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**United States Agency for International Development
Bank Supervision and Enforcement Program**



FINAL REPORT

**Contract No. NIS-1-00-98-00035-00 - Task Order No. 1
Period of Performance: October 1999 - April 2002**

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Booz Allen Hamilton, on behalf of itself and its subcontractor, Bankworld Inc., is pleased to submit this Final Report for the USAID Bank Supervision and Enforcement Program in Georgia, Contract No. NIS-1-00-98-00035-00, Task Order No. 1, completed April 30, 2002.

We take this opportunity to thank USAID/Washington, USAID/Tblisi, the National Bank of Georgia and various other counterparts in the Republic of Georgia for their kind cooperation and assistance.

Should there be any question on the Report, we would most welcome hearing.

Booz Allen Hamilton

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Bank Supervision and Enforcement Program

1. Introduction

Under the requirements of the Task Order, Booz Allen Hamilton and Bankworld Inc., were to provide technical assistance to the National Bank of Georgia (NBG) for the continued development of its banking supervision program on behalf of United States Agency for International Development (USAID). This technical assistance was intended to provide practical training and assistance in the following areas of bank supervision:

- Organizational development and structure of the banking supervision department;
- On-site examination policy and procedures, including the practical implementation of inspection techniques based on international standards;
- Improvements in off-site surveillance and database development;
- Analysis of problem banks, including remedial programs;
- Design and implementation of a chart of accounts consistent with International Accounting Standards (IAS) as well as to help the NBG better understand its role in assisting the commercial banks adopt and implement IAS to improve transparency in the Georgian Banking System, and;
- A review and enhancement of the existing legal infrastructure.

The NBG has been performing an analysis of the commercial banking system using the CAMEL system since late 1996. Since that time the International Monetary Fund, the World Bank, EU TACIS, and other international donors have been assisting the NBG improve its procedures to supervise and monitor the commercial banking system prior to the start of the current USAID Program.

As previously noted, the NBG's banking supervision department has been preparing on-site inspection reports based on the CAMEL system. However, the scope of their review and the quality of their analysis needed to be improved significantly. The NBG had also developed an off-site program that consisted of monthly and quarterly reports that were being submitted to the NBG. These reports were intended to allow the NBG to monitor the financial condition of the commercial banks between inspections. However, the quality and depth of these reports were in need of substantial improvement. In addition, the NBG had not developed a database system, which would utilize the information provided by the regulatory reports as an off-site surveillance system. The reports generated from such a system should compare a bank's performance using ratio and trend and peer group analysis to identify potentially harmful trends and problems in individual banks and the banking system as a whole.

Phase I of the USAID Banking Supervision Program began in October 1999 with two resident advisors (RA). In reviewing the work that was previously done in the supervision department, it was determined that only superficial improvements had taken place. For example, the on-site inspectors were using a new inspection manual and procedures that had been developed previously. However, a closer review and analysis of the procedures being utilized indicated the inspectors did not understand the basic intent and meaning of the bulk of what had been developed.

Phase I of USAID's program was structured to reinforce the bank supervision staff's ability to identify and control risks in the commercial banking system. Upon arrival in Georgia, the Resident Advisors quickly confirmed that the existing supervision staff had a reasonable awareness of the supervisory issues, but had little practical understanding of how to apply real and practical solutions to the problems confronting the commercial banks. Specifically, they were in need of significant training and coaching on how to apply international supervisory policies/practices to address problems as they were discovered.

In June 2000 the program was amended to include an additional resident advisor for accounting issues. This particular advisor was assigned to help the NBG better understand its role in helping the commercial banks adopt and implement international accounting standards. One of the primary objectives for this person was to help the NBG with the design and implementation of a chart of accounts that was consistent with international accounting standards. In January 2001, two additional accounting advisors were added to the program to help the commercial banks implement and better understand international accounting standards. It was intended that these two accounting advisors were to spend most of their time working with the largest commercial banks in assisting them implement international accounting standards. Their work was to be a continuation of the work begun by EU TACIS. The TACIS advisors completed their contract in February 2001 after which the USAID Advisors took over the responsibility for the commercial bank accounting.

