

HŽ CARGO d.o.o., Zagreb
SUSTAINABLE CROATIAN RAILWAYS IN EUROPE
PROJECT
INTERNATIONAL BANK FOR RECONSTRUCTION AND
DEVELOPMENT LOAN No. 8502 HR

PROJECT FINANCIAL STATEMENTS
AND
SPECIAL ACCOUNT STATEMENT
TOGETHER WITH INDEPENDENT AUDITOR `S REPORTS
FOR THE YEAR ENDED
31 December 2015

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INDEPENDENT AUDITOR'S REPORT

1. We have audited the accompanying Financial Statements of the SUSTAINABLE CROATIAN RAILWAYS IN EUROPE PROJECT (hereinafter: the "Project) financed under the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT LOAN No. 8502 HR(Loan), which comprise the Statement of Assets and Liabilities, the Statement of Sources and Uses of Funds, the Statement of Uses of Funds by Project Activities, Statement of Expenditure (SOE) and Designated Account Statement for the year ended 31 December 2015 (all together, the "Project Financial Statements").

2. The Project Financial Statements are the responsibility of the Project's management. Our responsibility is to express an opinion on the Project Financial Statements based on our audit.

3. We conducted our audit in accordance with International Standards on Auditing issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall statement presentation. We believe our audit provides a reasonable basis for our opinion.

The Project management's policy is to prepare the accompanying statements on the cash receipts and payments basis in conformity with International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants. On this basis, cash receipts are recognized when received and cash expenditures are recognized when paid rather than when incurred.

4. In our opinion, Financial Statements of the SUSTAINABLE CROATIAN RAILWAYS IN EUROPE PROJECT present fairly in all material respects the cash receipts and payments of the Project during the year ended 31 December 2015 in accordance with International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants.

5. With respect to Summary Statement of Expenditure ("SOE") - Application for Loan Withdrawal:

(a) adequate supporting documentation has been maintained to support claims for reimbursements of expenditures incurred; (b) the Summary Statement of Expenditure has been reconciled to the other Project Financial Statements and (c) the expenditure disbursements underlying the Summary Statement of Expenditure have been made in accordance with the purposes intended in the Loan Agreement No. 8502 HR.

BDO CROATIA d.o.o., Zagreb
Trg J. F. Kennedy 6b
10000 Zagreb
Republic of Croatia



BDO Croatia d.o.o.
za pružanje revizorskih, konzalting
i računovodstvenih usluga
Zagreb, J.F. Kennedy 6/b

Zdenko Balen, certified auditor, Member of the Management Board

Zagreb, 29 June 2016

STATEMENT OF ASSETS AND LIABILITIES
For the year ended 31 December 2015

	Notes	31 December 2015	31 December 2014
		EUR	EUR
Assets			
Front end fee	8	103.750	-
Project expenditures	8	11.271.959	-
Designated Account	9	7.006	-
TOTAL		11.382.715	-
Liabilities			
IBRD Loan No. 8502 HR	2	11.382.708	-
TOTAL		11.382.708	-
NET ASSETS	9	7	-

Project is effective as of 4 August 2015.

STATEMENT OF SOURCES AND USES OF FUNDS
For the year ended 31 December 2015

	Actual in EUR		Plan in EUR	
	2015	Cumulative till 31 December 2015	Plan for Project Life	Completion Progress in %
Sources of Funding				
Counterpart funding	-	-	-	-
IBRD Loan Funds	11.375.709	11.375.709	41.500.000	27%
Payments from Designated Account	1.006.650	1.006.650	-	-
Reimbursement	10.265.309	10.265.309	-	-
Direct Payments	103.750	103.750	-	-
Less:				
Project expenditures by loan categories	11.375.709	11.375.709	41.500.000	27%
HZC Retrenchment Payments - cat 4.	11.218.310	11.218.310	23.100.000	49%
Goods, works, non-consulting services, consultants' services and Training for Part C - cat 5.	53.649	53.649	18.296.250	0%
Front end fee - cat 8.	103.750	103.750	103.750	100%

Designated account balance is not included in the statement.

