

Audited Project Financial Statements

Project Number: 45389-002

Loan Number: 2921

Period covered: 1 January 2013 to 31 December 2013

AZE: Second Road Network Development Investment Program, Project 1

Prepared by Ministry of Transport

For the Asian Development Bank

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 Public Communications Policy (2011) and as agreed between ADB and the Ministry of Transport.

SECOND ROAD NETWORK DEVELOPMENT PROGRAM

PROJECT 1 LOAN 2921 AZE

**REPORT OF INDEPENDENT AUDITORS
AND
SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2013**

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STATEMENT OF MANAGEMENT RESPONSIBILITIES

Management has prepared and is responsible for the special purpose project financial statements and related notes of the Second Road Network Development Program Project 1, Loan 2921 AZE (hereinafter the "Project") financed by the Asian Development Bank (the "ADB") and the Government of Azerbaijan (the "GOA"). These have been prepared in accordance with the basis of accounting described in Note 2 and Note 3 to the accompanying special purpose project financial statements.

The Project maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorisation and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The system contains self-monitoring mechanisms that allow management to be reasonably confident that controls, as well as the Project's administrative procedures and internal reporting requirements operate effectively. There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error or the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statements preparation.

Signed on behalf of project management:



Project Director
Jamil Rustamkhanli

30 June 2014



Project Finance Manager
Rashad Kerimov

REPORT OF INDEPENDENT AUDITORS
To the Management of the Second Road Network Development Program
Project 1 Loan 2921 AZE

We have audited the accompanying special purpose project financial statements of the Second Road Network Development Program Project 1, Loan 2921 AZE (hereinafter the "Project") implemented by Azer Road Service Open Joint Stock Company (OJSC) which comprise the statement of financial position as of 31 December 2013, statement of sources and uses of funds, statement of project expenditure by categories and statement of project account for the year then ended and a summary of significant accounting policies and other explanatory information. We have also audited the Project's compliance with the conditions of the relevant Loan Agreements, the Asian Development Bank guidelines and Laws of the Azerbaijan Republic.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting described in Note 2 and Note 3 of the accompanying special purpose financial statements and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing ("ISA") applicable to the audit of financial statements and to compliance auditing, with special reference to ISA 800 "The Independent Auditor's Report on Special Purpose Audit Engagements" and to the relevant Loan Agreements, the Asian Development Bank guidelines and Laws of the Azerbaijan Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement and about whether the Project has complied with the conditions of the relevant agreements, guidelines, laws and regulations.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion:

- a) the aforementioned financial statements and appended notes that were also the subject of the audit, fairly present in all material respects the financial position of the Project as at 31 December 2013 and the results of its operations for the year applied on a basis described in the Note 2 and Note 3 to the accompanying special purpose project financial statements;
- b) Azer Road Service OJSC has in all material respects utilized the proceeds of the loan withdrawn from the Asian Development Bank only for purposes of the Project as agreed between the Asian Development Bank and the Government of the Azerbaijan Republic in accordance with the loan agreement; and no proceeds of the loan have been utilized for other purposes; and
- c) Azer Road Service OJSC was in compliance at the balance sheet date in all material respects with the financial covenants of the loan agreement.

Basis of Accounting and Restriction on Distribution as Use

Without modifying our opinion we draw attention to Note 2 and Note 3 which describe the basis for accounting and the purpose of these financial statements. These financial statements may not be suitable for any other purpose. These special purpose project financial statements and auditor's report thereon are intended solely for the information and use of the management of the Project, the Government of the Azerbaijan Republic and the Asian Development Bank and are not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton Azerbaijan

30 June 2014



SECOND ROAD NETWORK DEVELOPMENT PROGRAM
 PROJECT 1, LOAN 2921 AZE
 STATEMENT OF FINANCIAL POSITION
 AS OF 31 DECEMBER 2013
 (Expressed in US dollars)

	Note	2013	Cumulative
ASSETS AND PROJECT EXPENDITURE			
Cash at bank		-	-
Project expenditure		-	-
		<u>-</u>	<u>-</u>
SOURCES OF FUNDS			
Project financing		-	-
Foreign exchange difference		-	-
		<u>-</u>	<u>-</u>



 Project Director
 Jamil Rustamkhanli


30 June 2014


 Project Finance Manager
 Rashad Kerimov

**SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
STATEMENT OF RECEIPTS AND PAYMENTS (CASH FLOWS)
FOR THE YEAR ENDED 31 DECEMBER 2013
(Expressed in US dollars)**

OPENING BALANCES	Note	2013	Cumulative
GOA Project account		-	-
Cash on hand		-	-
		-	-
SOURCES OF FUNDS			
ADB direct payments	6	-	-
GOA funds	6	-	-
		-	-
LESS			
PROJECT EXPENDITURE			
ADB share of expenditure			
Works	8	-	-
Consultants	8	-	-
		-	-
GOA share of expenditure			
Land acquisition		-	-
Value Added Tax for works		-	-
Value Added Tax for consultants		-	-
Bank charges		-	-
		-	-
TOTAL EXPENDITURE		-	-
ADD/LESS: EXCHANGE DIFFERENCES			
Gains/(loss) ADB		-	-
Gains/(loss) GOA		-	-
		-	-
CLOSING BALANCES			
GOA Project account		-	-
Cash on hand		-	-
		-	-