In June 2000 the program's legal component was also expanded from the 88 days contained in the original terms of reference. The expanded time for the legal work was required due to the need to completely rewrite the two banking laws in existence, and the need to develop and implement approximately 15 new or revised regulations.

As a result of the need to institutionalize the regulatory process, specific training programs were developed and implemented on how to review a bank's quality of assets, including the adequacy of reserves for loan losses. This training included the proper analysis and classification of assets, and went well beyond the simple number of days a loan is delinquent. In addition, the inspection staff was instructed on how to analyze the borrower's ability to repay the debt in a timely manner. A corporate governance program was also developed and implemented to ensure that the banks are being managed in a prudent manner and that each director is fully

living up to his/her fiduciary responsibility. An in-depth analysis of the internal and external audit practices and recommendations for improving the accounting and internal control functions where warranted were to be made.

This report is intended to highlight and document the progress made during the first phase of the USAID project from October 1999 to April 2002.

2. Executive Summary

The Senior Management of the NBG recognized the need for a strong regulatory program and has been cooperative in assisting with the design of a supervision regime to help improve the transparency and discipline in the banking system. The increased discipline and transparency is intended to help reduce the risk of financial instability of the commercial banks in Georgia.

In helping the NBG exercise and promote prudential supervision, the USAID Contractor (Booz Allen Hamilton) and its subcontractor Bankworld, Inc. (BWI), realized very early in this program that a major change in the emphasis of inspecting commercial banks was needed. In the initial stages of Phase I, it was determined that a major amount of the regulatory staff's time and efforts were still being used to determine compliance with economic requirements and ratios which were totally unrelated to determining the various risks of commercial banks that operate in a market economy. It was explained to the on-site and off-site staff that their role needed to change. As explained, their role as a regulator needed to focus on how banks identify, measure, and control various risks in their operations. Important elements in this process were provided to the staff, including: the need to evaluate the quality of the banks' loan portfolios, the adequacy of loan loss provisions, the accuracy and reliability of the accounting systems and the financial reports (balance sheets and income statements) being produced by management and the levels of internal controls within the banks.

As stated elsewhere in this report, the primary emphasis for the banking supervision and enforcement program was to assist the NBG in implementing international standards and best practices with a view to strengthen prudential supervisory techniques for the commercial banking system in Georgia.

3. Summary of Tangible Results

This subsection is intended to highlight the achievements that took place during Phase I. Additional information is provided in more detail under each of the program components.

With regard to the **on-site function** the following significant events took place:

- More comprehensive procedures were developed and implemented with respect to inspecting a bank's accounting and internal control systems, asset classification write-ups, and the analysis of provisions and reserves;

- A completely new format for the on-site inspections was developed and has been utilized for the past 18 months;
- 24 full scope inspections were conducted in which an RA was present at the commercial bank to provide on-the-job training and coaching to the inspectors. Each of these reports was translated into English in their entirety and formal written feedback was provided to the staff with regard to the strengths and weaknesses of the reports;
- Numerous workshops were conducted to go over the results of the inspections in a formal setting to discuss the ratings assigned to the bank based on the analysis performed by the on-site staff, and;
- An accreditation program was developed and introduced which included 5 courses. 4 of the courses have been completed, with the 5th course scheduled for the summer of 2002 during Phase II.

With regard to the **off-site function**, the following significant events took place:

- Developments on the new set of regulatory reports were submitted to the NBG each month by the commercial banks;
- A completely new design and format of the CAEL report for the off-site analysts was developed and implemented, and;
- The design and programming of a database program to be used as an off-site surveillance system to monitor a bank's performance between on-site inspections, which is now operational.

