein supporting documents are not required to be submitted for expenditures that are below the SOE ceiling set for the project (SOE ceiling could range between $50k to $100k per payment). The ceiling is set based on the risk rating of the EA or IA. The purpose of the SOE procedure is to streamline disbursement processing of individual payments. SOE is normally used under Reimbursement or Advance Fund procedure.

132. Based on identified risks in this FMA it is recommended that in the case of TDF, loan proceeds will not be on-lent by MOF into a dedicated account until demonstrated satisfactory performance under the direct payment approach. At project commencement, it is proposed to apply the direct payment approach for salaries of TDF project management group staff, and the reimbursement procedure for office expenses like stationary, internet and cars funded through the project. For MDF the advance account will be available for these expenses.

Figure 3: Funds Flow Diagram for Project



VII. RISK ASSESSMENT

133. A financial management internal control and risk management assessment was conducted. The overall project financial management pre-mitigation risk is assessed as Substantial.

134. The financial management risks include: (i) inherent risks, and (ii) Project (control) risks. Inherent risk is the susceptibility to factors arising from the project's environment, such as country rules and regulations and entity working environment. Project (or control) risk is the susceptibility that the Project's accounting and internal controls framework will be inadequate to ensure Project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

135. The risks identified are explained hereafter in the Financial Management, Internal Control and Risk Assessment (FMICRA) and appropriate risk mitigation measures have been advised within relevant paragraphs. Financial management risks and associated risk mitigation measures need to be considered and updated throughout the life of the Project.

A. Inherent risks

Table 3: FMICRA – Inherent risks

Risk type	Risk Assessment	Risk Description	Mitigation Measures
1. Country Specific	Low	Budget Execution Risk – Actual expenditure deviates from budget estimates.	PEFA Performance Assessment (2018) concluded that public financial management systems in Georgia are strong. The expenditure side of the budget performs according to plan. Control of contractual commitments is effective.
	Moderate	The current COVID-19 pandemic is having negative implications on the country's macroeconomic conditions. Containment measures adopted by the country and related governments might impact the implementation schedule and costs estimates of the project activities.	The project implementation schedule and cost estimates have been reviewed in line with the needs of the country due to COVID-19 pandemic. Further revision of costs will be undertaken during project implementation.
2. Entity specific a) MRDI	Low	Any weakness in the MRDI governance procedures could impede effective management	MRDI has well-established finance and budgetary functions, with low staff turnover. It is subject to review through SAO and its Internal Audit Department. MRDI has extensive experience as an EA, including in several ADB projects, and is able to support MDF at the MOF on budgetary allocations.

Risk type	Risk Assessment	Risk Description	Mitigation Measures
b) TCM	Moderate	Any weakness in the TCM governance procedures could impede effective management and project implementation	TCM has established finance and budgetary functions, and is subject to internal review, including through SAO and its Internal Audit Department. However, TCM has no prior experience as an EA, which represents an importance change in its role and requires capacity building support
c) MDF	Moderate	Weakness in MDF governance structures can adversely affect project implementation	Governance structures within MDF are generally sound. It has considerable experience as an IA and staff that are well experienced in ADB procedures.
d) TDF	Substantial	Weakness in governance structures can adversely affect project implementation	TDF has a sound governance structure, with financial risk kept at a minimum being a non-for-profit agency with no borrowing ability. However, TDF does not have experience as an IA, nor with internationally financed projects. Moreover, recent audits have raised project management concerns that require strengthening.
Overall Assessment	**Moderate**		

B. Project Risks

136. Inherent risks for the two EAs and two IAs are summarized in turn in the following tables.

Table 4: FMICRA – Inherent risks: MRDI

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
1. Executing entity	Low	The Entity may not be able to support the IA in aspects of financial management	MRDI has significant experience in donor funded projects, including with ADB projects in conjunction with MDF, the Roads Department and UWSCG as IAs.
2. Funds Flow	Moderate	The Project funds might not be available on a timely basis, with poor systems of tracking to validate their use for intended purposes.	MRDI has significant experience managing ADB projects as an EA.

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
3. Staffing	Moderate	The Project might not have sufficient and adequately qualified Financial Management and Accounting staff, thus affecting the implementation of disbursement and financial management activities.	MRDI staff performing financial management functions require further training on ADB procedures.
4. Planning and budgeting	Low	Project budgets might not be adequately monitored, resulting in adverse variances which might limit budget availability for key project activities.	MRDI has extensive experience in budgeting and monitoring, and is able to support MDF through budgetary requests for locally funded project components, and liaising with MOF as required
5. Financial reporting and external audits	Low	The Entity might not be able to comply with the statutory and ADB requirements for submission of audited entity financial statements within prescribed timelines.	MRDI is not directly involved in project reporting, though project data is incorporated into its own reporting, which is subject to auditing by SAO
6. Internal audit	Moderate	The Project might not be subject to sufficient and appropriate internal audit arrangements.	MRDI's IAD is well established and staffed, with few risks regarding the auditing of its own operations. It also audits MDF, with staff familiar with ADB procedures and those of other IFIs. However, further training in ADB procedures is required.
7. Information Systems	Low	The information systems might not be sufficient to ensure accurate recording and reporting of the Project's financial transactions.	MRDI is integrated into Government software for information storage (e-doc) and payments (e-Treasury). MRDI applies the same accounting software (ORIS manager) as MDF and other IAs, which facilitates project reporting.
Overall Project Risk	**Low to Moderate**		

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Table 5: FMICRA – Inherent risks: TCM

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
1. Executing entity	Moderate	The Entity may not be able to support the IA in aspects of financial management	TCM has no previous experience acting as an EA in ADB projects, with limited other experience in projects funded by other IFIs.
2, Funds Flow	Moderate	The Project funds might not be available on a timely basis, with poor systems of tracking to validate their use for intended purposes.	TCM's lacks experience in loan administration and will need training, including in ADB procedures

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
3. Staffing	Substantial	The Project might not have sufficient and adequately qualified Financial Management and Accounting staff, thus affecting the implementation of disbursement and financial management activities.	TCM financial management staff have no previous experience acting as an EA and will require training on ADB procedures.
4. Planning and budgeting	Moderate	The Project budgets might not be adequately monitored, resulting in adverse variances which might limit budget availability for key project activities.	TCM has experience in budgeting and monitoring, and is able to support TDF through budgetary requests for locally funded project components, and liaising with central agencies as required
5. Financial reporting and external audits	Moderate	The Entity might not be able to comply with the statutory and ADB requirements for submission of audited entity financial statements within prescribed timelines.	TCM is not directly involved in project reporting, though project data is incorporated into its own reporting, which is subject to auditing by SAO. TCM needs to implement IPSAS cash-modified reporting and supporting financial policies and procedures to enhance its financial practices
6.Internal audit	Moderate	The Project might not be subject to sufficient and appropriate internal audit arrangements.	The internal audit of TCM's activities is covered by its internal audit program as well as SAO procedures. The unit is subject to national standards of internal auditing and also has no experience of ADB financed or similar projects
7.Information Systems	Moderate	The information systems might not be sufficient to ensure accurate recording and reporting of the Project's financial transactions.	TCM is integrated into Government software for information storage (e-doc) and payments (e-Treasury). TCM will need to amend its accounting software to meet the needs of the project and its reporting, though tailoring is expected to be possible within existing software packages.
Overall Project Risk	**Moderate**		

Table 6: FMICRA – Inherent risks: MDF

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
1. Implementing entity	Low	The Entity might not have adequate and appropriate structure for effective financial management.	MDF has an appropriately established departmental structure for the accounting and financial reporting functions. The Finance Department has extensive experience in donor-financed projects, with staff dedicated to existing ADB projects.

