

Audited Project Financial Statements

Project Number: 42401-015

Loan Number: 3407

Period covered: 1 January 2019 to 31 December 2019

AZE: Power Distribution Enhancement Investment Program – Tranche 1

Prepared by Azerishiq Open Joint-Stock Company.

For the Asian Development Bank

Date received by ADB: 18 December 2020

The audited project financial statements are documents owned by the borrower. The views expressed herein do not necessarily represent those of ADB's Board of Directors, Management, or staff. These documents are made publicly available in accordance with ADB's Access to Information Policy and as agreed between ADB and Azerishiq Open Joint-Stock Company.

**POWER DISTRIBUTION
ENHANCEMENT INVESTMENT
PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**Special-Purpose Financial Statements and
Independent Auditors' Report**
For the Year Ended December 31, 2019

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

TABLE OF CONTENTS

| | Page |
|---|-------------|
| INDEPENDENT AUDITORS' REPORT | 1-2 |
| SPECIAL-PURPOSE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019: | |
| Special-purpose Balance Sheet | 3 |
| Statement of Summary of Sources and Uses of Funds | 4 |
| Statement of Uses of Funds and by Project Components | 5 |
| Notes to the Special-purpose Financial Statements | 6-10 |

INDEPENDENT AUDITORS' REPORT

To the Management of Power Distribution Enhancement Investment Program Project 1:

Opinion

We have audited the Special-Purpose Financial Statements of Power Distribution Enhancement Investment Program-Project 1 (the "Project") implemented by "Azerishiq" OJSC, which comprise the Special-Purpose Balance Sheet as at December 31, 2019, and the Statement of Summary of Sources and Uses of Funds, the Statement of Uses of Funds by Project Components for the year then ended and a basis of accounting and other explanatory notes (collectively referred to as the "Special-Purpose Financial Statements") financed under the Asian Development Bank ("ADB") through loan agreement number 3407-AZE (the "Loan Agreement").

In our opinion, the accompanying Special-Purpose Financial Statements present fairly, in all material respects, the financial position of the Project as at December 31, 2019, the cash receipts and disbursements on behalf of the Project for the year ended December 31, 2019 in accordance with IPSAS "Financial Reporting under the Accrual Basis of Accounting" and relevant provisions of the Loan Agreement as described in Note 2 of the Special-Purpose Financial Statements.

The Republic of Azerbaijan has utilized all proceeds of the loan withdrawn from Asian Development Bank only for the purposes of the Project as agreed between the Asian Development Bank and the Republic of Azerbaijan in accordance with the Loan Agreement and no proceeds of the loan have been utilized for other purposes.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Special-Purpose Financial Statements section of our report. We are independent of the Project in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

Basis of Accounting and Restriction on Distribution and Use

We draw attention to Note 2 to the Special-Purpose Financial Statements, which describes the basis of accounting. The Special-Purpose Financial Statements are prepared to assist the Project's Implementation Unit in complying with the financial reporting provisions of the Loan Agreements referred to above. As a result, the Special-Purpose Financial Statements may not be suitable for any other purpose. Our report is intended solely for the Project Management Team, the Government of the Republic of Azerbaijan and the ADB and should not be distributed to or used by parties other than Project's Implementation Unit and the ADB. Our opinion is not modified in respect of this matter.

ASSURANCE ADVISORY TAX LEGAL

Statement of Expenditure

We draw attention to Note 9 to the Special-Purpose Financial Statements, which describes the accounting policies related to Method of Disbursement. Project Agreement requires opinion on Statement of Expenditure, however no Statement of Expenditure was established for this Project.

Expiration of the Project

Without qualifying our opinion, we also draw attention to Note 1, which describes the fact that the Project's closing date is December 31, 2019 and payables and commitments as at December 31, 2019 will be settled through the funds of "Azerishiq" OJSC.

Responsibilities of Management for the Special-Purpose Financial Statements

Management is responsible for the preparation and fair presentation of the Special-Purpose Financial Statements in accordance with IPSAS and relevant provisions of the Loan Agreements as described in Note 2 to the Special-Purpose Financial Statements, 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 Responsibilities 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 auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Special-Purpose Financial Statements.

