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GEORGIA'S INNOVATION & TECHNOLOGY AGENCY

SPECIAL PURPOSE FINANCIAL STATEMENTS

National Innovation Ecosystem (GENIE) Project
(IBRD Loan NUMBER 8595-GE)

Together with Independent Auditors' Report

For the year ended 31 December 2018

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INDEPENDENT AUDITOR'S REPORT

To the Management of GEORGIA'S INNOVATION AND TECHNOLOGY AGENCY

Opinion

We have audited the special purpose financial statements of "National Innovation Ecosystem Project" ("Project") financed by Financing Agreement IBRD Loan Number 8595-GE dated 28 March 2016 ("Financing Agreement"), and implemented by Georgia's Innovation and Technology Agency ("GITA"), which comprise the statement of cash receipts and payments and the statement of expenditures per components for the year ended 31 December 2018, and notes to the special purpose financial statements, including a summary of significant accounting policies.

In our opinion,

1. the accompanying financial statements present fairly, in all material respects, the cash flows for the year ended 31 December 2018 in accordance with International Public Sector Accounting Standard: *Financial Reporting Under the Cash Basis of Accounting ("IPSAS-Cash Basis")*;
2. funds have been used in accordance with the conditions of the Financing Agreement concluded between the International Bank for Reconstruction and Development ("IBRD") and Georgia, and WB Guidelines, and only for the purposes for which the financing was provided;
3. supporting documents, records and accounts have been maintained to support claims for reimbursement of expenditures incurred. Expenditures included in the withdrawal applications and reimbursed against are eligible for financing under the Financing Agreement; Interim Unaudited Financial Statements (IFSs) issued by GITA during the Reporting year are in agreement with the underlying books of account;
4. The Designated Accounts used has been maintained in accordance with the provision of the Financing Agreement, and World Bank related guidelines;
5. Goods, Works and Services financed have been procured in accordance with the Financing Agreement and World Bank related guidelines.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs") as issued by International Auditing and Assurance Standards Board ("IAASB") of the International Federation of Accountants ("IFAC"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Project and of the GITA in accordance with the *International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code")*, and we have fulfilled out other ethical requirements in accordance with IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter - Slow Progress in the Project implementation

Without qualifying our opinion, we draw your attention to Note 7 of these special purpose financial statements disclosing slow progress of the Project implementation and the measures taken by the Management of the GITA.

Emphasis of Matter - Cash Basis of Accounting

We draw attention to Note 2 to the financial statements, which describes that financial statements are prepared in accordance with cash basis framework, as a result, they may not be suitable for another purposes. Our opinion is not modified in respect of this matter.

BDO LLC, a Georgian Limited Liability Company, is a member of BDO International Limited, a UK Company limited by guarantee, and forms part of the international BDO network of independent member firms.

E 102416

Other Matter

The financial statements of the Project for the period from 1 June 2016 to 31 December 2016, and for the year ended 31 December 2017 were audited by another auditor who expressed an unmodified opinion on those statements on 21 June 2018.

Responsibilities of the Management for the Financial Statements

Management of the GITA is responsible for the preparation and fair presentation of the special purpose financial statements in accordance with IPSAS-Cash Basis issued by the International Public Sector Accounting Standards Board ("IPSASB") of the IFAC and Loan Handbook for World Bank Borrowers ("WB Guidelines"), and for such internal control as Management determines is necessary to enable the preparation of special purpose financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility for the Audit of the Special Purpose Financial Statements

Our objectives are to obtain reasonable assurance about whether the special purpose financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements arise from fraud and error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these special purpose financial statements.