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
2. Funds Flow	Moderate	The Project funds might not be available on a timely basis, with poor systems of tracking to validate their use for intended purposes.	MDF has sufficient treasury controls to track and monitor the funds flow, with assigned staff roles and documented policies and procedures. As a mitigating measure, a dedicated bank account shall be opened and maintained for managing the Project funds. The Borrower shall ensure that funds are timely released and made available for the Project activities.
3. Staffing	Moderate	The Project might not have sufficient and adequately qualified Financial Management and Accounting staff, thus affecting the implementation of disbursement and financial management activities.	The Finance Department in MDF has experienced and qualified professional staff. The loss of key staff members could affect the segregation of duties and workload management. The financial management activities are expected to increase due to the addition of the Project and warrant the assignment of a dedicated staff member to the Project if staff cannot be fully transferred from the SUTIP project.
4. Planning and budgeting	Moderate	The Project budgets might not be adequately monitored, resulting in adverse variances which might limit budget availability for key project activities.	MDF has a budget monitoring system which allows for daily reporting using a bottom-up approach. A quarterly budget utilization report is also submitted to MRDI. The process works well for payments in GEL but the need for manual calculations for multi-currency contracts creates risk.
5. Asset management	Moderate	The entity might not have appropriate HR and infrastructural resources to effectively manage its operating assets.	MDF has limited fixed assets. However, these are managed effectively, with regular updates made to the fixed asset register under Georgian legislation. MDF has a relatively experienced Financial Department, including staff knowledgeable in ADB procedures.

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
6. Financial reporting and external audits	Moderate	The Entity might not be able to comply with the statutory and ADB requirements for submission of audited entity financial statements within prescribed timelines.	The financial reporting controls in MDF are adequately designed and operate as per identified policies and procedures. External auditors have expressed unqualified audit opinion on MDF's financial statements for the FY 2019 and in previous years. Furthermore, unqualified opinions have been expressed by project auditors for the ADB SUTIP project. Certain changes to MDF's internal accounting procedures are required to facilitate automated reporting under ADB requirements. However, due to high costs, these changes are not seen as priority, especially as auditors have not raised major issues with SUTIP reporting.
7. Internal audit	Moderate	The Project might not be subject to sufficient and appropriate internal audit arrangements.	The internal audit of MDF's activities is covered by MRDI's internal audit program as well as SAO procedures. MRDI's IAD is well staffed. However, the lack of on-site internal auditing creates a risk of activities not being closely monitored between scheduled visits (roughly every 2 years).
8. Information Systems	Moderate	The information systems might not be sufficient to ensure accurate recording and reporting of the Project's financial transactions.	MDF is integrated into Government software for information storage (e-doc) and payments (e-Treasury). MDF has its own Management Information System and accounting software. The accounting software is capable to producing basic financial reports though manual processes are required to develop project financial statements. In the medium term a solution is recommended to allow for automated reports, though no major issues have risen under the current arrangements.
Overall Project Risk	**Moderate**		

L = low, M = moderate, S = substantial.

Table 7: FMICRA – Inherent risks: TDF

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
1.Implementing entity	Substantial	The Entity might not have adequate and appropriate structure for effective financial management.	TDF is looking to develop a similar structure to MDF for Tbilisi based projects. However, it does not have experience with donor-finance projects, though it is currently setting up a PIU. Moreover, it needs to address identified weaknesses in project management procedures.
2. Funds Flow	Substantial	The Project funds might not be available on a timely basis, with poor systems of tracking to validate their use for intended purposes.	TDF has treasury controls that meet GOG requirements but has no experience with ADB or similar projects. The creation of a PIU is mitigating this risk.
3. Staffing	Substantial	The Project might not have sufficient and adequately qualified Financial Management and Accounting staff, thus affecting the implementation of disbursement and financial management activities.	TDF financial staff is experienced in national standards, though it does not have experience in implementing projects for donor agencies, with no experience of ADB procedures. The setting up of a PIU, with an experienced Financial Manager is mitigating this risk. Appropriate training in ADB procedures will need to be provided to all finance and PIU staff in TDF.
4. Planning and budgeting	Substantial	The Project budgets might not be adequately monitored, resulting in adverse variances which might limit budget availability for key project activities.	TDF's budget monitoring system is sound, but its accounting system will need modifying to meet the needs of the Project. The Project is also exposed to risk of budget variations which require constant and effective request for funds and monitoring of implementation. Weaknesses identified by SAO in project management practices will need to be addressed.
5. Asset management	Moderate	The entity might not have appropriate HR and infrastructural resources to effectively manage its operating assets.	TDF has limited fixed assets. However, these are managed effectively, with regular updates made to the fixed asset register under Georgian legislation, with processes for write-off.

Risk type	Risk Assessment	Risk Description	Risk Mitigation Measures / Justification for risk assessment
6. Financial reporting and external audits	Substantial	The Entity might not be able to comply with the statutory and ADB requirements for submission of audited entity financial statements within prescribed timelines.	TDF has no experience with ADB requirements. It will need to update its financial statements from national standards to IPSAS cash modified, and also tailor its accounting system to allow statements to be prepared under ADB requirements. It is setting up a PIU with a Finance Manager experienced in ADB procedures, with additional recruitment of an accountant/disbursement officer required.
7. Internal audit	Substantial	The Project might not be subject to sufficient and appropriate internal audit arrangements.	The internal audit of TDF is covered by TCM's internal audit program. TCM's IAD is equipped for its role under national standards though without experience in ADB or similar projects. It also requires training support in international auditing practices.
8. Information Systems	Moderate	The information systems might not be sufficient to ensure accurate recording and reporting of the Project's financial transactions.	TDF is integrated into Government software for information storage (e-doc) and payments (e-Treasury). TDF needs to amend its accounting software to meet the needs of the project and its reporting, though tailoring is expected to be possible within existing software packages.
Overall Project Risk	**Substantial**		

L = low, M = moderate, S = substantial.

VIII. PROPOSED FINANCIAL MANAGEMENT ACTION PLAN

137. Based on the identified risks and proposed mitigation measures, a time-bound financial management action plan is given below:

Table 8: Financial Management Action Plan (FMAP)

Entity	Action Plan	Responsibility	Timing
MRDI	Training on ADB procedures and international auditing best practices for Internal Audit Department	ADB	By loan effectiveness date
	Include ADB project in the annual internal audit plan	MRDI	By Q1 2022
	Complete FM Manual	MRDI	Six months from loan effectiveness date
TCM	Assign dedicated staff to the project within TCM	TCM	By loan effectiveness date
	Training on loan management and ADB procedures for the Internal Audit staff and financial staff assigned to project	ADB	By loan effectiveness date

	Training on international auditing best practices to Internal Audit staff	ADB	By loan effectiveness date
	Create financial management manual to support IPSAS-based accounting	TCM	By December 2021
	ADB project included in the annual internal audit plan	TCM	By Q1 2022
MDF	Employ an additional ADB disbursement officer to manage project disbursement and reporting	MDF /ADB	By loan effectiveness date
	Open and maintain a dedicated bank account for managing the Project funds.	MDF	Within 2 weeks after loan effectiveness
	Training on ADB procedures for new disbursement officer in MDF	ADB	Within 2 weeks after loan effectiveness
TDF	Fully set up the PIU within TDF, including recruitment of a project accountant	TDF	By loan effectiveness date
	Training on ADB procedures for PIU and relevant Finance Division staff at TDF	ADB	By loan effectiveness date
	Introduce IPSAS cash-modified financial reporting	TCM	By December 2021
	Create financial management manual to support IPSAS-based accounting	TCM	By December 2021

IX. FINANCIAL STATEMENT ANALYSIS

A. Historical Financial Statement Analysis of MDF

Introduction

138. MDF engages in several activities to support the long-term institutional and socio-economic development of municipalities, investing in local infrastructure and services and making other expenditure to improve economic and social conditions for the local population. Examples of this expenditure includes urban renovation of the cities, enhancing infrastructure at tourist and cultural heritage monuments and construction and rehabilitation of schools and kindergartens. The investment undertaken by MDF is undertaken in close corporation with international donor organizations and the GOG, the major financiers of its activities.