STATEMENT OF USES OF FUNDS BY PROJECT ACTIVITY
For the year ended 31 December 2015

Project Components and Subcomponents	2015.		Cumulative till 31 December 2015		Plan Project Life EUR	Completion in %
	EUR	EUR	EUR	EUR		
C 1. Retrenchment payments - retroactive reimbursement	10.265.309	10.265.309	10.265.309	13.012.501		79%
Severance Payments - voluntary leaves	4.877.832	4.877.832	4.877.832			-
Severance Payments - business reasoned dismissal	3.934.325	3.934.325	3.934.325			-
Railway Fund Payments	1.453.152	1.453.152	1.453.152			
C 1. Retrenchment payments - current	953.001	953.001	953.001	7.854.748		12%
Severance Payments	115.758	115.758	115.758			
Severance Payments - business reasoned dismissal	175.342	175.342	175.342			
Railway Fund Payments	661.901	661.901	661.901			
C 2. Investment to contribute to the restructuring plan of HZC	53.649	53.649	53.649	18.400.000		0%
Investment	-	-	-	793.531		0%
Goods	-	-	-	6.393.105		0%
Non-consulting	-	-	-	9.723.684		0%
Consulting services	-	-	-	1.152.281		0%
Operating cost	53.649	53.649	53.649	337.399		16%
Front End Fee	103.750	103.750	103.750	103.750		100%
TOTAL	11.375.709	11.375.709	11.375.709	39.370.999		29%

**Summary Reports and Statement of Expenditure
for the year ended 31 December 2015**

		in Loan currency EUR					
Withdrawal application No.	Date of receipt of funds (DA, reimbursement)	Initial Deposit/ (Recovery of the Designated Account)	1. HZC Retrenchment Payments - cat 4.	2 Goods, works, non-consulting services, consultants' services and Training for Part C - cat	3. Front end fee - cat 8.	Total Expenditures Claimed in SOE	Amount Received (DA reimbursement)
1.	30 September 2015	53.649	-	-	-	-	53.649
2	19 October 2015	(53.649)	-	53.649	-	53.649	-
3.	26 October 2015	-	10.265.309 ²⁾	-	-	10.265.309	10.265.309
4.	30 October 2015	960.000	-	-	-	0	960.000
5.	25 November 2015	(953.001)	953.001	-	-	953.001	-
Total		6.999¹⁾	11.218.310	53.649	-	11.271.959³⁾	11.278.958

- 1) Amount of EUR 6.999 plus EUR 7 of interest booked on Designated Account gives total amount of EUR 7.006, that represents balance on Designates Account as of 31 December 2015.
- 2) Amount of EUR 10.265.309 relates to retroactive reimbursement of retrenchment payments in the period from 16 May until 15. April 2015.
- 3) Total expenditures claimed in SOE in the amount of EUR 11.271.959 plus front end fee in the amount of EUR 103.750 gives total Project cost as of 31 December 2015 in the amount of EUR 11.375.709

DESIGNATED ACCOUNT STATEMENT
for the year ended 31 December 2015

(EUR)

Account No. HR2123900011300035785
 Depository Bank Hrvatska poštanska banka d.d., Zagreb
 Address Jurišićeva 4, Zagreb
 Loan IBRD Loan No. 8502

	For the year EUR	From the beginning of the Project EUR
1 Opening balance at the beginning of the period	-	-
Add:		
2 World Bank advances into DA during the period	1.013.649,00 ¹⁾	1.013.649,00
3 Interest earned (if credited into DA)	6,91	6,91
Funds available during the period	1.013.655,91	1.013.655,91
Less:		
4 Payments for eligible expenditures during the period	1.006.650,02	1.006.650,02
5 Refund to World Bank from the DA during the period	-	-
6 Service charges (if debited to DA)	-	-
	<u>1.006.650,02</u>	<u>1.006.650,02</u>
7 Closing balance at the end of the period	<u>7.005,89</u>	<u>7.005,89</u>

**Payments from the WB Special Account
 for the Project expenditures**

Description/supplier/contract	Date	Amount in EUR	Amount in HRK
RAILDATA - share in railway projects	13 Oct 2015	53.649	
Non retroactive retrenchments	25.Nov2015	953.001	7.269.492 ²⁾
Total		<u>1.006.650</u>	<u>7.269.492</u>

1) There were two payments transactions (advances) into Designated Account from World Bank: at 30 September 2015, amount of EUR 53.649 and at 30 October 2015, amount of EUR 960.000.

