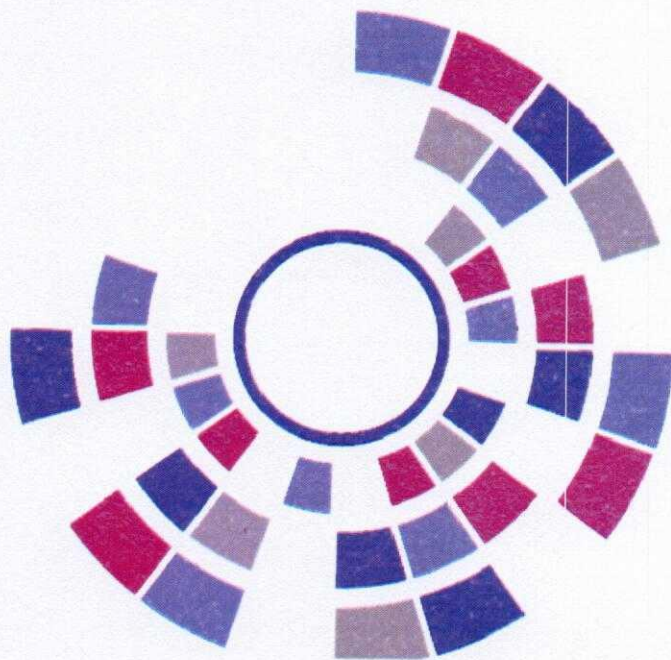


Project Financial Statements and
Independent Auditor's Report

Renewable Resources and Energy Efficiency Fund

Geothermal exploratory drilling project
SCF-SREP Grant No. TF0A0544

As of and for the year ended December 31, 2016



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Independent auditor's report

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To the board of trustees of the Renewable Resources and Energy Efficiency Fund,

Opinion

We have audited the accompanying project financial statements of the Geothermal exploratory drilling project (the "Project"), financed by the International Bank for Reconstruction and Development (the "IBRD") acting as an implementing agency of the Scaling-up Renewable Energy Program (the "SREP") under the Strategic Climate Fund (the "SCF") Grant Agreement SCF-SREP Grant No. TF0A0544, which comprise the statement of financial position as of December 31, 2016, the statement of the Project sources and uses of funds, the statement of uses of funds by Project activities, the designated account statement as of and for the year ended December 31, 2016 as well as the statement of expenditures ("SOE") submitted to the World Bank for the year ended December 31, 2016 in support of the Grant Agreement SCF-SREP Grant No. TF0A0544 withdrawals, and a summary of significant accounting policies and other explanatory information.

In our opinion, the project financial statements give a true and fair view of the financial position of the Geothermal exploratory drilling project as of December 31, 2016, and of the funds received and expenses incurred for the year then ended, in accordance with the accounting policies described in the note 2 to the project financial statements, the World Bank guidelines, and the relevant points of the Grant Agreement SCF-SREP Grant No. TF0A0544.

In addition, in our opinion, the SOEs submitted together with the internal controls and procedures involved in their preparation can be relied upon to support the applications for the Grant Agreement SCF-SREP Grant No. TF0A0544 withdrawals.

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 *Auditor’s Responsibilities for the Audit of the Project Financial Statements* section of our report. We are independent of the “Renewable Resources and Energy Efficiency Fund” (the “R2E2 Fund”) in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (the “IESBA Code”) together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Armenia, and we have fulfilled our other ethical responsibilities in accordance with those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of a Matter

We draw attention to note 2 to the project financial statements, which describes the basis of accounting. The project financial statements are prepared to assist the management of the Renewable Resources and Energy Efficiency Fund to meet the requirements of the financial reporting of the World Bank. As a result, the project financial statements may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Responsibilities of Management and Those Charged with Governance for the Project Financial Statements

Management is responsible for the preparation and fair presentation of the project financial statements in accordance with the accounting policies described in the note 2 to the project financial statements, the World Bank guidelines, and the relevant points of the Grant Agreement SCF-SREP Grant No. TF0A0544, and for such internal control as management determines is necessary to enable the preparation of project financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor’s Responsibilities for the Audit of the Project Financial Statements

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

Statement of the Project sources and uses of funds

Grant Agreement TFOA0544
 As of and for the year ended December 31, 2016

In US dollars

	Actual		Planned		Variance		Life of Project
	For the year	As of December 31, 2016	For the year	As of December 31, 2016	For the year	As of December 31, 2016	
<i>Sources of funds</i>							
IBRD Grant Number TF 0A0544 (note 5)	4,926,330	6,239,937					
Government co-financing	1,163,120	1,413,679					
Total	6,089,450	7,653,616					
Exchange rate difference	24,933	25,014					
<i>Less: Uses of funds</i>							
Goods, works, non-consulting services, consultants' services and operating costs under the Project (note 6)	6,199,939	7,590,553	6,201,669	7,693,121	(1,730)	(102,568)	10,687,500
Total	6,199,939	7,590,553	6,201,669	7,693,121	(1,730)	(102,568)	10,687,500
Net increase/(decrease) in working capital (note 7)	(85,556)	88,077					

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 9 to 13.