139. MDF is largely self-funded, with the largest part of its expenditure based on a revolving fund (restricted reserves) whose funds can only be used for the purpose of project-related expenditure. It also earns income from bank deposits, and from loans to municipalities and other entities.

Financial data considered.

140. Statutory Financial Statements for the period 2017-2019 that have been prepared under IFRS and subject to external audit have been reviewed. A four-year period of analysis is possible covering 2016-2019 given the publication of previous year data in the 2017 accounts.

141. Over the four-year period, MDF has broadly reported positive net income, as set out in the summary of its Income Statement below.

Table 9: Income Statement 2016-2019 (GEL)

INCOME	**2016**	**2017**	**2018**	**2019**
Finance Income	3,840,723	4,408,606	10,765,785	13,589,073
Income from loans to municipalities	3,446,998	5,294,578	2,080,537	3,615,135
Other interest income	1,907,322	1,721,996	997,069	618,985
Other income	-	-	4,820	1,193,512
Financial income	**9,195,043**	**11,425,180**	**13,848,211**	**19,016,705**
EXPENSES				
Provision for legal cases	-	-	-	-6,469,415
Employee benefits	-4,225,165	-3,640,496	-3,628,463	-4,356,257
Tax expenses other than income tax	-	-1,067,592	-2,055,979	-2,958,542
Impairment of doubtful receivables	-	-	-1,223,169	-4,396,549
Depreciation and amortization	-513,181	-557,919	-557,145	-483,941
Other administrative expenses (net)	5,270,121	-4,510,343	-721,620	-925,649
Total expenses	**531,775**	**-9,776,350**	**-8,186,376**	**-19,590,353**
Gains/losses from exchange rate differences	6,309,470	-2,267,087	528,269	5,323,902
Profit for the year	**16,036,288**	**-618,257**	**6,190,104**	**4,750,254**
Income tax expense	-959,066	-426,575	-856,848	-
Net profit (loss) for the year	**15,077,222**	**-1,044,832**	**5,333,256**	**4,750,254**

142. The key source of income contributing towards the net profit in recent years has been finance income, which is interest income from bank deposits. The interest received has been close to 10% per annum, representing a margin above the GOG refinancing rate, currently at 8%. MDF also earns interest on loans to municipalities. These loans represent the on-lending of certain funds provided by donor institutions for investment projects. MDF generally earns an interest rate of 11-12% from on-lending. These loans are unsecured, though credit risk to MDF is relatively low. In some cases, MDF effectively acts as an agent between the MOF and the municipality, while in other cases the municipalities are provided budgetary allocations to meet these loan obligations to MDF. Other interest income is earned on medium term loans to Tbilisi City Municipality, United Water Supply Company of Georgia and some Commercial Banks.

143. Annual expenses have varied significantly. In 2019 a large provision is provided for legal expenses. This provision is related to land acquisition under a project loan, which will be subsequently reimbursed through the expenditure process (revolving fund). Impairment for doubtful receivables increased notably in 2019. However, a large proportion of this impairment provision relates to lending to municipalities for which MDF entails limited credit risk, with any shortfall being subsequently reimbursed by the GOG. Depreciation and amortization have been relatively constant and reflects the limited fixed assets owned by MDF. Gains and losses from exchange rate differences reflect that MDF receives money from donors in USD or EUR, which are converted to GEL on a periodic basis, with the fluctuation between the date the funds are received and converted resulting in a foreign exchange gain or loss. Ultimately any change in costs from foreign exchange impacts are reflected in the final loan amount, minimising the foreign exchange exposure to MDF.

144. MDF’s balance sheet reflects the current nature of much of its financial activities, with high proportions of current assets and liabilities. A breakdown of assets is set out in the following table.

Table 10: Balance Sheet – Assets 2016-2019 (GEL)

Non-current assets	**2016**	**2017**	**2018**	**2019**
Property and equipment	2,495,049	2,277,570	1,947,678	2,424,093
Intangible assets	281,942	313,417	265,558	218,023
Receivables from municipalities	-	27,397,811	25,927,993	21,938,718
Loans to municipalities	25,485,644	20,380,012	21,154,210	17,722,893
Other loans disbursed	30,608,993	11,969,704	4,548,973	16,450,468
Other	-	86,487	-	-
TOTAL NON-CURRENT ASSETS	**58,871,628**	**62,425,001**	**53,844,412**	**58,754,195**
Current assets				
Loans to municipalities	6,016,231	6,662,126	5,903,848	6,361,450
Receivables from municipalities	-	2,113,759	2,329,695	4,082,878
Other loans disbursed	5,558,628	5,197,808	25,857,342	25,907,680
Other	3,488,087	3,630,230	2,747,692	1,844,875
Receivables and advances	94,056,012	99,896,827	54,739,514	112,994,377
Deposits in banks	30,000,000	36,000,000	58,000,000	116,166,904
Cash and cash equivalents	39,608,316	230,865,327	185,645,343	175,722,844
TOTAL CURRENT ASSETS	**278,727,274**	**384,366,077**	**335,223,434**	**443,081,008**
TOTAL ASSETS	**337,598,902**	**446,791,078**	**389,067,846**	**501,835,203**

145. Non-current assets are primarily composed of loans to municipalities, receivables from municipalities (loans to municipalities where MDF acts as an agent and has no credit risk on the lending) and other loans. Key components of current assets represent interest earning bank deposits, cash and cash equivalents (state treasury and commercial bank accounts) and advances to contractors, which is the major component of the “receivables and advances” entry.

146. Reserves and liabilities are set out in the following table. This shows that the predominant form of reserves is the balance on the revolving fund held with the GOG and IFIs and retained earnings.

Table 11: Balance Sheet – Reserves and Liabilities 2016-2019 (GEL)

	2016	**2017**	**2018**	**2019**
Reserves				
Restricted reserves	242,892,022	331,108,766	257,672,065	344,947,335
Retained earnings	58,550,247	57,505,415	62,838,673	67,588,927
TOTAL RESERVES	**301,442,269**	**388,614,181**	**320,510,738**	**412,536,262**
Non-current liabilities				
Grants related to assets	2,422,430	2,038,490	1,707,654	1,604,507
Long term debt	14,693,589	27,397,811	25,927,993	21,938,718
Provisions	-	-	-	6,469,415
TOTAL NON-CURRENT LIABILITIES	**17,116,019**	**29,436,301**	**27,635,647**	**30,012,640**
Current liabilities				
Current portion of long-term debt	-	2,170,290	2,329,695	4,082,878
Trade and other payables	19,040,614	26,570,306	38,591,766	55,203,423
TOTAL CURRENT LIABILITIES	**19,040,614**	**28,740,596**	**40,921,461**	**59,286,301**
TOTAL RESERVES AND LIABILITIES	**337,598,902**	**446,791,078**	**389,067,846**	**501,835.203**

147. MDF has significant cash balances built up, which was over 175 GEL million (approx. $55 million) at the end of 2019. The cashflow components fluctuate in line with the status of project financing, key major items of expenditure (e.g., advances to contractors), as well as investment decisions. A breakdown of key components of the cashflow statement from 2016 to 2019 is set out in the following table.