2) Effective rate applied was 7,628 HRK for 1 EUR

NOTES TO THE PROJECT FINANCIAL STATEMENTS

for the year ended 31 December 2015

1. GENERAL INFORMATION

In May 2015 International Bank for Reconstruction and Development approved three loans to railway sector totalling to EUR 163,5 million, of which EUR 43 million to the company HŽ PUTNIČKI PRIJEVOZ d.o.o., Zagreb, EUR 41.5 million to the company HŽ CARGO d.o.o., Zagreb and EUR 79 million to the company HŽ INFRASTRUKTURA d.o.o., Zagreb. Granted loans are part of the “Sustainable Croatian Railways in Europe Project” (SUCRE) which became effective on 4 August 2015.

The objective of the Project is to improve the operational efficiency and the financial sustainability of the public railway sector in the Republic of Croatia.

The Project consists of the following parts:

Part A Support to the Sector Restructuring and Coordination

1. Finalizing asset management separation among the railway companies and clarifying the legal status of their main assets, through the provision of consulting services and non-consulting services to Ministry of Maritime Affairs, Transport and Infrastructure.
2. Project coordination support, sector reform monitoring, and definition of railway services obligations with HŽ INFRASTRUKTURA d.o.o., Zagreb and HŽ PUTNIČKI PRIJEVOZ d.o.o., Zagreb through the provision of consulting services, non-consulting services, Training, and Operating Costs to Ministry of Maritime Affairs, Transport and Infrastructure.

Part B Support to restructuring of the company HŽ PUTNIČKI PRIJEVOZ d.o.o., Zagreb

1. Retrenchment. Provision of the retrenchment payments for the company HŽ PUTNIČKI PRIJEVOZ d.o.o., Zagreb, including job outplacement and retraining services, counselling and advisory support.
2. Investment to contribute to the restructuring plan of the company HŽ PUTNIČKI PRIJEVOZ d.o.o., Zagreb
 - (a) Rehabilitating rolling stock to improve efficiency of the fleet.
 - (b) Modernizing and integrating information technology.
 - (c) Preparing studies to adapt business processes to reorganize operations and improve energy efficiency of operations.
 - (d) Capacity building on management and restructuring.

Part C Support to the restructuring of the company HŽ CARGO d.o.o., Zagreb

1. Retrenchment -provision of the retrenchment payments for the company HŽ CARGO d.o.o., Zagreb, including job outplacement and retraining services, counselling and advisory support.

NOTES TO THE PROJECT FINANCIAL STATEMENTS

for the year ended 31 December 2015

2. Investment to contribute to the restructuring plan of the company HŽ CARGO d.o.o., Zagreb

- (a) Rehabilitating rolling stock to improve efficiency of the fleet.
- (b) Modernizing and integrating information technology.
- (c) Capacity building on management and restructuring.

Part D Support to the restructuring of the company HŽ INFRASTRUKTURA d.o.o., Zagreb and enabling investment to increase system efficiency

1. Retrenchment Provision of the retrenchment payments for the company HŽ INFRASTRUKTURA d.o.o., Zagreb including job outplacement and retraining services, counselling and advisory support.

2. Installing railway safety crossings based on prioritization criteria set forth in Supplemental Letter 4.

3. Undertaking other railway safety works, including:

- (a) Reinforcing cuts and slope on the two corridors from Rijeka;
- (b) Rehabilitating or replacing the Klostar and Ljubosina bridges on the Zagreb-Rijeka axis.

4. Undertaking emergency infrastructure investments, including:

- (a) Rehabilitating the Ogulin - Moravice line;
- (b) Rehabilitating the Varazdin-Cakovec line; and
- (c) Replacing switches, electrical, and support systems (for safety and signalling) on international and national corridors selected pursuant to criteria set forth in Supplemental Letter #4; and
- (d) Constructing and improving the Borongaj, Rijeka-Brajdica, and Vinkovci railway stations.

5. Capacity building on management and restructuring.

The Company is responsible for the management of the activities including procurement, disbursement, financial management, monitoring, reporting and coordination. The objective of this components is to support operational and financial restructuring of the Company and to contribute in restoration of the physical infrastructure's conditions.

2. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT LOAN AGREEMENT

HŽ CARGO d.o.o., Zagreb (the Company) signed a Loan Agreement with the International Bank for Reconstruction and Development (the Bank) in the amount of EUR 41,5 millions on 6 May 2015 for the financing of the Sustainable Croatian Railways in Europe Project. Principal, charges, fees and interest are the obligations of the Company as a Borrower.