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

- Identify and assess the risks of material misstatement of the Special-Purpose 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 Project's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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

Baker Tilly Azerbaijan

March 17, 2020

Baku, the Republic of Azerbaijan


POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE

SPECIAL-PURPOSE BALANCE SHEET
AS AT DECEMBER 31, 2019

(Amounts expressed in the United States Dollars unless otherwise indicated)

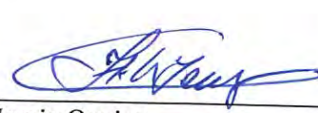
| | Notes | December 31, 2019 | December 31, 2018 |
|--|-------|----------------------|----------------------|
| ASSETS AND CUMULATIVE USES OF FUNDS | | | |
| Cash at bank | 3 | - | 575,604 |
| Completed works and received goods | 4 | 293,794,657 | 290,286,604 |
| Interest and commitment charges | | 10,509,362 | 6,540,083 |
| Accumulated exchange rate difference | | 25,558 | 25,558 |
| TOTAL ASSETS AND CUMULATIVE USES OF FUNDS | | 304,329,577 | 297,427,849 |
| SOURCES OF FUNDS AND LIABILITIES | | | |
| Cumulative ADB funds | | 249,970,476 | 242,448,639 |
| Cumulative Government funds | | 54,324,589 | 54,324,589 |
| Payable to subcontractors | 5 | 34,512 | 654,621 |
| TOTAL SOURCES OF FUNDS AND LIABILITIES | | 304,329,577 | 297,427,849 |

Approved and signed on behalf of management of the Project:


Ramil Yusifov
Deputy Chairman

March 17, 2020
 Baku, the Republic of Azerbaijan




Namig Orujov
Head of Finance Department

March 17, 2020
 Baku, the Republic of Azerbaijan

The notes on pages 6-10 form an integral part of these Special-Purpose Financial Statements.

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**STATEMENT OF SUMMARY OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2019**

(Amounts expressed in the United States Dollars unless otherwise indicated)

| | December 31, 2019 | December 31, 2018 | Cumulative December 31, 2019 |
|--|----------------------|----------------------|------------------------------------|
| OPENING BALANCE | | | |
| Project Account | 575,604 | 9,884,356 | |
| FUND RECEIVED | | | |
| ADB Loan Number 3407-AZE | | | |
| Direct funding | 3,552,558 | 87,814,952 | 239,461,114 |
| Interest and commitment charges | 3,969,279 | 5,059,899 | 10,509,362 |
| Subtotal ADB Loan Number 3407-AZE | 7,521,837 | 92,874,851 | 249,970,476 |
| Government of Azerbaijan | | | |
| Advance to the Project Account | - | 6,523,194 | 54,324,589 |
| Subtotal Government of Azerbaijan | - | 6,523,194 | 54,324,589 |
| TOTAL FUND RECEIVED | 7,521,837 | 99,398,045 | 304,295,065 |
| EXPENDITURE | | | |
| ADB Loan Number 3407-AZE | | | |
| Civil works | (180,336) | (84,984,031) | (226,275,770) |
| Consulting services | (658,722) | (1,264,494) | (3,460,460) |
| Goods | (2,713,500) | (1,566,427) | (9,724,884) |
| Interest and commitment charges | (3,969,279) | (5,059,899) | (10,509,362) |
| Subtotal ADB Loan Number 3407-AZE | (7,521,837) | (92,874,851) | (249,970,476) |
| Government of Azerbaijan | | | |
| Civil works | (32,525) | (15,297,126) | (48,382,763) |
| Goods | (450,131) | (281,957) | (5,270,774) |
| Consulting services | (92,948) | (227,609) | (595,192) |
| Incremental operating costs | - | (19,189) | (50,302) |
| Subtotal Government of Azerbaijan | (575,604) | (15,825,881) | (54,299,031) |
| TOTAL EXPENDITURE | (8,097,441) | (108,700,732) | (304,269,507) |
| FOREIGN EXCHANGE DIFFERENCE | | | |
| Project Account | - | (6,065) | (25,558) |
| Foreign exchange difference | - | (6,065) | (25,558) |
| CLOSING BALANCE | | | |
| Project Account | - | 575,604 | |
| TOTAL CLOSING BALANCE | - | 575,604 | |

Approved and signed on behalf of management of the Project:

Ramil Yusifov
Deputy Chairman

March 17, 2020
Baku, the Republic of Azerbaijan

Namig Orujov
Head of Financial Department

March 17, 2020
Baku, the Republic of Azerbaijan

The notes on pages 6-10 form an integral part of these Special-Purpose Financial Statements.

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**NOTES TO THE SPECIAL-PURPOSE FINANCIAL STATEMENTS
FOR THE ENDED DECEMBER 12, 2019**

(Amounts expressed in the United States Dollars unless otherwise indicated)

1. DESCRIPTION OF THE PROJECT

On July 22, 2016, “Azerishiq” OJSC (“Recipient”) and the Asian Development Bank (“ADB”) have agreed to lend to the Recipient, on the terms and conditions set forth or referred to in the Loan Agreement 3407 AZ (the “Loan Agreement”), a credit facility in the amount equivalent to USD 250,000,000 (the “Loan”) to assist in financing Power Distribution Enhancement Investment Program – Project 1 (the “Project”). The Loan Agreement became effective from September 2, 2016 by ADB letter submitted to the Minister of Finance on September 2, 2016.