Table 12: Cashflow statement, 2016-2019 (GEL)

	2016	2017	2018	2019
Profit/loss after income tax	15,077,222	-1,044,832	5,333,256	4,750,254
Depreciation and amortization	513,181	557,919	557,145	483,941
Finance and related costs	-1,030,456	1,909,238	65,789	-
Provisions	-	-	2,902,008	10,865,964
Income from grants related to assets	-196,947	-276,119	-330,836	-134,153
Finance income	-9,195,044	-11,425,180	-13,946,024	-17,823,193
Income tax expense	959,066	426,575	856,848	-
Foreign exchange gain (loss)	-6,309,470	2,267,087	-528,269	-5,323,902
Operating loss before working capital changes	-182,448	-7,585,312	-5,090,083	-7,181,089
Change in receivables and advances	-34,736,781	-5,684,676	43,420,236	-59,652,256
Changes in other current assets	-3,424,783	-184,282	310,914	2,459,563
Change in deposits in banks	-7,400,000	-6,000,000	-22,000,000	-52,684,684
Changes in taxes recoverable and prepaid	-	-	-	-1,556,746
Change in payables	1,183,320	3,386,379	12,814,867	14,443,135
Income tax and interest paid	-316,106	-764,284	-1,185,708	-
Net cash used in operating activities				
Net cashflow from operating activities	**-44,876,798**	**-16,832,175**	**28,270,226**	**-104,172,077**
Cashflow from investing activities				
Interest received from municipalities and banks	8,994,679	9,409,812	12,174,700	15,637,705
Other	-248,205	-129,843	-179,717	-198,171
Net cashflow from investing activities	**8,746,474**	**9,279,969**	**11,994,983**	**15,439,534**
Cashflow from financing activities				
Projects financing (net)	16,490,543	88,216,744	-73,436,701	87,275,270
Repayment (issuance) of loans to municipalities net	-7,012,705	-23,055,162	975,226	3,426,524
(Issuance) repayment of other loans net	-3,446,872	20,108,377	-13,297,045	-11,984,799
Receipt of long-term debt	14,577,890	12,374,786	517,442	-
Net cashflow from financing activities	**20,608,856**	**97,644,745**	**-85,241,078**	**78,716,995**
NET INCREASE IN CASH AND EQUIVALENT	**-15,521,468**	**90,092,539**	**-44,975,869**	**-10,015,548**
Effect of FX changes on cash and equivalent	12,821,677	1,164,472	-244,115	93,049
EOY CASH AND CASH EQUIVALENT	**39,608,316**	**230,865,327**	**185,645,343**	**175,722,844**

148. A key volatile component in the financing component of the Cashflow statement is the project financing item (restricted reserves), which accounts for changes in net financing received and expenditures A breakdown of finance received, and expenditure incurred in 2018 and 2019 is set out in the table below. This shows the main financier of MDF's activities is the GOG, with ADB, World Bank and the EIB being the largest other contributors to MDF's investment activity.

Table 13: Funds in and out of the project finance fund 2018-2019 (GEL)

	2018 - in	2018 - out	2019 - in	2019 - out
Government of Georgia	118,311,026	-148,391,457	193,962,313	-125,477,292
ADB	61,085,073	-57,553,034	42,244,986	-71,735,314
Municipalities	-602,508	-2,184,147	8,410,578	-6,785,929
Swedish International Development Agency	8,048,284	-10,059,915	5,669,216	-7,111,790
Government of France	-	-2,051,362	-	-223,172

EBRD	517,442	-1,240,216	711,873	-699,632
MDF	4,322,950	-7,708,836	5,814,145	-4,744,640
World Bank	25,068,391	-32,547,296	51,422,404	-53,325,398
EIB	44,046,385	-72,497,481	97,402,109	-54,015,786
Council of Europe Development Bank	-	-	2,811,082	-327,540
Nordic Environment Finance Corporation	-	-	3,365,669	-92,612
TOTAL	**260,797,043**	**-334,233,744**	**411,814,375**	**-324,539,105**

149. Selected financial ratios are included in the following table. Due to limited reported debt repayment and interest expenses, many typical debt service ratios are not shown.

Table 14: Selected Financial Ratios

	2016	**2017**	**2018**	**2019**
Liquidity Ratios				
Current Ratio	14.64	13.37	8.19	7.47
Cash Ratio	7.33	8.03	4.54	2.96
Quick Ratio	12.27	11.51	5.87	4.87
Receivable (Days of Finance Income)	225.27	285.70	112.77	106.11
Payables (Days of Finance Income)	101.65	313.64	417.85	511.61
Profitability Ratios				
Admin expenses as % finance income	51.8%	53.4%	59.1%	103.0%
Excluding major provisions	51.8%	53.4%	59.1%	69.0%
Excluding major provisions and impairment	51.8%	53.4%	50.3%	45.9%
Net Profit Margin	164%	-9%	39%	25%
ROE (post-tax)	5.0%	-0.3%	1.7%	1.2%
ROA (pre-tax)	4.8%	-0.1%	1.6%	0.9%
Debt Ratios				
Debt to Assets Ratio	4.4%	6.1%	6.7%	4.4%
Debt to Equity Ratio	4.9%	7.1%	8.1%	5.3%
Debt Service Coverage Ratio[13]	60.21	2.79	-	-

150. The current ratio, cash ratio and quick ratios have high values and confirm strong liquidity and capacity for MDF to meet short term liabilities. Calculated receivables and particularly payables seem high, though financial risk to MDF is low. Around half of receivables incorporated in the calculation represent outstanding receivables from contractors when a contract is terminated, with a large part of the remainder receivables from municipalities. Payables include any overdraft balance on the treasury account and guarantees received from counterparties that are refundable in the State Budget.

151. In general, administrative expenditure is well below total financial income, indicating an ability to fund its key operating activities. Return on assets and equity are low, but positive, reflecting that the most significant part of its equity and assets is linked to the revolving fund. Consistent with this observation, the debt to asset and debt to equity ratios are low.

B. Financial Statement projections of MDF

152. Financial statement projections have been made to 2025 based on the same format as for the historical financial statement assessment. In developing these projections, data has been sourced from 2020 and 2021 budgetary projections of MDF and project projections made up to

[13] No interest payments or debt repayments are explicitly reported in the Financial Statements for 2018 and 2019.

2024 in MRDI budgetary documents. A core forecast is developed, largely reflecting current practice and incorporating budgetary allowances. A scenario is also developed, considering changes in the values of certain values that are critical to MDF's financial performance.

153. Key assumptions in developing the Income Statement projection include:

- MDF earns 10% on bank deposits and 10.5% on loans to municipalities, while it faces a refinancing rate of 8% on its borrowing reported as long term (from EBRD).
- Overall administrative expenditure (own expenditure of staff etc.,) follows that in the budget for 2020 and 2021 and thereafter increases by 4% per annum.
- An impairment provision of 1.5 million GEL is included each year for bad debt of municipalities.
- Depreciation of own fixed assets is estimated based on standard asset lives, with new additions (capital expenditure) based on average expenditure in the period 2017-19 for each category of asset, adjusted where necessary to ensure the net end of year asset value for each asset category does not reduce.
- No short term explicit foreign exchange gains or losses.
- Income tax of 15% is applicable on pre-tax profit.