With regard to the **legal function**, the following significant events took place:

- The complete redrafting of the two prominent banking laws in Georgia. The Law on the National Bank of Georgia and the Law on Commercial Bank Activities;
- The approval of the two aforementioned laws by the NBG's Supervisory Council and the Georgian Parliament and signed into law by President Shevardnadze;
- The formulation and the approval of the following regulations by the Ministry of Justice:
 - Asset Classification and Loan Loss Provisioning Regulation;
 - Conflict of Interest and Transactions with Related Parties Regulation;
 - Internal Audit Regulation;
- The formulation and drafting of the following regulations:
 - Fit and Proper Regulation for Bank Administrators;
 - Regulatory Capital Regulation;
 - Regulation on Prompt and Corrective Actions;
 - Regulation on Credit Concentrations and Large Exposures;
 - Regulation on Fixed Assets.Each of these regulations has been completed and is currently awaiting approval by the Ministry of Justice, and;

- The introduction of several new transactional tools to assist with the merger of a large problem bank with a healthy bank. The agreement is referred to as a Purchase and Assumption Agreement that had never before been used in Georgia in a successful resolution of a troubled bank.

With regard to **Problem Bank Resolution**, the following significant events took place:

- The appointment of temporary administrators for three large problem banks;
- A final resolution to each of the three problem banks mentioned above was consummated. At the time of resolution, each of these three banks were one of the largest 10 banks in Georgia and accounted for approximately 10% of the total banking assets in the country;
- The first successful resolution of a trouble bank that had been in place in the Temporary Administration and was later sold to a healthy Georgia Bank;
- The introduction of several new enforcement techniques to control or minimize the problems of several banks. These new initiatives include the issuance of 4 Cease and Desist Orders, a Restriction on Dividends, Capital Calls and other procedures intended to control and minimize the financial losses and defalcations of troubled banks;
- The development and establishment of formal criteria for defining a problem bank, and;
- The establishment of a special unit within the supervision department to develop criteria for defining problem banks, policies, and procedures for dealing with such banks.

With regard to **Accounting Methodology**, the following significant events took place:

- The development and implementation of a new Chart of Accounts that is substantially in compliance with International Accounting Standards;
- The creation of a new Accounting Methodology Department within the Banking Supervision Department;
- The creation of an Accounting Regulation and six position papers on different accounting topics. These position papers will be offered to the commercial banks to assist in a better understanding of specific accounting issues, and;
- The development and completion of an internal audit manual to be used by the commercial banks as a guideline for enhancing their internal audit programs. The manual consisted of over two hundred pages of internal control questionnaires and other reference materials for use by the commercial banks accounting staff.

With regard to **Commercial Bank accounting** the following significant events took place:

- During the past 12 months, 4 seminars were provided to the commercial bank accountants. Approximately 200 bankers and accountants attended these seminars;

- 6 pilot banks were selected by the NBG to receive intensive technical assistance in the implementation of international accounting standards, and;
- Development of a Help-desk to provide assistance to the remaining commercial banks in Georgia on inquiries related to the conversion to the new COA and implementation of IAS at the transaction level.

4. Objectives Achieved

Given below are the objectives achieved during the phase just completed. These objectives were proposed in the Work Plans approved for the period, October 1999-April 2002. Also noted below are certain items not included in the Work Plans but were accomplished to meet the immediate needs. A tabular presentation of the accomplishments of Phase I relative to the Terms of Reference is also attached.

On-site Supervision

- The continued development and implementation of an inspection program for the commercial banks utilizing the CAMEL system as the standard for performing on-site inspections. Specifics include a review and revision of the current inspection procedures to increase the inspectors' effectiveness in identifying and quantifying the various risks posed by the individual banks;
- The review of the inspection report and changes made where necessary to take into consideration the commercial banks' compliance with certain new initiatives including the development of a new asset classification regulation and new accounting standards;
- The implementation of a new philosophy for using the inspection report as a management tool which effectively communicates a commercial bank's strengths and weaknesses to the subject bank's supervisory board and the development of a follow up procedures to ensure the necessary corrective actions are taken by the subject bank;
- Performance of at least 20 on-site inspections, in which the resident advisor will be on-site at the commercial banks during the years 2000 and 2001. The resident advisor was to participate in inspections of one of the large banks, as ranked by assets or banks that present a systemic risk to the banking sector. The inspection reports were to be translated into English in their entirety and the Resident Advisor was to perform a formal review process at the conclusion of each inspection with the inspectors;
- The continued development and refinement of a legal framework that will support the work of the supervisory department in adopting and implementing the timely and appropriate actions needed to eliminate the commercial banks' violations of laws and regulations and other unsound practices.