It was agreed that the Company will pay to the Bank a front-end fee in the amount of 0,25% from the total loan amount or EUR 103.750. The Commitment charge payable by the Company is 0,25% per annum on the unwithdrawn loan balance.

The interest payable by the Company is at a rate equal to reference rate for the loan currency plus the variable spread. Interest, commitment charges on the unwithdrawn loan balance and other charges shall be repayable semi-annually in arrears on 15 July and 15 January in each year.

The principal amount of the loan repayable on each principal payment date is determined by multiplying: withdrawn loan balance as of the first principal payment date; by the instalment share for each principal payment date as shown in the table below:

NOTES TO THE PROJECT FINANCIAL STATEMENTS
for the year ended 31 December 2015

Principal payment date	Instalment share (Expressed as a percentage)
15 July 2020	2,28%
15 January 2021	2,34%
15 July 2021	2,40%
15 January 2022	2,46%
15 July 2022	2,52%
15 January 2023	2,58%
15 July 2023	2,64%
15 January 2024	2,71%
15 July 2024	2,78%
15 January 2025	2,85%
15 July 2025	2,92%
15 January 2026	2,99%
15 July 2026	3,07%
15 January 2027	3,14%
15 July 2027	3,22%
15 January 2028	3,30%
15 July 2028	3,39%
15 January 2029	3,47%
15 July 2029	3,56%
15 January 2030	3,65%
15 July 2030	3,74%
15 January 2031	3,83%
15 July 2031	3,93%
15 January 2032	4,02%
15 July 2032	4,12%
15 January 2033	4,23%
15 July 2033	4,33%
15 January 2034	4,44%
15 July 2034	4,55%
15 January 2035	4,54%

NOTES TO THE PROJECT FINANCIAL STATEMENTS
for the year ended 31 December 2015

Pursuant to the finance contract, the Company has to ensure documents on the assets/funds usage and shall purchase goods, procure services and order works for the Project in accordance with the current edition of the IBRD Guide to Procurement.

The Company has to use funds approved by and remitted from the loan exclusively for the purpose they were intended. The Bank is authorized to cancel further assets usage if they establish that the approved assets are not used for designated purposes.

3. DEBT SERVICE COVERAGE

Except as the Bank shall otherwise agree, the Company shall not incur any debt unless a reasonable forecast of the revenues and expenditures of the Company shows that the estimated net revenues of the Company for each fiscal year during the term of the debt to be incurred:

(a) shall be at least 1.0 times the estimated debt service requirements of the Company in such year on all debt of the Company including the debt to be incurred, up to the Closing Date; and

(b) shall be at least 1.1 times the estimated debt service requirements of the Company in such year on all debt of the Company including the debt to be incurred, after the Closing Date until the repayment of the Loan under this Agreement.

4. PROJECT COST AND FINANCING

Sources of funds (in EUR million)	Total	Retrenchment Payments under Part C of the Project	Goods, works, non-consulting services, and consultants' services for Part C of the Project	Capitalization of interest charges & front-end fee
IBRD loan	41,5	23,1	18,3	0,1
Government funds	0	0	0	0
Total	41,5	23,1	18,3	0,1

5. PROJECT MANAGEMENT

Project implementation unit ("PIU") has been established within the Company and is in charge for the project implementation.

6. ACCOUNTING RECORDS AND BASE FOR PRESENTATION

Within the business books (general ledger) of the Company are recorded all Project transactions.

Project accounting records are also kept in supporting tables (excel), based on which the enclosed Financial Statements of the Project have been made.

7. DEVIATIONS FROM AGREED CONDITIONS

There were no deviations from the contracted terms.

8. PROJECT EXPENDITURES

Expenditures in EUR	31 December 2015
Retrenchment Payments	11.218.310
Goods, works, non-consulting services, and consultants' services	53.649
Front end fee	103.750
Total	11.375.709

9. DESIGNATED ACCOUNT AND NET ASSETS

The Company opened Designated Account at Hrvatska poštanska banka d.d., Zagreb ("HPB") in order to realize the Project. Designated Account balance as of 31 December 2015 in the amount of EUR 7.006 is confirmed by the bank statement of HPB. As of 31 December 2015 interest in the amount of EUR 7 have been booked in the account and represents net assets of the Project.

10. VALUE ADDED TAX

As per 31 December 2015, Value Added Tax (VAT) was not paid from the loan funds, as transaction so far did not include VAT taxable transactions.