154. In developing the Balance Sheet projection key assumptions on assets, reserves and liabilities include:

- Relatively stability in the on-lending to municipalities from MOF, with direct lending from MDF to Municipalities being as per budgetary allowances for 2020 and 2021, with this remaining stable in future years.
- No other new lending.
- A gradual increase in in receivables and advances to contractors.
- A target increase in overall bank deposits of 10 million GEL per year.
- An increase in the balance of the restrictive reserves (revolving fund) equal to the project expenditure allocated to MDF in loan funding.
- No long-term borrowing, though as the financing of the EBRD Solid Waste Management program is considered as long-term borrowing in MDF's balance sheet, repayments and interest payments are estimated, and are treated as long-term debt repayment for the forecast period.
- A gradual increase in payables and retentions from contractors of 4% per annum.

155. Based on the above assumptions the income statement reports a positive net profit throughout the period. The net profit margin is within the range of 18-27% for 2020-25, compared with 25% in 2019. A critical financing component for MDF is interest income, which remains well above interest costs – and despite the assumption of new long-term loans - due to the relatively large accumulated balances of bank deposits.

Table 15: Income Statement projection 2020-2025 (GEL)

INCOME	**2020**	**2022**	**2022**	**2023**	**2024**	**2025**
Finance Income	12,116,690	13,116,690	14,116,690	15,116,690	16,116,690	17,116,690
Income from loans to municipalities	4,671,216	4,329,235	3,975,770	3,559,304	3,079,838	2,537,373
Other interest	237,061	57,837	44,984	32,131	19,279	6,426
Other income	130,813	130,813	130,813	130,813	130,813	130,813
Financial income	17,155,780	17,634,575	18,268,257	18,838,939	19,346,620	19,791,302
EXPENSES						
Employee benefits	-5,700,000	-4,630,000	-4,815,200	-5,007,808	-5,208,120	-5,416,445

INCOME	2020	2022	2022	2023	2024	2025
Cost of goods sold	-2,513,870	-4,267,502	-4,397,034	-4,526,739	-4,655,944	-4,783,861
Impairment of doubtful receivables	-1,500,000	-1,500,000	-1,500,000	-1,500,000	-1,500,000	-1,500,000
Depreciation and amortization	-486,130	-532,498	-594,966	-664,941	-743,403	-831,460
Other expenses inc. finance costs	-3,048,286	-2,118,166	-1,818,166	-1,518,966	-1,220,598	-923,096
Total expenses	**-13,248,286**	**-13,048,166**	**-13,125,366**	**-13,218,454**	**-13,328,066**	**-13,454,862**
Gains/losses from forex differences	-	-	-	-	-	-
Profit for the year	3,907,493	4,586,409	5,142,891	5,620,484	6,018,555	6,336,440
Income tax expense	-586,124	-687,961	-771,434	-843,073	-902,783	-950,466
Net profit (loss) for the year	**3,321,369**	**3,898,448**	**4,371,457**	**4,777,412**	**5,115,771**	**5,385,974**

156. Based on the assumptions applied, the share of current assets in overall assets increases due to the assumption of lower on-lending of funds via MOF, and an increase in estimated cash and cash equivalents, and in bank deposits.

Table 16: Balance Sheet – Assets 2020-2025 (GEL)

Non-current assets	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Property and equipment	2,432,178	2,528,057	2,624,215	2,720,661	2,817,407	2,914,467
Intangible assets	218,023	218,023	218,023	218,023	218,023	218,023
Receivables from municipalities	18,586,854	14,869,483	11,152,113	7,434,742	3,717,371	-0
Loans to municipalities	21,036,229	20,202,172	18,768,115	16,734,057	14,100,000	10,865,943
Other loans	3,520,249	2,640,187	1,760,124	880,062	-	-
Other	-	-	-	-	-	-
NON-CURRENT ASSETS	**45,793,533**	**40,457,922**	**34,522,589**	**27,987,545**	**20,852,801**	**13,998,432**
Current assets						
Loans to municipalities	4,734,057	5,334,057	5,934,057	6,534,057	7,134,057	7,734,057
Receivables from municipalities	3,717,371	3,717,371	3,717,371	3,717,371	3,717,371	3,717,371
Other loans disb.	7,880,062	880,062	880,062	880,062	880,062	-
Other	1,844,875	1,844,875	1,844,875	1,844,875	1,844,875	1,844,875
Receivables and advances	116,764,685	121,375,272	126,170,283	131,157,094	136,343,378	141,737,113
Deposits in banks	126,166,904	136,166,904	146,166,904	156,166,904	166,166,904	176,166,904
Cash/ equivalents	206,126,431	220,608,365	227,995,619	232,164,527	234,304,152	234,768,629
CURR, ASSETS	**467,234,385**	**489,926,906**	**512,709,171**	**532,464,891**	**550,390,799**	**565,968,949**
TOTAL ASSETS	**513,027,918**	**530,384,828**	**547,231,760**	**560,452,436**	**571,243,600**	**579,967,382**

157. Movements in the reserves and liabilities are shown below. The amount of restricted reserves is assumed to increase gradually, with a near doubling in non-current liabilities due to the assumption of new long-term debt.

Table 17: Balance Sheet – Reserves and Liabilities 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Reserves						
Restricted reserves	352.022.335	365.722.335	378.289.009	386.667.120	392.114.754	395.055.691
Retained earnings	70.910.296	74.808.744	79.180.201	83.957.613	89.073.384	94.459.359
TOTAL RESERVES	**423.815.358**	**441.413.805**	**458.351.936**	**471.507.459**	**482.070.865**	**490.397.777**
Non-current liab.						
Grants related to assets	3.104.507	4.566.507	6.086.987	7.668.286	9.312.837	11.023.171
Long term debt	18.227.079	14.227.079	10.227.079	6.227.079	2.227.079	-
Provisions	6.469.415	6.469.415	6.469.415	6.469.415	6.469.415	6.469.415
NON-CURRENT LIABILITIES	**27.801.001**	**25.263.001**	**22.783.481**	**20.364.780**	**18.009.331**	**17.492.586**
Current liabilities						
Current portion of long-term debt	4.000.000	4.000.000	4.000.000	4.000.000	4.000.000	2.227.079
Trade and other payables	57.411.560	59.708.022	62.096.343	64.580.197	67.163.405	69.849.941
CURRENT LIABILITIES	**61.411.560**	**63.708.022**	**66.096.343**	**68.580.197**	**71.163.405**	**72.077.020**
RESERVES AND LIABILITIES	**513.027.918**	**530.384.828**	**547.231.760**	**560.452.436**	**571.243.600**	**579.967.382**

158. Under all the above assumptions, MDF is able to increase its cash balances, with the increase most pronounced in the beginning of the forecast period, partly due to the repayment of loans by Commercial Banks and the United Airports of Georgia that are not assumed to be re-lent.