- The development and implementation of an inspector accreditation (training) program to sustain and institutionalize the overall supervision function;
- Conducting a comprehensive and complete review of the Banking Supervision Department to determine if the present structure and staffing is adequate given the current workload of each division, and;
- The development of a working group consisting of the IMF, IFC, EBRD, World Bank, USAID, and other donors involved in the commercial banking system to enhance the communication process, involving the various reforms being implemented between the donors and relevant participants.

Off-site Surveillance

- A review of the commercial banks' ability to submit timely and accurate financial information and recommendations for improvement on a regular basis to the NBG's Bank Supervision Department;
- Further development and refinement of the off-site surveillance system to assist in the identification of potential problems at commercial banks between the regularly scheduled inspections, which referred to as a CAEL Report;
- The introduction of developed and implemented monthly financial/regulatory reports and supporting schedules based on the requirements of the new Chart of Accounts;
- Development of a mapping schedule from the old Chart of Accounts to the new one for the commercial banks along with written instructions on how to use the new regulatory reports;
- In conjunction with the NBG's Information Technology Group, development of a data based information and analytical reporting system. This system will be derived from the new regulatory reports and will contain quarterly financial ratios and peer group data similar to the Uniform Bank Performance Report (UBPR), and;
- Development of an integrated approach to linking the on-site and off-site program, critical to ensure that all pertinent supervisory information concerning a commercial bank's activities is shared between these two areas.

Problem Bank Resolution

- The primary emphasis on improving the methodology of the NBG for affecting the resolution of problem banks, including procedures utilizing any new expanded enforcement techniques, provided under the new laws and

regulations that have been developed and implemented, and those that are in the process of being developed;

- Accurate measurement of the financial risk of each troubled bank and minimization of the cost of resolving the individual problems without increasing the risk to the entire banking system;
- Assistance to the NBG in determining a definition of what constitutes a problem bank;
- Continued assistance to help implement solutions directed at rehabilitation rather than liquidation of troubled banks;
- The refinement of a system of Supervisory Action Plan to be implemented by the supervisory staff of the NBG when a commercial bank becomes a "problem bank" as defined by the NBG, and;
- Development of a policy to coordinate the transfer of responsibility for the liquidation of problem and/or insolvent banks when they are declared insolvent or upon the revocation of the bank's license to the appropriate division within the banking supervision department.

Legal

Legislative Tasks

- Strengthening of the legal framework with regard to NBG enforcement powers, antimonopoly authority, and investigative authority;
- Evaluating of Georgia's two primary banking laws, the "Organic Law on the National Bank" (NBL) and the "Law on Activities of Commercial Banks" (CBL);
- Evaluating of the effectiveness of other relevant laws, particularly the "Companies Act," the Civil Code," the "Criminal Code," the "Administrative Violations Code," the "General Administrative Code," "the Administrative Procedures Code," and the "Law on Capital Markets;"
- Drafting of all needed amendments to the banking laws with the participation and approval of the NBG, sending them to appropriate Ministries and the banking community for comment and approval, and ultimately sending all of the needed amendments of the banking laws to Parliament for enactment, and;
- Effecting the proposed enactment of the amendments.