Reconciliation of the Designated Account

	in EUR
Loan disbursed until 31 December 2015	11.382.708
Amount on Designated account	7.006
Add: total expenditures stated in the Statement of sources and Uses of funds	11.271.959
Add: Front-end fee	103.750
	11.382.715
Minus: Interest earned	(7)
Total recorded	11.382.708

MANAGEMENT LETTER

HŽ Cargo d.o.o.
Heinzlova 51
10000 Zagreb

Dear Sirs,

We are pleased to submit this letter, containing our comments, observations, and recommendations concerning the internal control structure and other matters which resulted from our audit of the Project Financial Statements of the SUSTAINABLE CROATIAN RAILWAYS IN EUROPE PROJECT (Project) financed under INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT LOAN No. 8502 HR as of 31 December 2015.

In planning and performing our audit we considered the project's internal control structure in order to determine our auditing procedures for the purpose of expressing an opinion on the Financial Statements taken as a whole, and not to provide assurance on the internal control structure. Our report cannot, therefore, be expected to include all possible comments and recommendations that a more extensive special examination might indicate. We also considered the degree of compliance of the Project with the Loan covenants, the Bank's Procurement guidelines, Disbursement guidelines and the Bank's financial reporting guidelines.

This report is intended solely for the information and use of the Bank and the Project Implementation Unit. We would be pleased to discuss our comments, observations, and recommendations with you.

With respect,

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Trg J. F. Kennedy 6b
10000 Zagreb
Republic of Croatia



BDO Croatia d.o.o.
za pružanje revizorskih, konzalting
i računovodstvenih usluga
Zagreb, J.F. Kennedy 6/b



Zdenko Balen, certified auditor, Member of the Management Board

Zagreb, 29 June 2016

ACCOUNTING RECORDS, SYSTEMS AND CONTROLS

Nothing significant noted.

DEFICIENCIES AND WEAKNESSES IN SYSTEMS AND INTERNAL CONTROLS

Nothing significant noted.

COMPLIANCE WITH THE FINANCIAL COVENANTS AND BANK'S GUIDELINES

The conditions set in the loan agreement for the Debt Service Coverage ("DSC") are that estimated net revenues of the Borrower for each fiscal year during the term of the debt to be incurred:

- (a) shall be at least 1.0 times the estimated debt service requirements of the Borrower in such year on all debt of the Borrower including the debt to be incurred, up to the Closing Date; and
- (b) shall be at least 1.1 times the estimated debt service requirements of the Borrower in such year on all debt of the Borrower including the debt to be incurred, after the Closing Date until the repayment of the Loan under this Agreement.

Calculation of Debt Service Coverage Ratio is prepared for year 2015 based on audited data of financial statements prepared by the Borrower. According to the Borrower, forecast for 2016 and beyond can't be determined as "reasonable", therefore, for the period 2016 and beyond DSCR was not prepared as it is influenced by various factors that affects the accuracy of data.

Based on noted data DSCR for 2015 is 353.4, that is significantly higher than required value.

It is required that the Borrower regularly monitors movement of DSC ratios and communicate with the Bank in order to meet the provisions of the Loan Agreement regarding entering into arrangements or contracts that that could materially affect, the ability of the Borrower to perform any of its respective obligations under Loan Agreement.

OTHER MATTERS

Nothing significant noted.

CHECKLIST

Loan name:	SUSTAINABLE CROATIAN RAILWAYS IN EUROPE PROJECT
Loan #:	IBRD 8502 HR
Audited year:	31 December 2015

Included N/A

	Included	N/A
I. Audit Report (Opinion):		
A. Applicable accounting standards noted	X	
B. Applicable auditing standards noted	X	
C. Opinion on all forms of disbursement:		
1. Financial statements	X	
2. Designated Account	X	
D. All sources of financing for the project are noted	X	
II. Financial statements:		
A. Revenue Entity (all of the following are required):		
1. Balance Sheet		X
2. Cash Flow Statement		X
3. Income Statement		X
B. Non-Revenue Entity (all of the following are required):		
1. Statement of Assets and Liabilities	X	
2. Summary of Sources and Uses of Funds	X	
C. If applicable (refer to the Loan Agreement):		
1. Statement of Expenditure (SOE)	X	
2. Special Account Statement	X	
III. Notes to the Financial Statements	X	
IV. Management Letter to the Project implementation unit	X	