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

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

We communicate with Management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

The engagement partner responsible for the audit resulting in this independent auditor's report is:

Ivane Zhuzhunashvili (# SARAS-A-720718)

For and on behalf of BDO LLC

Tbilisi, Georgia

29 May 2019

National Innovation Ecosystem Project

IBRD Loan Number 8595-GE

STATEMENT OF CASH RECEIPTS AND PAYMENTS

For the year ended 31 December 2018

(Amounts are shown in US dollars)

	Note	Actual			Budget	Variance
		For the year ended 31 December 2018	Cumulative as at 31 December 2017	Cumulative as at 31 December 2018	Cumulative as at 31 December 2018	Cumulative as at 31 December 2018
TOTAL OPENING CASH		1,660,593	-			
Sources of Funds	8					
IBRD Loan Number 8595-GE		1,000,000	2,200,000	3,200,000		
TOTAL FUNDS		**2,660,593**	**2,200,000**	**3,200,000**	-	-
Project Expenditures	7					
(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)		1,247,320	439,407	1,686,727	3,418,651	1,731,924
(2) Goods, non-consulting services, consultants' services, Training and Operating Costs for Part 1(c) of the Project, including BfD Payment		47,857	-	47,857	49,000	1,143
(3) Front-end Fee		-	100,000	100,000	100,000	-
TOTAL EXPENDITURES		**1,295,177**	**539,407**	**1,834,584**	**3,567,651**	**1,733,067**
TOTAL ENDING CASH	6	**1,365,416**	**1,660,593**	**1,365,416**		

29 May 2019

Avtandil Kasradze
Chairman of GITA

Nestan Tsagareishvili
Financial Management Specialist

The notes on pages 7-16 form an integral part of these special purpose financial statements.

National Innovation Ecosystem Project

IBRD Loan Number 8595-GE

STATEMENT OF EXPENDITURE PER COMPONENT

For the year ended 31 December 2018

(Amounts are shown in US dollars)

Components	Actual			Budget	Variance
	For the year ended 31 December 2018	Cumulative as at 31 December 2017	Cumulative as at 31 December 2018	Cumulative as at 31 December 2018	Cumulative as at 31 December 2018
1. Innovation Infrastructure	326,855	53,574	380,429	1,688,589	1,308,160
2. Innovation Services	37,843	42,857	80,700	258,600	177,900
3. Innovation Financing	731,781	32,618	764,399	889,150	124,751
4. Project Implementation Support	198,698	310,358	509,056	631,312	122,256
Front-end fee	-	100,000	100,000	100,000	-
	1,295,177	**539,407**	**1,834,584**	**3,567,651**	**1,733,067**

29 May 2019

Avtandil Kasradze
Chairman of GITA

Nestan Tsagareishvili
Financial Management Specialist

The notes on pages 7-16 form an integral part of these special purpose financial statements.

1. General information

1.1. The Project

The Financing Agreement IBRD Loan Number 8595-GE was signed on 28 March 2016 between Georgia and the International Bank for Reconstruction and Development ("IBRD"), according to which IBRD provided financing to the Georgia in the amount of 40,000,000 United States dollars (USD).

The Financing Agreement became effective on 21 July 2016.

The financing was provided for the implementation of "National Innovation Ecosystem Project" ("Project", "GENIE").

The payment currency of IBRD Loan Number 8595-GE is United States dollars (USD).

The Closing date of IBRD Loan Number 8595-GE is set 30 April 2021.

The Grace Period for submitting withdrawal application for expenditures incurred before the Closing date is four months following the Closing date: 31 August 2021.

1.2. The Project objectives

The objective of this project is to increase innovative activities of firms and individuals in Georgia, and their participation in the digital economy.

The Project consists of the following parts:

Part 1: Innovation Infrastructure

(a) Develop of a network of Innovation Hubs and Innovation Centers in selected cities, towns and villages;
(b) Design of a Broadband for Development Program to support the increase in adoption and use of broadband internet services and advanced information technology by Eligible Households and Eligible MSMEs, with a focus on rural areas, inter alia, by providing BfD Payments and related training, and preparation of the Broadband for Development Program Manual; and
(c) Pilot, and, as applicable, implement the Broadband for Development Program, and provide BfD Payments and related training.