Statement of uses of funds by Project activities

Grant Agreement TF0A0544
 As of December 31, 2016 and for the year ended December 31, 2016

In US dollars

	Actual		Planned		Variance		
	For the year	As of December 31, 2016	For the year	As of December 31, 2016	For the year	As of December 31, 2016	Life of Project
A.1.1 Construction of access road and other associated infrastructure	76,718	1,442,291	76,883	1,522,305	(165)	(80,014)	1,508,086
A1.2. Drilling of slim exploratory wells	5,443,028	5,443,028	5,454,723	5,454,723	(11,695)	(11,695)	4,429,825
A.2.1. Well logging and well testing	352,858	352,858	342,024	342,024	10,834	10,834	217,243
A.2.2 Technical supervision and support	310,016	335,057	310,683	356,713	(667)	(21,656)	208,334
A2.3. Project audit and operating costs	17,319	17,319	17,356	17,356	(37)	(37)	31,250
B.1.1. Construction of water infrastructure and rig pad	-	-	-	-	-	-	260,416
B.1.2. Drilling of production-size exploratory well	-	-	-	-	-	-	2,773,438
B.2.1. Well logging, mud logging and well testing	-	-	-	-	-	-	373,493
B.2.2. Feasibility study for a potential geothermal power plant	-	-	-	-	-	-	302,082
B.2.3. Technical supervision and support consultant	-	-	-	-	-	-	312,500
B.2.4. Transaction advisory support	-	-	-	-	-	-	208,333
B2.5. Project audit and operating costs	-	-	-	-	-	-	62,500
Total	6,199,939	7,590,553	6,201,669	7,693,121	(1,730)	(102,568)	10,687,500

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 9 to 13.

SOE withdrawal schedule

Grant Agreement TF0A0544
For the year ended December 31, 2016

In US dollars

Application No.	Category
	Goods, works, non-consulting services, consultants' services and operating costs under the Project
DA-4	7,481
DA-6	1,626
DA-7	20,224
DA-8	49,434
DA-9	1,802
DA-11	2,396
DA-14	667
Total	83,630

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 9 to 13.

Designated account statement

Grant Agreement TFOA0544
As of and for the year ended December 31, 2016

In US dollars

Opening balance as of January 1, 2016		252,974
Add:		
Grant replenishment during the year	4,551,075	<u>4,551,075</u>
	<u>4,551,075</u>	<u>4,551,075</u>
Present outstanding amount advanced to the designated account (1)		<u>4,804,049</u>
Closing balance as of December 31, 2016		243,576
Add:		
Amount of eligible expenditures paid during the year	4,560,473	
Service charges (if applicable)	-	
	<u>4,560,473</u>	<u>4,560,473</u>
Total advance accounted for (2)		<u>4,804,049</u>
Discrepancy (1) – (2) to be explained		-

This statement is to be read in conjunction with the notes to and forming part of the project financial statements set out on pages 9 to 13.

Notes to the project financial statements

1 Activity

Renewable Resources and Energy Efficiency Fund (the "Fund") has been established on November 21, 2005, in accordance with the decree N799 of the Government of the Republic of Armenia ("RA") dated April 28, 2005.

The Fund implements the Geothermal exploratory drilling project (the "Project"), which is financed under the Grant Agreement SCF-SREP Grant No. TF0A0544 signed between the International Bank for Reconstruction and Development (the "IBRD") acting as an implementing agency of the Scaling-up Renewable Energy Program (the "SREP") under the Strategic Climate Fund (the "SCF") and the Government of the Republic of Armenia on June 16, 2015.

The objective of the Project is to confirm whether the geothermal resource at the Project site is suitable for power generation and, if confirmed, to involve the private sector in the development of the geothermal power plant.