Project Director
Jamil Rustamkhanli


Project Finance Manager
Rashad Kerimov


30 June 2014

The notes set out on pages 10-14 form an integral part of these financial statements


SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
STATEMENT OF PROJECT EXPENDITURE BY CATEGORIES
FOR THE YEAR ENDED 31 DECEMBER 2013
(Expressed in US dollars)

	Note	2013	Cumulative
Component 1			
Works			
Construction of Masall-Jalilabad road	7	-	-
		-	-
Component 2			
Project implementation support for:			
Construction supervision		-	-
Program management		-	-
		-	-
Bank charges		-	-
	7	-	-
Land acquisition*	7	-	-
		-	-

*The Borrower acting through relevant government authorities to ensure that all land and rights-of-way required for the Project are made available free and clear from any and all rights and claims of third parties and any other encumbrances whatsoever in a timely manner.


 Project Director
 Jamil Rustamkhanli

30 June 2014


 Project Finance Manager
 Rashad Kerimov


The notes set out on pages 10-14 form an integral part of these financial statements

**SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
STATEMENT OF PROJECT ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2013
(Expressed in US dollars)**

	GOA AZN Account 2013	GOA USD Account 2013
Opening balance	-	-
Add		
Funds from GOA for the Project	-	-
Less: GOA expenditure		
Value Added Tax for works	-	-
Bank charges	-	-
Add /(Less): Exchange difference Gains/(Losses)		
ADB	-	-
GOA	-	-
Closing balance	-	-


Project Director
Jamil Rustamkhanli

30 June 2014


Project Finance Manager
Rashad Kerimov

The notes set out on pages 10-14 form an integral part of these financial statements

SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2021 AZE
NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2013
(Amounts are expressed in US dollars unless otherwise indicated)

1. BACKGROUND

Loan Agreement 2021-AZE (Ordinary Operations) dated 22 April 2013 between the Republic of Azerbaijan (the "Borrower" or "GOA") and Asian Development Bank (the ADB) has been signed for the implementation of the Second Road Network Development Program, Project 1 (the "Project").

ADB agreed to lend to the Borrower from ADB's ordinary capital resources an amount of USD 250,000,000 (two hundred and fifty million US Dollars), as such amount may be converted from time to time through a currency conversion in accordance with the provisions of the loan agreement. The objective of the Project is to build an adequate, efficient, safe, and sustainable road network linking the Republic of Azerbaijan domestically and internationally.

The Project consists of the following components:

- i) Construction of approximately 30.0 km of a new four lane road section between the cities Masalli and Jalilabad on the new Masalli-Shorsulu road;
- ii) Project implementation support for construction supervision and program management covering planning, procurement, project implementation, financial management and compliance with safeguard requirements.

The Loan effective date is 30 July 2013. Initially, the Project is expected to be completed by 30 June 2016. Counterpart financing, as stipulated by the agreement, is to be provided by the Government of the Azerbaijan Republic.

2. BASIS OF PREPARATION

Basis of Accounting - these special purpose project financial statements (SPPFSs) are prepared in accordance with the International Public Sector Accounting Standard ("IPSAS") *Financial Reporting under the Cash Basis of Accounting* issued by the International Public Sector Accounting Standards Board ("IPSASB"), an independent standard-setting body within the International Federation of Accountants ("IFAC") and incorporate the following principal accounting policies, which have been consistently followed in all material respects and comply with the relevant ADB Guidelines.

Period of accounts - these special purpose project financial statements cover the financial year ended 31 December 2013.

These special purpose project financial statements cover the Project implemented by the Project Implementation Unit (PIU) established under the Azer Road Service Open Joint Stock Company (ARS or the "Company").

**SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
(CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2013
(Amounts are expressed in US dollars unless otherwise indicated)**

3. ACCOUNTING POLICIES

3.1 Overall consideration

These Special Purpose Project Financial Statements have been prepared under the historical cost convention. The significant accounting policies that have been used in the preparation of these financial statements are summarised below.

3.2 Transactions and balances in foreign currencies

Functional and presentation currency

The Project is domiciled in the Republic of Azerbaijan where the local currency is the Azerbaijani Manat ("AZN"). The ADB portion of Project's transactions are funded and expended in United States dollars and GOA portion of transactions are funded and expended in AZN. In accordance with the requirements of the ADB, these special purpose project financial statements are presented in United States dollars ("US dollar", "USD" or "US\$"), which is the presentation currency of the Project.