Part 2: Innovation Services

Carry out outreach and communication activities, and provide training and technical assistance in support of:
(a) building the innovation community, and organizing and carrying out innovation competitions;
(b) carrying out periodic skills needs assessments of firms and developing digital economy skills of individuals; and
(c) developing the innovation capacity of individuals and firms.

Part 3: Innovation Financing

(a) Provision of Matching Grants, selection of Eligible MSMEs for receipt of Matching Grants and supervision of Matching Grants;
(b) Provision of technical assistance to Eligible MSMEs to prepare and implement Sub-Projects; and
(c) Provision of technical assistance to stimulate alternative forms of innovation financing and investment in the digital economy.

Part 4: Project Implementation Support

Provision of support for Project management and fiduciary oversight, monitoring and evaluation, and impact evaluation activities.

1.3. The Project Budget

The Project is wholly financed by IBRD Loan Number 8595-GE, inclusive of all taxes.

Category	IBRD Loan Number 8595-GE	Total	IBRD Credit Expenditure Financing (inclusive of taxes)
	USD	USD	
(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	31,016,000	31,016,000	100%
(2) Goods, non-consulting services, consultants' services, Training and Operating Costs for Part 1(c) of the Project, including BfD Payment	8,884,000	8,884,000	100%
(3) Front-end Fee	100,000	100,000	
(4) Interest Rate Cap or Interest Rate Collar premium	-	-	
Total	40,000,000	40,000,000	

1.4. Project Implementation

The Project is implemented by Georgia's Innovation and Technology Agency ("GITA") under the Ministry of Economy and Sustainable Development of Georgia (MoESD).

GITA is responsible for all project implementation; including coordination of the gathering and processing of the results of monitoring, reporting, fiduciary functions, and safeguard procedures in close cooperation with relevant institutions participating in the Project.

The GITA address is: 7, Innovation str. 0114, TechPark, Okrokana, Tbilisi, Georgia.

2. Summary of significant accounting policies

2.1. Preparation and presentation of financial statements

The special purpose financial statements are prepared in accordance with the International Public Sector Accounting Standard: *Financial Reporting Under the Cash Basis of Accounting* (IPSAS-Cash Basis), issued by the International Public Sector Accounting Standards Board (IPSASB) within the International Federation of Accountants (IFAC), and presented in accordance with Loan Handbook for World Bank Borrowers.

The principal accounting policies applied in the preparation of these special purpose financial statements are set out below. These policies have been consistently applied to all the periods presented.

2.2. Cash basis of accounting

Project financing is recognised as a source of project funds when the cash is received. Project expenditures are recognised as a use of project funds when the payments are made.

2.3. Reporting currency

The reporting currency of these special purpose financial statements is United States Dollars (USD). The expenditures made in local currency, Georgian Lari (GEL), are translated into USD based at the exchange rate prevailing at the date of the transaction as issued by the National Bank of Georgia (NBG).

The exchange rate defined by the NBG is as follows:

	USD
Exchange rate as at 31 December 2018	2.6766
Exchange rate as at 31 December 2017	2.5922

2.4. Taxes

According to the Georgian Tax Legislation, the Company pays all the taxes on unified treasury code applicable for all taxes. Taxes are paid in accordance with the tax regulation of Georgia.

2.5. Budget

Expenditure budget is created based on actual accumulated expenditures for the last period plus the updated procurement plans for the Reporting year.