Table 18: Cashflow statement, 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Profit/loss after income tax	3,321,369	3,898,448	4,371,457	4,777,412	5,115,771	5,385,974
Depreciation and amortization	486,130	532,498	594,966	664,941	743,403	831,460
Finance and related costs	1,898,286	1,618,166	1,298,166	978,166	658,166	338,166
Provisions	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Income from asset related grants	1,500,000	1,462,000	1,520,480	1,581,299	1,644,551	1,710,333
Finance income	-17,155,780	-17,634,575	-18,268,257	-18,838,939	-19,346,620	-19,791,302
Income tax expense	586,124	687,961	771,434	843,073	902,783	950,466
Foreign exchange gain (loss)	-	-	-	-	-	-
Operating loss before working cap, changes	-7,863,870	-7,935,502	-8,211,754	-8,494,047	-8,781,945	-9,074,902
Change in receivables and advances	-3,770,308	-4,610,587	-4,795,011	-4,986,811	-5,186,284	-5,393,735
Changes in other current assets	-	-	-	-	-	-
Change in deposits in banks	-10,000,000	-10,000,000	-10,000,000	-10,000,000	-10,000,000	-10,000,000
Changes in taxes recoverable & prepaid	-	-	-	-	-	-

	2020	2021	2022	2023	2024	2025
Change in payables	2,208,137	2,296,462	2,388,321	2,483,854	2,583,208	2,686,536
Income tax and interest paid	-2,484,410	-2,306,128	-2,069,600	-1,821,239	-1,560,949	-1,288,632
Net cashflow from operating activities	**-21,910,451**	**-22,555,754**	**-22,688,044**	**-22,818,244**	**-22,945,971**	**-23,070,733**
Cashflow from investing activities						
Interest received from municipalities/ banks	17,155,780	17,634,575	18,268,257	18,838,939	19,346,620	19,791,302
Other	-494,215	-628,378	-691,123	-761,388	-840,150	-928,519
Net cashflow from investing activities	**16,661,565**	**17,006,197**	**17,577,134**	**18,077,551**	**18,506,471**	**18,862,783**
Cashflow from financing activities						
Projects financing (net)	7,075,000	13,700,000	12,566,674	8,378,111	5,447,634	2,940,938
Repayment (issuance) loans to municipalities	531,428	2,451,428	3,051,428	3,651,428	4,251,428	4,851,428
(Issuance) repayment of other loans net	31,049,045	7,880,062	880,062	880,062	880,062	880,062
Receipt of long-term debt	-3,003,000	-4,000,000	-4,000,000	-4,000,000	-4,000,000	-4,000,000
Net cashflow from financing activities	**35,652,473**	**20,031,490**	**12,498,164**	**8,909,602**	**6,579,124**	**4,672,428**
NET INCREASE IN CASH / EQUIVALENT	**30,403,587**	**14,481,933**	**7,387,254**	**4,168,909**	**2,139,624**	**464,477**
FX changes on cash/ equivalent	-	-	-	-	-	-
EOY CASH AND CASH EQUIVALENT	**206,126,431**	**220,608,365**	**227,995,619**	**232,164,527**	**234,304,152**	**234,768,629**

159. Selected financial ratios as shown for the historical analysis are included in the following table.

Table 19: Selected Financial Ratios 2020-2025

	2020	2021	2022	2023	2024	2025
Liquidity Ratios						
Current Ratio	7.61	7.69	7.76	7.76	7.73	7.85
Cash Ratio	3.36	3.46	3.45	3.39	3.29	3.26
Quick Ratio	5.26	5.37	5.36	5.30	5.21	5.22
Receivable (Days of Finance Income)	106.38	106.39	105.61	105.34	105.55	106.20
Payables (Days of Finance Income)	589.79	596.73	599.07	604.16	611.84	622.02
Profitability Ratios						
Admin expenses as % finance income	66.2%	64.8%	64.7%	65.0%	65.5%	66.3%
Excluding major provisions	66.2%	64.8%	64.7%	65.0%	65.5%	66.3%
Excluding major provisions and impairment	57.4%	56.3%	56.5%	57.0%	57.7%	58.7%
Net Profit Margin	19%	22%	24%	25%	26%	27%
ROE (post-tax)	0.8%	0.9%	1.0%	1.0%	1.1%	1.1%
ROA (pre-tax)	0.8%	0.9%	0.9%	1.0%	1.1%	1.1%
Debt Ratios						
Debt to Assets Ratio	3.6%	2.7%	1.9%	1.1%	0.4%	0.0%
Debt to Equity Ratio	4.3%	3.2%	2.2%	1.3%	0.5%	0.0%

	2020	2021	2022	2023	2024	2025
Debt service coverage ratio	1.18	1.10	1.22	1.33	1.43	1.54

160. The above analysis shows that MDF's financial prospects depend on the availability of a strong flow of interest income, and particularly an important different between interest income and costs. Moreover, its liquidity has been strong due to ongoing increases in its restricted reserves balance.

161. To test the sensitivity of its financial statement the following scenario has been run:

- Reduction in average interest received on deposits 25% (previous return of 10% becomes 7.5%), without any change in the interest payable on loans.
- Slower increase in new bank deposits from 2021 (5 million GEL per year instead of 10 million GEL).
- No increase in the restricted reserve balance.

162. The key impacts from the above scenario are seen on the anticipated net profit and increase in cashflow as shown in the table below.

Table 20: Selected impacts of scenario analysis 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Finance income (core scenario)	12,116,690	13,116,690	14,116,690	15,116,690	16,116,690	17,116,690
Interest income (sensitivity)	12,116,690	9,650,018	10,025,018	10,400,018	10,775,018	11,150,018
Revised pre-tax income	3,907,493	1,119,736	1,051,218	903,812	676,882	369,768
Taxation	-586,124	-167,960	-157,683	-135,572	-101,532	-55,465
Net income	**3,321,369**	**951,776**	**893,535**	**768,240**	**575,350**	**314,303**
Cash flow impact						
Annual cash flow (core scenario)	30,403,587	14,481,933	7,387,254	4,168,909	2,139,624	464,477
Annual cash flow (sensitivity)	30,403,587	16,535,262	-3,657,342	-3,218,374	-2,848,431	-2,548,132
EOY cash and equivalents	**206,126,431**	**222,661,693**	**219,004,351**	**215,785,977**	**212,937,546**	**210,389,414**

163. Corresponding financial ratios shows a gradual worsening of the net profit ratio and the returns on equity and asset. At the same time the ratio of administrative expenses to finance increase increases (as finance income reduces), while estimated receivables and payables also increase. However, liquidity ratios remain strong.

Table 21: Selected Financial Ratios – scenario analysis 2020-2025

	2020	2021	2022	2023	2024	2025
Liquidity Ratios						
Current Ratio	7.61	7.64	7.47	7.31	7.15	7.17
Cash Ratio	3.36	3.50	3.31	3.15	2.99	2.92
Quick Ratio	5.26	5.40	5.22	5.06	4.91	4.89
Receivable (Days of Finance Income)	106.38	132.42	136.09	140.52	145.81	152.03
Payables (Days of Finance Income)	589.79	742.74	771.98	805.95	845.21	890.48
Profitability Ratios						
Admin expenses as % finance income	66.2%	80.7%	83.4%	86.7%	90.5%	94.9%

	2020	2021	2022	2023	2024	2025
Excluding major provisions	66.2%	80.7%	83.4%	86.7%	90.5%	94.9%
Excluding major provisions and impairment	57.4%	70.1%	72.8%	76.1%	79.8%	84.0%
Net Profit Margin	19%	7%	6%	5%	4%	2%
ROE (post-tax)	0.8%	0.2%	0.2%	0.2%	0.1%	0.1%
ROA (pre-tax)	0.8%	0.2%	0.2%	0.2%	0.1%	0.1%
Debt Ratios						
Debt to Assets Ratio	3.6%	2.7%	1.9%	1.2%	0.4%	0.0%
Debt to Equity Ratio	4.3%	3.2%	2.3%	1.4%	0.5%	0.0%
Debt Service Coverage Ratio	1.18	0.49	0.44	0.38	0.29	0.16

164. The above analysis is relatively simplified. However, the projections, seen together with historical performance suggest that financial risks in MDF are relatively limited and can be managed through budgetary provisions where necessary. Due to MDF's role as an IA, loans from ADB and other IFIs are primarily passed through MDF's accounts as income and expenditure under its restricted reserves balance, and hence any repayment obligations are limited. This said, MDF's capacity to take on lending is highly restricted, especially in this scenario due to the decline in its net income. A substantial restricted reserves balance provides an important liquidity cushion, while the large amount of bank deposits allows for sufficient return to meet administrative expenses not covered through other sources of finance, including a margin for loan write-down, the risk of which is limited due to Government financial support of municipalities.