Foreign currency transactions and balances

Transactions in currencies other than the presentation currency are treated as transactions in foreign currencies. Cash receipts and payments arising from transactions in a foreign currency are recorded in the Project's presentation currency by applying to the foreign currency amount the exchange rate between the presentation currency and the foreign currency at the date of receipt and payment. Cash balances held in a foreign currency are reported using the closing rate, which is the spot exchange rate at the reporting date. Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash receipts and payments. However, the effect of exchange rate changes on cash held in a foreign currency is reported in the statement of sources and uses of funds and other statements in order to reconcile cash at the beginning and the end of the period. These amounts are presented separately from cash receipts and payments and include the differences, if any, had those cash receipts and payments and balances been reported at end-of-period exchange rates. At 31 December 2013, the official AZN/USD exchange rate set by the Central Bank of Azerbaijan ("CBAR") was 0.7845.

3.3 Cash

Cash balances are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash balances include balances with the Capital Bank of the Republic Azerbaijan.

3.4 Funding

Project financing is recognised as a source of project funds when the cash is received. The main funds for the Project are provided by the Asian Development Bank and the Government of the Azerbaijan Republic under relevant loan agreement.

**SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
(CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2013
(Amounts are expressed in US dollars unless otherwise indicated)**

3. ACCOUNTING POLICIES (CONTINUED)

3.5 Project expenditure

Project expenditure is recognised as a use of project funds when payment is made. The Project expenditure is classified under certain categories in accordance with the signed loan agreements. In addition, the project expenditure is also disclosed by source considering the requirements of the funding parties.

Works

Works are construction or civil works financed out of the proceeds of the loan, and including services such as drilling or mapping, and project related services that are provided as part of a single responsibility or turnkey contract, but excluding consulting services.

Consulting

Consulting services rendered by consultants are for a finite period of time and have a well-defined scope of work described by clear terms of reference (TOR), and are generally of an intellectual nature. They cover a wide range of diverse activities, which may entail but are by no means limited to feasibility studies, advisory services, construction supervision, policy studies, strategy formulation, and preparation of key documents such as tender documents, training, quality control, financial and accounting services, environmental or social impact studies, economic and financial analyses, professional editing and public information provision.

3.6 Project Management

Project Implementation Unit (PIU) is established within ARS to undertake day-to-day Project management and implementation functions. No PIU expenditure is funded by the Project 1, Loan 2921 AZE.

3.7 Taxation

Tax expense represents the payment of the Value Added Tax (VAT). VAT is paid based on invoices submitted for the completed works and provided services at the rate stipulated by the Tax Code of the Republic of Azerbaijan during the reporting period (2013 at 18%).

The tax legislation of the Republic of Azerbaijan in particular may give rise to varying interpretations and amendments and management interpretations may differ from that of tax authorities. Management believes that the PIU has made all tax payments that are due.

4. METHOD OF WITHDRAWAL

Direct payments from the Loan account

Under this method, the PIU prepares applications based on supporting documents which are submitted to the ADB. Payments are made from the loan account directly to the contractors and consultants.

Project account (GOA)

The Project maintains a separate account where the GOA funds are accumulated. The funds are further disbursed to pay Value Added Tax for the payment to contractors and consultants. Any unused balance on the Project account at 31 December 2013 is carried forward to next financial year

SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
(CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2013
(Amounts are expressed in US dollars unless otherwise indicated)

5. OPERATING ENVIRONMENT

The Project's principal activities are within the Republic of Azerbaijan. Laws and regulations affecting entities operating in the Republic of Azerbaijan are subject to rapid changes and the Project's operations could be at risk as a result of negative changes in the political and economic environment.

6. FUNDS PROVIDED FOR THE PROJECT

	2013	Cumulative
ADB share		
Direct Payments for works (For 2013 See Note 8)	-	-
Direct payments to consultants (For 2013 See note 8)	-	-
	-	-
GOA share		
GOA funds for VAT	-	-
GOA funds for land acquisition	-	-
	-	-
	-	-
	-	-

7. PROJECT EXPENDITURE

	ADB	GOA	Total
Component 1			
Works			
Construction of Masall-Jalilabad road	-	-	-
	-	-	-
Component 2			
Project implementation support for:	-	-	-
Construction supervision	-	-	-
Program management	-	-	-
	-	-	-
Bank charges	-	-	-
	-	-	-
Land acquisition	-	-	-
	-	-	-
	-	-	-

**SECOND ROAD NETWORK DEVELOPMENT PROGRAM
PROJECT 1, LOAN 2921 AZE
NOTES TO THE SPECIAL PURPOSE PROJECT FINANCIAL STATEMENTS
(CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2013
(Amounts are expressed in US dollars unless otherwise indicated)**

8. APPLICATIONS FOR WITHDRAWAL SCHEDULE

Works

No direct payments have been made to contractors for works from ADB share of expenditure in 2013.

Consultant services

No direct payments have been made to consultants from ADB share of expenditure in 2013.

9. EVENTS AFTER THE REPORTING PERIOD

Non-adjusting events

No significant non-adjusting events have occurred between the reporting date and the date of authorisation of these special purpose project financial statements.

Adjusting events

No significant adjusting event has occurred between the reporting date and the date of authorisation of these special purpose project financial statements.