The Project consists of the following phases:

Phase 1

A.1. Construction of Access Road and First Phase of Exploratory Drilling

A.1.1. Construction of access road and other associated infrastructure

Carrying out the following activities to facilitate the drilling activities under Phase 1 A.1.2 of the Project: (a) construction of a gravel road with sufficient length and width to allow for safe transportation of equipment and other materials to the Project Site; (b) preparation of rig pads for slim-size wells; and (c) installation of equipment and minor works at the water source.

A.1.2. Drilling of slim exploratory wells

Drilling of up to two slim-size wells.

A.2. Technical Assistance and Supervision

A.2.1. Well logging and well testing

Carrying out the following activities: during the implementation, and at the completion of, activity under Phase 1 A.1.2. above, including, *inter-alia*: (i) analyses of the cuttings from the borehole, well temperature, and pressure measurements; and (ii) gathering of essential data such as drilling progress and changes in temperature during, and at the end of, each drilling stage.

A.2.2. Technical supervision and support

(i) Providing technical assistance for the supervision of the activity under Phase 1 A.1.2 above; (ii) providing technical support in the review of the information obtained from the completion of the activity under Phase 1 A.2.1 above; (iii) providing other technical advice and support during the implementation of this Phase 1, as required by the R2E2 Fund; and (iv) preparing the Technical Report.

A.2.3. Project audit and Operating Costs

Carrying out Project audits and financing Operating Costs for Phase 1 of the Project.

Phase 2

B.1. Construction of Water Infrastructure, Rig Pads and Second Phase of Exploratory Drilling

B.1.1. Construction of Water Infrastructure and Rig Pad

Carrying out the construction of (i) infrastructure to supply water for the drilling activities under Phase 2 B.1.2. below; and (ii) a rig pad(s) for production-size well(s).

B.1.2. Drilling of production-size exploratory well

Drilling of at least one production-size well.

B.2. Technical Assistance and Supervision

B.2.1. Well logging, mud logging and well testing

Carrying out the following activities during implementation, and at the completion of, the activity under Phase 2 B.1.2. above, including, *inter-alia*: (i) analysis of the cuttings from the borehole, well temperature and pressure measurements; and (ii) gathering of data such as drilling progress and changes in temperature during, and at the end of, each drilling stage.

B.2.2. Feasibility study for a potential geothermal power plant

Carrying out a feasibility study of a potential geothermal power plant (excluding construction), which will include, *inter-alia*: (i) a technical viability assessment of a potential geothermal power plant; and (ii) an assessment of the economic and financial viability of a potential geothermal power plant.

B.2.3. Technical supervision and support

(i) Providing technical assistance for the supervision of the activity under Phase 2 B.1.2 above; (ii) providing technical support in the review of the information obtained from the completion of the activity under Phase 2 B.2.1 above; and (iii) providing other technical advice and support during the implementation of this Phase 2 as required by the R2E2 Fund.

B.2.4. Transaction advisory support

Providing advisory services to the Recipient on the design and implementation of a public-private partnership (PPP) scheme in the construction and operation of a potential geothermal power plant.

B.2.5. Project audit and operating costs

Carrying out Project audits and financing Operating Costs for Phase 2 of the Project.

In accordance with the Grant Agreement the financing of the Project is implemented through the following category:

Category	Percentage of expenses to be financed	Amount of the grant allocated (in USD)
Goods, works, non-consulting services, consultants' services and operating costs under the Project	80 %	8,550,000
Total		8,550,000

The legal address of the Fund is Melik Adamyan 1, Yerevan, Armenia.

The average number of the Fund's staff in 2016 was 15 (2015: 15).

2 Significant accounting policies

2.1 Basis of preparation

The project financial statements were prepared in accordance with the accrual basis of accounting as well as the World Bank guidelines and the relevant points of the Grant Agreement SCF-SREP Grant No. TF0A0544. Significant accounting policies are disclosed below.

2.2 Functional and presentation currency

The national currency of the Republic of Armenia is Armenian dram. These project financial statements are presented in US dollars (presentation currency).

In preparing the project financial statements, transactions in currencies other than US dollar are recorded at the rates of exchange defined by the Central Bank of Armenia prevailing on the dates of the transactions. For direct payments denominated in currencies other than US dollar to the contractor/consultant from the World Bank share, the exchange rate set out for the presentation of the operation in the system client connection (<https://clientconnection.worldbank.org>) is used. At each reporting date, bank balances, advances and payables denominated in foreign currencies are retranslated at the rate defined by the Central Bank of Armenia prevailing on that date, which is 483.94 Armenian drams for 1 US dollar as of December 31, 2016. Any exchange rate differences are recognized in the statement of the Project sources and uses of funds and the accumulated figure of exchange rate difference is disclosed in the Statement of financial position under "Exchange rate differences".