C. Historical Financial Statement Analysis of TDF

Introduction

165. TDF is a non-profit (non-commercial) legal entity, whose aim is to preserve the historical appearance of the City of Tbilisi and to promote the value of real estate. TDF is almost entirely funded out of budgetary contributions, earning a small income from bank deposits.

Financial data considered.

166. Accounts are developed under Georgian Standards reflecting the requirements of SAO. Accounts prepared under local standards are not directly comparable to accounts prepared under IFRS, with focus placed on the balance sheet and the two main sources of equity: its net worth, which broadly reflects the difference between budgetary allocations and expenditure; and accumulated retained earnings within TDF. A three-year period of analysis is set out based on the period 2017-2019.

167. Over the three-year period, total assets and liabilities of TDF have more than doubled, as set out in the summary of its Balance Sheet below.

Table 22: TDF Balance Sheet 2017-2019 (GEL)

	2017	2018	2019
Financial Assets			
Bank accounts	1,856,970	2,098,948	1,735,011
Advance payments goods and services	20,859,526	18,703,042	28,625,752
Advance payments financial assets	0	15,916,424	11,667,705
Other	125,414	71,933	96,804
Total financial assets	**22,841,910**	**36,790,347**	**42,125,272**

	2017	2018	2019
Non-financial assets			
Assets and materials	14,811,322	12,943,699	24,149,052
Work in progress	522,699	12,618,035	25,188,662
Inventory and other assets	698,656	3,135,722	3,220,326
Total non-financial assets	**16,032,677**	**28,697,456**	**52,558,040**
Total assets	**38,874,587**	**65,487,803**	**94,683,312**
Liabilities and equity			
Income and other taxes payable	812,055	812,055	812,055
Net worth	16,303,859	42,801,508	72,584,097
Retained earnings	21,516,027	21,622,016	21,197,480
Other	242,646	252,225	89,680
Total liabilities	**38,874,587**	**65,487,804**	**94,683,312**

168. The key component of financial assets are advance payments for goods and services and financial assets, while non-financial assets reflect TDF own assets and construction work in progress. The Funds liabilities and equity are largely accounted for its net worth, which has increased by more than four times since 2017 and its retained earnings, whose balance has remained largely constant. TDF has no debt financing.

169. A summary of the net worth balance is shown below. The balance has increased over the three years reflecting that budgetary allocations have growth faster than capital expenditure and other expenditure on TDF's administrative activities.

Table 23: TDF Net Worth balance – 2017-2019 (GEL)

	2017	2018	2019
Starting value	4,079,820	16,303,859	42,801,508
Total credits	**37,884,387**	**62,392,689**	**77,016,940**
Budget	37,672,400	62,365,494	71,981,397
Income	192,348	20,061	236,302
Other revenue	19,639	7,134	4,799,242
Total debits	**25,660,348**	**35,895,041**	**47,568,919**
Salaries	1,937,210	1,983,267	1,950,014
Goods and services	489,766	435,084	969,242
Depreciation	17,538	185,857	334,567
Other charges (construction)	22,985,066	33,223,060	35,342,845
Other liabilities	230,757	67,772	8,637,683
Net impact	**12,224,039**	**26,497,649**	**29,448,022**
End of year value	16,303,859	42,801,508	72,249,530

170. The inherent self-financing capacity of TDF is reflected by its retained earnings. Net changes to this balance, from income and expenditure was relatively low in 2019, with the main income reflecting interest on bank accounts.

Table 24: TDF – Retained Earnings 2017-2019 (GEL)

	2017	2018	2019
Starting retained earnings balance	43,590,750	21,516,027	21,622,016
Total income	**3,625,920**	**762,880**	**221,002**
Operating income	*294,302*	*236,932*	*192,239*
Non-operating income	*3,331,618*	*525,947*	*28,763*
Total expenditure	**25,700,643**	**656,891**	**645,538**
Operating expenditure	*14,945,181*	*291,274*	*645,538*
Salaries	0	0	302,084

Goods and services	17,879	1,858	15,723
Consumption of fixed capital	250,762	245,160	269,740
Grants payable	14,128,440	1,392	55,266
Others	548,101	42,865	2,726
Non-operating expenditure	*10,755,461*	*365,617*	*0*
Balance on year	**-22,074,723**	**105,989**	**-424,536**
End of year balance	21,516,027	21,622,016	21,197,480

171. Given its current reporting arrangements, which does not specify net income, nor separate assets and liabilities by duration (current/non-current), typical financial ratios are not provided. Moreover, debt/equity ratios or debt coverage ratios are not applicable given the lack of any lending by TDF. However, the performance of TDF is consistent with a non-for-profit entity operating primarily under budgetary contributions, with the reported data showing that budgetary contributions have been more than sufficient to meet its operating needs.

D. Financial Statement projections of TDF

172. Financial statement projections have been made to 2025 based on the same format as for the historical financial statement assessment. In developing these projections, data has been sourced from 2020 and 2021 budgetary projections of TDF, which is complemented by own assumptions. A core forecast is developed, reflecting the importance of budgetary allowances to TDF, for which key assumptions applied include:

- Capital expenditure funded out of budgetary contributions increases by 10% per annum after 2021, with advances to contractors rising in line with capital expenditure.
- Expenditure under the LCIP project is treated as a grant, with a notional amount of GEL 65 million included over 2022 and 2023.
- TDF earns 10% on bank deposits, its sole source of income aside from budget contributions and grants. A small increase in the balances is envisaged to facilitate a greater share of self-financing.
- Overall administrative expenditure (own expenditure of staff etc.,) follows that in the budget for 2020 and 2021 and thereafter increases by 5% per annum.
- Capital expenditure on TDF own facilities is projected similar to allowances in 2021 and 2022, with average depreciation of 20 years reflecting the high proportion of buildings in TDF's fixed assets.
- No short term or long-term borrowing is undertaken consistent with TDF's Charter.

173. Over the period to 2025, total assets and liabilities of TDF are expected to increase around 30% reflecting higher assumed capital expenditure program. The increase is reflected in the advanced payments and the net worth balance. The increase is much lower than over the period 2017-2019 as it is assumed that the gap between budgetary inflows and expenditure is relatively small (95% of contributions spent).

Table 25: Projected TDF Balance Sheet 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Financial Assets						
Bank accounts	1,735,011	3,735,011	5,735,011	7,735,011	7,735,011	7,735,011
Advanced payments goods and services	28,625,752	28,625,752	31,488,327	34,637,160	38,100,876	41,910,964
Advanced payments financial assets	11,667,705	11,667,705	12,834,476	14,117,923	15,529,715	17,082,687

	2020	2021	2022	2023	2024	2025
Other	96,804	96,804	96,804	96,804	96,804	96,804
Total financial assets	**42,125,272**	**44,125,272**	**50,154,618**	**56,586,898**	**61,462,406**	**66,825,465**
Non-financial assets						
Assets and materials	23,271,786	22,112,309	21,187,331	20,247,354	19,292,376	18,322,398
Work in progress	27,187,008	27,526,849	29,978,716	31,941,238	34,721,122	35,575,776
Inventory and other assets	3,220,326	3,220,326	3,220,326	3,220,326	3,220,326	3,220,326
Total non-financial assets	**53,679,121**	**52,859,484**	**54,386,373**	**55,408,918**	**57,235,804**	**57,118,500**
Total assets	**95,804,393**	**96,984,756**	**104,540,991**	**111,995,816**	**118,698,210**	**123,943,966**
Liabilities and equity						
Income and other taxes	812,055	812,055	812,055	812,055	812,055	812,055
Net worth	74,288,977	77,126,981	84,766,083	92,116,593	98,726,152	103,897,164
Retained earnings	20,613,681	18,956,040	18,873,173	18,977,488	19,068,343	19,145,066
Other	89,680	89,680	89,680	89,680	89,680	89,680
Total liabilities	**95,804,393**	**96,984,756**	**104,540,991**	**111,995,816**	**118,698,210**	**123,943,966**

174. Growth in financial assets is largely accounted for by advance payments for goods and services and financial assets, while the increase in non-financial assets reflects increased construction work in progress. The growth in the Funds liabilities and equity is entirely due to an increase in its net worth balance.