Legislation Not in Work Plan Which Was Delivered During Phase I of the Project

- The “Amending Law” portion of the amended NBL mandated that a draft proposal for a “Law on Non-Bank Depository Institutions” be delivered to Parliament by the year’s end. The delivery of this Law was not foreseen as a deliverable in the planning of the Project’s Phase I, and hence does not appear in the Work Plan, and;
- Accordingly, at the year’s end, a draft “Law on Non-Bank Depository Institutions –Credit Unions” was delivered to Parliament exactly on its Expected Delivery Date.

Regulatory Tasks

It should be noted that in April 2001, in view of evolving realities in Georgia’s Parliament and at the NBG some of the delivery dates of regulations were shifted and put back for several months with the concurrence of USAID.

- Drafting and delivering the NBG the following draft regulations.
 - (a) “Regulation on Asset Classifications and Loan Loss Reserves”
 - (b) “Regulation on Conflicts of Interest and Transactions with Related Parties”
 - (c) “Regulation on Internal Audit”
 - (d) “Regulation on Minimum and Risk Adjusted Capital Requirements
 - (e) “Regulation on Prompt Corrective Actions”
 - (f) “Mergers of Banks and of Persons Who Control Them”
 - (g) “Regulation on Credit Concentration and Large Exposures”
 - (h) “Regulation on Liquidity Requirements”
 - (i) “Regulation on Fixed Asset Limitations”
 - (j) “Regulation on Licensing and Branching”
 - (k) “Regulation on Foreign Exchange Exposures”
 - (l) “Regulation on Securities Activities and Investments Classification”
 - (m) “Regulation on Holding and Activities of Persons Who Control Banks”

(n) "Regulation on Corporate Governance"

Administrative Law

- Providing NBG with technical assistance on the "Law on Administrative Procedures" and to the extent possible use new rules on regulatory promulgation.

Judicial Task

- Discussion and analysis of both USAID's Rule of Law Program and its Economic Restructuring Program as well as other available Judicial Training programs in Georgia, and;
- Opportunities where the current Legal Advisor and a dedicated Georgian lawyer will organize and/or participate in the training of judges by teaching a course emphasizing financial law reform as opposed to commercial law reform. It was planned that the course would also introduce the administrative law doctrine of "judicial review" whereby the courts would give "due deference" (presumptive respect) to the expertise of regulators such as the NBG rather than permitting their corrective actions to be litigated on their merits unless it appears that a decision to take a corrective action was arrived at in an arbitrary or capricious manner or was politically motivated.

Administrative Task

- Engaging of a Georgian Attorney to join the project and to work with the Legal Advisor, the NBG Department of Supervision and the NBG Legal Department on legal, legislative and regulatory issues. The lawyer developed skills enabling him/her to continue to serve in a senior capacity at the NBG after the Project ends.

Institutional Development and Training of the Legal Department

- Completing of at least 2 training courses for the Legal Department based on comparative legal analysis and developing the skills and abilities of members of the NBG Legal Department; and,
- Completing of a comparative analysis between legal frameworks of regional banking sectors and other leading banking sector models, including the United States and EU Banking Directives.

Accounting Methodology – NBG

- Promoting the institutional development of internationally based bank accounting standards throughout the banking supervision department and the commercial banking sector;
- The continued development of the NBG's capacity to support commercial bank accounting reform and facilitate the full implementation of IAS in the commercial banking system. This process was to be assisted with the design, implementation, and staffing of a new division within the banking supervision department, the Accounting Methodology Department (AMD), and to be primarily responsible for ensuring that the banking supervision department is current on the technical issues involving the implementation of International Accounting Standards within the commercial banking system;
- Development of an internal audit function in commercial banks with the assistance of the AMD, and;
- Training of commercial banks accounting staff and bank supervision staff on IAS requirements through the development of accounting policies and regulations that support the adoption of International Accounting Standards.