In addition to the loan agreement, additional financing is provided by the Government of the Republic of Azerbaijan in the amount of USD 75,000,000. The Project’s closing date of December 31, 2018 had been extended to December 31, 2019.

The main objective of the Project is improved power distribution efficiency and reliability. Also as a part of the Investment Program, the Project aims to increase availability of reliable electricity supply to all domestic consumers.

The Project consists of the following components:

Component A

Rehabilitation and augmentation of aging medium and low-voltage distribution networks including approximately 4 units of 110 kV substations, 16 units of 35 kV substations, 1,157 units of 6-10 kV transformer stations; 54 km of 110 kV distribution lines, 124 km of 35 kV distribution lines, and 1,237 km of 6-10 kV distribution lines;

Component B

Replacement of approximately 3,900 km of 0.4 kV customer service lines with new self-supporting aerial bundled cables, including installation of approximately 175,409 smart digital electric meters. The existing 0.4 kV bare overhead conductors will be completely replaced;

Component C

Support for institutional strengthening of the Borrower, including:

- (a) Technical, financial and administrative support to the PMU for the management and supervision of the Project, and capacity building and training for financial management, accounting and auditing, Project management, procurement, monitoring and evaluation, human resources management, social and environmental safeguards compliance and monitoring;
- (b) Improvement of operation and maintenance facilities in the Borrower’s regional distribution networks, including construction of administration centers and procurement of vehicles and equipment (including information technology equipment).

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**NOTES TO THE SPECIAL-PURPOSE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)**

(Amounts expressed in the United States Dollars unless otherwise indicated)

2. BASIS OF ACCOUNTING

Statement of compliance

The Special-Purpose Financial Statements have been prepared on the accrual basis of accounting in conformity with the International Public Sector Accounting Standards (“IPSAS”) “Financial Reporting under the Accrual Basis of Accounting” issued by the International Public Sector Committee of the International Federation of Accountants (“IFAC-PSC”) and incorporate the principal accounting policies from the “Guidelines: Handbook for Borrowers on the Financial Management and Analysis of Projects” financed by the ADB.

Other basis of preparation criteria

The Special-Purpose Financial Statements are prepared under the historical cost basis of accounting. Source funding and government contributions are recognized when the related cash is received or paid out on behalf of the Project. Expenditures are accounted for when the contractual ground for payment of funds from account of the Project occurs.

Foreign currency transactions and translation

The Project uses the United States Dollar (“USD”) as its functional currency for following reasons:

- a) ADB’s funding is received in the USD;
- b) Budgets and financial reports for the Project are prepared in the USD.

Balance sheet monetary items denominated in currencies other than USD have been translated into the USD using the exchange rate of the Central Bank of the Republic of Azerbaijan (“CBRA”) effective as at appropriate date. All income and expense transactions denominated in currencies other than USD are converted into USD using the exchange rate of the CBRA prevailing on the date of transaction. At December 31, 2019 the official AZN/USD exchange rates set by the CBRA was 1.7000 (2018: 1.7000).

Critical accounting judgments

In preparation of these Special-Purpose Financial Statements the Project management used its judgment in interpretation of “taxes and duties” concept as defined in the Loan Agreement. According to the Loan Agreement, ADB finances the Projects exclusive of taxes and duties imposed within the territory of the Borrower. According to the interpretation of the Project management, these taxes include both direct (income tax, social taxes, withholding taxes, etc.) and indirect taxes (VAT). Therefore, all such taxes were classified as Government of Azerbaijan expenditure and financed only by the Government of Azerbaijan.

3. CASH AT BANK

The PMU doesn’t maintain separate bank account for the Project activities, instead utilizes general bank account of “Azerishiq” OJSC at “Kapital Bank” OJSC (Ganjlik branch) for the funding and disbursement purposes. As at December 31, 2019 cash at bank was equal to the nil (2018: AZN 979,102 or USD 575,604).

POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE

NOTES TO THE SPECIAL-PURPOSE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)

(Amounts expressed in the United States Dollars unless otherwise indicated)

4. COMPLETED WORKS AND RECEIVED GOODS

As at December 31, 2019 and December 31, 2018 completed works and received goods for the Project comprise the followings:

| | December 31, 2019 | December 31, 2018 | Cumulative December 31, 2019 |
|---|----------------------|----------------------|------------------------------------|
| ADB share | 3,372,222 | 87,201,832 | 239,461,114 |
| Government of Azerbaijan share | 135,831 | 15,723,545 | 54,333,543 |
| Total completed works and received goods | 3,508,053 | 102,925,377 | 293,794,657 |

5. PAYABLE TO SUBCONTRACTORS

As at December 31, 2019 and December 31, 2018 the liabilities to subcontractors represented the followings:

| | December 31, 2019 | December 31, 2018 |
|--------------------------|----------------------|----------------------|
| Civil works | - | 180,336 |
| Consultant's services | 34,512 | 474,285 |
| Total liabilities | 34,512 | 654,621 |

Commitment per expenditure categories were as follows.

| Category | December 31, 2019 |
|--------------------------|----------------------|
| Consultants' services | 29,248 |
| VAT | 5,264 |
| Total commitment* | 34,512 |

* According to the letter received from ADB dated on June 28, 2019, commitment after extended deadline of December 31, 2019 will be financed by the Recipient.