175. A summary of the net worth balance over the forecast period is shown below. The increase in the overall net worth balance reflects a relatively small and stable excess of credits over debits.

Table 26: Projected TDF Net Worth balance – 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Starting value	72,249,530	74,288,977	77,126,981	84,766,083	92,116,593	98,726,152
Total credits	**72,182,600**	**95,943,481**	**147,469,987**	**142,865,978**	**129,294,518**	**139,858,510**
Budget	72,182,600	95,943,481	107,469,987	117,865,978	129,294,518	139,858,510
Income	0	0	40,000,000	25,000,000	0	0
Other revenue	0	0	0	0	0	0
Total debits	**70,143,152**	**93,105,477**	**139,830,884**	**135,515,468**	**122,684,960**	**134,687,497**
Salaries	1,982,844	2,093,600	2,198,280	2,308,194	2,423,604	2,544,784
Goods and services	731,507	592,250	621,863	652,956	685,603	719,884
Depreciation	1,207,453	1,209,978	1,224,978	1,239,978	1,254,978	1,269,978
Other charges (construction)	60,002,247	82,602,149	128,517,514	123,319,266	109,526,192	120,478,812
Other liabilities	6,219,102	6,607,500	7,268,250	7,995,075	8,794,583	9,674,041
Net impact	**2,039,447**	**2,838,004**	**7,639,102**	**7,350,510**	**6,609,559**	**5,171,012**
End of year value	74,288,977	77,126,981	84,766,083	92,116,593	98,726,152	103,897,164

176. The self-financing capacity of TDF is assumed low throughout the forecast period, consistent with comments from TDF that there is no plan to require the Fund to increase its self-sufficiency. The main source of income is expected to remain interest on bank accounts, which is assumed to increase in line with a larger balance of funds in the bank and allow bonuses and own contributions to capital expenditure to be covered. Overall, largely due to anticipated expenditure increases from own funds in 2021, the retained earnings balance is expected to fall slightly over the forecast period.

Table 27: Projected TDF Retained Earnings 2020-2025 (GEL)

	2020	2021	2022	2023	2024	2025
Starting balance	21,197,480	20,613,681	18,956,040	18,873,173	18,977,488	19,068,343

	2020	2021	2022	2023	2024	2025
Total income	**173,501**	**373,501**	**573,501**	**773,501**	**773,501**	**773,501**
Operating income	*173,501*	*373,501*	*573,501*	*773,501*	*773,501*	*773,501*
Total expenditure	**757,300**	**2,031,142**	**656,368**	**669,186**	**682,646**	**696,778**
Operating expenditure	757,300	2,031,142	656,368	669,186	682,646	696,778
Salaries	304,485	207,360	217,728	228,614	240,045	252,047
Goods and services	49,158	181,800	38,640	40,572	42,601	44,731
Consumption of fixed capital	403,657	1,641,982	400,000	400,000	400,000	400,000
Balance on year	**-583,799**	**-1,657,641**	**-82,867**	**104,315**	**90,855**	**76,723**
End of year balance	20,613,681	18,956,040	18,873,173	18,977,488	19,068,343	19,145,066

177. The most critical variable reflecting TDF's financial operations is the budgetary allowance provided by TCM. The key financial risk would relate to a shortage of funding, which would inextricably affect TDF's ability to meet its capital program. However, to the extent that income and expenditure would be equally cut the overall impact could be managed, especially given positive balances for net worth and retained earnings (to a lesser extent). Given TDF's prohibition on borrowing together within minimal income generating capacity, no major changes in its financial operations are envisaged in the medium term.

X. PROPOSED FINANCIAL MANAGEMENT COVENANTS

178. The proposed financial management covenants are enlisted below:

a. The Entity (IA) shall (i) maintain separate accounts and records for the Project; (ii) prepare annual project financial statements (APFS) in accordance with accounting principles acceptable to ADB; (iii) have such statements audited annually by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with auditing standards acceptable to ADB; (iv) as part of each such audit, have the auditors prepare a report, which includes the auditors' opinion on the financial statements and the use of the proceeds under the Project, and a management letter (which sets out the deficiencies in the internal control of the Project that were identified in the course of the audit, if any); and (v) furnish to ADB, no later than 6 months after the close of the fiscal year to which they relate, copies of such audited financial statements, audit report and management letter, all in the English language, and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request;

b. ADB shall disclose the APFS and the opinion of the auditors on the financial statements within 14 days of the date of ADB's confirmation of their acceptability by posting them on ADB's website.

c. In addition to the APFS, the Entity shall (i) provide its annual entity financial statements (AEFS) prepared in accordance with financial reporting standards acceptable to ADB; (ii) have its entity financial statements audited annually by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with auditing standards acceptable to ADB; (iii) as part of each such audit, have the auditors prepare the auditors' opinion on the financial statements and compliance with the financial covenants of the Loan Agreement; and (iv) furnish to ADB, no later than 1 month after approval by the relevant authority, copies of such audited financial statements and auditors' opinion, all in the English language, and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.

d. The Entity shall enable ADB, upon ADB's request, to discuss the financial statements for the Project and the Entity's financial affairs where they relate to the Project with the auditors appointed and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB. This is provided that such discussions shall be conducted only in the presence of authorized officer of the Fund, unless the Fund shall otherwise agree.

e. TCM and TDF will implement financial reporting under the IPSAS cash-modified approach for its entity-wide financial statement during the 2021 Financial Year.

f. For TDF, for the first fiscal year payments will be based on the Direct Payment system. Based on a satisfactory opinion in the first audit ADB will decide if payments can revert to the Advance Account and SOE procedure.

XI. CONCLUSION

179. Financial management risks are most acute for TCM and TDF due to them not having previous experience with ADB projects and limited exposure to other IFI projects. Risks are most evident with delays in external audits for TCM and TDF, weak project management practices in TDF and continued reliance on local standards for financial reporting, instead of internationally accepted standards for public service bodies like the IPSAS cash-modified approach. Identified actions aim to mitigate these risks through extensive training on ADB procedures for relevant financial staff in TCM and TDF and the Internal Audit division in TCM, strengthening the Internal Audit division of TCM, requiring the preparation of entity accounts using IPSAS cash-modified approach and associated manuals, and requiring timely presentation of external audits in both entities. For budgetary activities, several safeguards that apply to all budgetary entities in Georgia, provide protection for the planning and budget drawdown process in TCM and TDF.

180. MRDI and MDF have extensive experience in executing and implementing projects for ADB, which significantly mitigates risk. While there is a need for ADB training, this is ongoing in nature as project finance and accounting staff dedicated to the SUTIP program have been with MDF for more than 5 years, while the level of knowledge of ADB procedures is generally high. Financial procedures are well developed with MDF's entity level reporting performed using IFRS, while the external audit process has operated on a timely basis with no major issues raised. MDF as an Entity is largely self-funded, with most non-project expenditure financed from interest income earned on bank accounts and some loans to municipalities and related bodies. While its financial situation is sound, it does not have the necessary earning ability to significantly increase its borrowing.