3. Summary of Summary Reports and SOEs

IBRD Loan Number 8595-GE

(a) SOEs submitted and approved during the year ended 31 December 2018 can be presented as follows:

Withdrawal Application N	Withdrawal application date	Disbursement Category		Total
		(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	(2) Goods, non-consulting services, consultants' services, Training and Operating Costs for Part 1(c) of the Project, including BfD Payment	
5	02-Feb-18	88,229	-	**88,229**
6	13-Apr-18	85,646	2,009	**87,655**
7	16-Aug-18	618,897	7,547	**626,444**
	Total	**792,772**	**9,556**	**802,328**

(b) SOEs submitted and approved during the year ended 31 December 2017 can be presented as follows:

Withdrawal Application N	Withdrawal application date	Disbursement Category		Total
		(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	(2) Goods, non-consulting services, consultants' services, Training and Operating Costs for Part 1(c) of the Project, including BfD Payment	
2	17-Feb-17	42,991	-	**42,991**
3	20-Jun-17	187,341	-	**187,341**
4	25-Oct-17	120,847	-	**120,847**
	Total	**351,179**	**-**	**351,179**

4. Statement of Designated Accounts

Financing Agreement	IBRD Loan Number 8595-GE
Bank account number	GE65NB0331100001150207
Bank	National Bank of Georgia
Bank location	2 Sanapiro street, Tbilisi, Georgia, 0114
Account currency	USD

	For the year ended 31 December 2018	Cumulative as at 31 December 2017	Cumulative as at 31 December 2018
1. DA Opening balance	1,660,593	-	-
2. Add: opening discrepancy	-	-	-
3. IBRD advance/replenishment during the current semester	1,000,000	2,100,000	3,100,000
4. Less: Refund to IBRD from DA during the current semester	-	-	-
5. Present outstanding amount advanced to DA	**2,660,593**	**2,100,000**	**3,100,000**
6. DA closing balance as at carried forward to next period	1,365,416	1,660,593	1,365,416
7. Add: Amount of eligible expenditures paid during the year	1,295,177	439,407	1,734,584
8. Service charges (if debited into DA)	-	-	
9. Less: Interest earned (if credited into DA)	-	-	
10. Total advance accounted for	**2,660,593**	**2,100,000**	**3,100,000**
11. Closing discrepancy (5)-(10)	-	-	-

5. Statement of Financial Position (Statement of Fund Balances)

The Statement of Financial Position discloses assets, liabilities and net assets of the Project as at reporting date.

	Note	For the year ended 31 December 2018	For the year ended 31 December 2017
ASSETS			
Cash	6	1,365,416	1,660,593
Prepayments		-	-
Total assets		**1,365,416**	**1,660,593**
LIABILITIES			
Payables		-	-
Total liabilities		**-**	**-**
NET ASSETS			
Cumulative income			
IBRD Loan 8595-GE	8	3,200,000	2,200,000
		3,200,000	**2,200,000**
Cumulative expenses			
Project expenses		1,834,584	539,407
Total net assets		**1,365,416**	**1,660,593**

6. Cash

IBRD Loan 8595-GE	Underlying Currency	31 December 2018	31 December 2017
Designated Account	USD	1,365,416	1,660,593
		1,365,416	**1,660,593**

7. Project Expenditures Implementation Progress

Category	Cumulative expenditures as at 31 December 2018	Cumulative expenditures as at 31 December 2017	Project budget	Progress 2017	Progress 2018
(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	1,686,727	439,407	31,016,000	1.4%	5.4%
(2) Goods, non-consulting services, consultants' services, Training and Operating Costs for Part 1(c) of the Project, including BfD Payment	47,857	-	8,884,000	0%	0.5%
(3) Front-end Fee	100,000	100,000	100,000	100%	100%
Total	**1,834,584**	**539,407**	**40,000,000**	**1.3%**	**4.6%**

(a) The Loan became effective on 21 Jul 2016 with closing date set on 30 April 2021. As of 31 December 2018 and 2017 only 4.6% and 1.3% of the Project is implemented, respectively. The project implementation has had several challenges which were related to unrealistic assumptions, lack of agreement on the approach to provide innovation services, lack of progress on innovation (matching grants) and insufficient organizational capacity of GITA. In this matter, the Agency went through several improvements to solve these problems. More specifically:

- Strengthening GITA managerial structure, appointing the Agency Chairman and a deputy chairwoman;
- Appointment of new manager for GENIE project with the enhanced authorities in order to improve the speed and phase of the project implementation;
- In May 2019, second Procurement Specialist was hired to enable GENIE team to move much faster as the procurement has been identified as one of the major bottlenecks;
- In May 2019, new Matching Grants were initiated with the overall amount of GEL650,000;

8. Financing IBRD Loan Number 8595-GE

	For the year ended 31 December 2018	Cumulative as at 31 December 2017	Cumulative as at 31 December 2018
Advance/(recovery)	197,672	1,748,821	1,946,493
Direct Payment	-	-	-
SOE and Summary Report	802,328	351,179	1,153,507
Front-end fee	-	100,000	100,000
Total	**1,000,000**	**2,200,000**	**3,200,000**
Total financing budget	**40,000,000**	**40,000,000**	**40,000,000**
Percentage of finance provided as at 31 December 2018 and 2017		**6%**	**8%**

9. Litigations

The Agency is defendant in a legal case filed by one of its individual consultants, where the this consultant is seeking compensation for the contractual agreement dismissal with the amount USD12,609. The Agency has already provided the statement of defense (response). There is no appointment of the advanced first hearing yet.

The Management does not expect that the decision of the court will cause withdrawal of benefits from the Agency in the future.

10. Events after the reporting period

The application #8 with the total amount of USD581,077.93 that consists of expenditures relating to the year ended 31 December 2018, was submitted to WB and was approved on 12 February 2019. Additionally, the Agency received USD2,000,000 trench from the WB on 12 of February 2019.

In February 2019 the Loan was restructured. After the restructuring the Loan Project Data is as follows:

Project Data	US$ (million)
Original Loan Amount	40.0
Revised Loan Amount	23.5
Total Disbursements	5.2
Disbursements in WB Fiscal Year	3.0
Effectiveness Date	21 July, 2016
Closing Date	April 30, 2021

10. Events after the reporting period (Continued)

Following a detailed Quality Enhancement Review and extensive discussions with the MoESD and GITA, including before, during, and after the Project Mid-Term Review, the following agreements have been reached:

- All components are to be restructured, according to details provided by WB;
- US$ 16.5 million of the remaining undisbursed project funds will be cancelled, leaving US$20.2 million available for future spending, and bringing down the overall estimated project cost to US$23.5 million;
- An additional cancelation of project funds will be automatically triggered in the event of insufficient disbursements progress against implementation milestones during the first year after restructuring;
- If implementation progress is significantly accelerated, the Bank will consider an extension of the Project's timeline;

National Innovation Ecosystem Project

IBRD Loan Number 8595-GE

Annex 1. RECONCILIATION BETWEEN THE AMOUNTS SUBMITTED BY THE GITA AND DISBURSED BY THE WORLD BANK

(Amounts are shown in US dollars)

IBRD Loan Number 8595-GE

For the year ended 31 December 2018

Expenditure Category	Appl.	GITA	WB	Difference
Advance/(recovery)	5	(88,229)	(88,229)	-
	6	(87,655)	(87,655)	-
	7	373,556	373,556	-
		197,672	**197,672**	-
(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	5	88,229	88,229	-
	6	87,655	87,655	-
	7	626,444	626,444	-
		802,328	**802,328**	-
Total		**1,000,000**	**1,000,000**	

For the year ended 31 December 2017

Expenditure Category	Appl.	GITA	WB	Difference
Advance/(recovery)	2	(42,992)	(42,992)	-
	3	1,412,660	1,412,660	-
	4	(120,847)	(120,847)	-
		1,248,821	**1,248,821**	-
(1) Goods, works, non-consulting services, consultants' services, Training and/or Operating Costs for Project, including Matching Grants (excluding Part 1(c) of the Project)	2	42,991	42,991	-
	3	187,341	187,341	-
	4	120,847	120,847	-
		351,179	**351,179**	-
Total		**1,600,000**	**1,600,000**	