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**NOTES TO THE SPECIAL-PURPOSE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)**

(Amounts expressed in the United States Dollars unless otherwise indicated)

6. APPLICATIONS FOR WITHDRAWAL SCHEDULE

As at December 31, 2019 and December 31, 2018, funding requested by the Project comprise the following:

| | Total amount |
|--|-------------------|
| Application for withdrawal No 251 (direct payment) | 125,202 |
| Application for withdrawal No 252 (direct payment) | 18,857 |
| Application for withdrawal No 253 (direct payment) | 180,336 |
| Application for withdrawal No 254 (direct payment) | 554,400 |
| Application for withdrawal No 255 (direct payment) | 17,718 |
| Application for withdrawal No 256 (direct payment) | 10,705 |
| Application for withdrawal No 257 (direct payment) | 383,600 |
| Application for withdrawal No 258 (direct payment) | 70,874 |
| Application for withdrawal No 259 (direct payment) | 42,819 |
| Application for withdrawal No 260 (direct payment) | 29,248 |
| Application for withdrawal No 261 (direct payment) | 264,024 |
| Application for withdrawal No 262 (direct payment) | 79,275 |
| Application for withdrawal No 263 (direct payment) | 1,775,500 |
| Total applications for funding during 2019 | 3,552,558 |
| Total applications for funding during 2018 | 87,814,952 |

7. BUDGET OF FUNDING

The categories of budget of funding are summaries below according to the Loan Agreement:

| ALLOCATION AND WITHDRAWAL OF LOAN PROCEEDS | | | | |
|--|---|----------|---------------------|--|
| Number | Item | Category | Original Allocation | Basis for withdrawal from the Loan Account |
| 1 | Turnkey contracts, goods, and consulting services | | 240,000,000 | 100 % of total expenditure claimed* |
| 2 | Interest and commitment charges | | 10,000,000 | 100 % of total amount due |
| | Total | | 250,000,000 | 250,000,000 |

* Amounts are presented exclusive of taxes and duties imposed within the territory of the Borrower.

8. METHOD OF DISBURSEMENT

The methods of disbursement were as follows:

Advance – ADB advances loan proceeds into the Advance Account of the Borrower to finance eligible expenditure as they are incurred and for which supporting documents will be provided at a later date.

There is no Advance Account established for the Project.

Direct Funding – ADB makes payments, at the Borrower's request, directly to a third party for eligible expenditure.

**POWER DISTRIBUTION ENHANCEMENT INVESTMENT PROGRAM – PROJECT 1
LOAN NUMBER 3407-AZE**

**NOTES TO THE SPECIAL-PURPOSE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)**

(Amounts expressed in the United States Dollars unless otherwise indicated)

Reimbursement Procedure – ADB reimburses the Borrower for expenditure eligible for financing pursuant to the loan agreement (“eligible expenditure”) that the Borrower has pre-financed from its own resources.

9. METHOD OF WITHDRAWAL

The methods of withdrawal were as follows:

ADB Advance Account

Advance Account is Advance disbursement accounts of the Project to effect the payment of eligible expenditure, within defined limits, which do not require individual authorization from the ADB.

Available amounts were drawn down within the limits determined by the relevant loan agreement for the payment of eligible expenditure for contractors from the Advance Account.

There is no Advance account established for the Project.

Project account

The Project maintains a separate account where the GOA funds are accumulated. The funds are further disbursed to pay VAT and WHT for the payment to contractors and consultants. Any unused balance on the Project account at December 31, is carried forward to next financial year.

Statement of expenditure (“SOE”)

The statement of expenditures (SOE) procedure is used for reimbursement of eligible expenditures for Project management support and individual consultants and to liquidate advances provided into the Advance account, in accordance with ADB’s Loan Disbursement Handbook and detailed arrangements agreed upon between the Borrower and ADB.

10. OPERATING ENVIRONMENT

The Project’s principal business activities are within the Republic of Azerbaijan. Laws and regulations affecting the Project’s operations in the Republic of Azerbaijan are subject to rapid changes and the Project’s operations could be at certain level of risk due to changes in the political and business environment.