2.3 Project financing

The financing received in the framework of the Grant Agreement SCF-SREP Grant No. TF0A0544 is recorded in the statement of financial position as "Accumulated Project financing" and is recognized at each replenishment. In addition, the current period funds received are disclosed in the statement of Project sources and uses of funds, showing the sources of funds.

2.4 Project expenses

The Project expenses are recognized on the accrual basis of accounting. The accumulated Project expenses are disclosed in the statement of financial position under non-current assets. In addition, current period expenses are disclosed in the statement of Project sources and uses of funds and statement of uses of funds by Project activity, both by category and by activities. Additionally, a further breakdown of expenses by categories is disclosed in note 6.

2.5 Accounts payable

Payables comprise the amounts to be paid and are stated at nominal value.

a The World Bank financing

To finance eligible expenditures for the Grant Agreement SCF-SREP Grant No. TF0A0544, the World Bank disburses proceeds from the Credit account using one or more of the disbursement methods, which are stated below:

a. Reimbursement

The Bank may reimburse the borrower to finance eligible expenditures that the borrower has prefinanced from its own resources.

b. Advance

The Bank may advance loan proceeds into a designated account of the borrower to finance eligible expenditures as they are incurred and for which supporting documents will be provided at a later date.

c. Direct payment

The Bank may make payments, at the borrower's request, directly to a third party for eligible expenditures.

d. Special commitment

The Bank may pay amounts to a third party for eligible expenditures under special commitments entered into, in writing, at the borrower's request and on terms and conditions agreed between the Bank and the borrower.

3. Closing date of the Project

The closing date of the Project was defined as May 31, 2019.

4. Accounts payable

In US dollars

	As of December 31, 2016	As of December 31, 2015
Payables to the Fund	80,129	12,033
Payables to suppliers	75,370	67,308
	<u>155,499</u>	<u>79,341</u>

Payable to the Fund include the amounts to be paid to the Fund, since the own resources of the Fund were used for the purposes of the Project.

5. Grant TFOA0544 (IBRD Fund)

In US dollars

	For the year ended December 31, 2016	As of December 31, 2016
SOE procedures	83,630	85,324
Designated account advances	-	600,000
Direct payment	375,255	375,255
Reimbursement	-	216,454
Other procedures	4,467,445	4,962,904
	<u>4,926,330</u>	<u>6,239,937</u>

Under the method of "SOE procedures" of financing, the Fund requests advance to and documentation of designated account accompanied by the statement of expenditure (SOE).

Under the method of "Other procedures" of financing, the Fund requests advance to and documentation of designated account accompanied by the records evidencing eligible expenditures for payments against contracts valued at more than the amounts in accordance with the Disbursement Letter and contracts that are subject to the World Bank's prior review.

6. Uses of funds by category descriptions

The statement of the Project sources and uses of funds discloses the expenses in one combined category, as depicted in the Grant Agreement SCF-SREP Grant No. TF0A0544. However, for the convenience of certain users, the breakdown of the uses of funds is disclosed in the table below.

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
Works	5,519,746	6,885,319
Consultants' services	680,193	705,234
	<u>6,199,939</u>	<u>7,590,553</u>

7. Net increase/(decrease) in working capital

In US dollars	For the year ended December 31, 2016	As of December 31, 2016
Increase/(decrease) in bank balances	(9,398)	243,576
Increase in accounts payable	(76,158)	(155,499)
	<u>(85,556)</u>	<u>88,077</u>

8. Reconciliation between the amounts received by the Fund and disbursed by the World Bank

Grant Agreement TF0A0544
 For the year ended December 31, 2016
 In US dollars

Category	Appl.	Fund	The World Bank	Difference
Goods, works, non-consulting services, consultants' services and operating costs under the Project				
	4-DA	349,486	349,486	-
	5-DA	375,255	375,255	-
	6-DA	299,509	299,509	-
	7-DA	467,217	467,217	-
	8-DA	305,697	305,697	-
	9-DA	565,061	565,061	-
	10-DA	489,137	489,137	-
	11-DA	558,713	558,713	-
	12-DA	445,802	445,802	-
	13-DA	471,789	471,789	-
	14-DA	598,664	598,664	-
		<u>4,926,330</u>	<u>4,926,330</u>	-
Total		<u>4,926,330</u>	<u>4,926,330</u>	-