Accounting Technical Assistance-Commercial Banks

- Promoting the increased public and regulatory transparency of the banking sector through promotion and institutional development of internationally based bank accounting standards;
- International Accounting Standards (IAS) conversion assistance and training to the commercial banks;
- Provide assistance to the NBG in a pilot analysis of at least six (6) key banks to determine whether compliance with IAS is acceptable and whether conversions to IAS have been completed on the transaction level;
- On-site direct assistance for the pilot banks on the conversion to the new IAS based Chart of Accounts (the "new COA"), interpretations and implementations of IAS at the transaction level, internal accounting policies and procedures and internal and external audits;
- Help-desk assistance to the remaining commercial banks in Georgia on the inquiries related to the conversion to the new COA and implementation of IAS at the transaction level;

- Conducting four (4) quarterly training seminars for the commercial banks' management, accountants, internal audit staff, and NBG staff on the IAS applicable to the commercial banking sector, IAS compliant financial reporting, internal controls, and internal and external audits;
- Assistance to the NBG Bank Supervision on the on-site inspections of the pilot banks in the areas of Accounting, Record Keeping and Internal Controls;
- Development of local accounting professionals on the IAS, technical research and writing skills, knowledge of banking industry, communication, consultation and presentation skills. Ensuring retention of the trained professionals in the banking sector for continued contribution to the sector's reform in Georgia.

5. Detailed Approach, Activities and Intermediate Results

On-site Supervision

- During the first year of the program the following number of inspections were performed in which a resident advisor was on-site at the commercial bank with the inspectors. Each of the resulting reports was translated into English in its entirety to allow a comprehensive review of the inspectors work.

"1" Rated Banks ("Sound" Banks)	0
"2" Rated Banks ("Satisfactory" Banks)	5
"3" Rated Banks ("Fair" Banks)	1
"4" Rated Banks ("Marginal" Banks)	4
"5" Rated Banks ("Unsatisfactory" Banks)	<u>3</u>
Total Bank Inspected in 2000	13

These banks accounted for approximately 70% of the assets in the banking system at the time of the inspections.

- In the initial stage of Phase I of the project, the Chief of Party (COP) and RA Stroud met with the senior management of the NBG to obtain their views and assessment of the banking system in Georgia. During the first month a Memorandum of Understanding was prepared along with a work plan, which detailed the goals and objectives for the first year of this project. The following items were also reviewed prior to the development of a formal work plan:
 - The financial reports (statements) being sent to the National Bank by the commercial banks;
 - The terms and definitions for the aforementioned financial reports;

- Several decrees passed by the NBG's Board including Decree No. 114, which detailed the Framework for Supervisory Actions Against Commercial Banks;
- Previous reports and materials prepared by the IMF;
- The format for the on-site inspection report and the inspection procedures, and;
- And the format for the monthly reports that were being submitted to the NBG by the commercial banks.

In addition to reviewing the above documents, RA Stroud reviewed a previous inspection report that had been translated into English to gain familiarity with the inspection process and to have a better understanding of the final work product. The inspection report was poorly written, and most of the conclusions were not adequately supported by the inspectors' analysis. The format of the report was not adequate either.

The following information is provided to illustrate the type of issues that were reviewed and discussed with the supervisory staff during the first year of working with the on-site inspectors.

- An initial review and assessment of the existing on-site inspection procedures was conducted. The conclusion was that the official procedures were comprehensive and sufficient in scope to allow the inspectors to perform an adequate assessment of a commercial bank's activities. The problem that was later discovered and confirmed was the fact that most of the inspectors did not sufficiently understand how to apply them. As a result, the RA's spent considerable time on inspections performing on the job training. However, this assessment did not preclude the RA's from continuing to refine the inspection procedures and other processes in the future. In fact, numerous suggestions to modify the format of the inspection report were implemented. These suggestions were intended to help the inspectors to increase their focus on the problems pertaining to the commercial banks' record keeping, accounting, and reporting deficiencies, and the adequacy of the loan loss provisions and reserves.
- In the first quarter of the year 2000, two workshops were held for the on-site and off-site departments. These workshops were intended to review the recently completed inspections reports on two large commercial banks. The first bank under consideration was assigned a composite rating of two by the on-site staff and three by the off-site staff. However, it was pointed out by the RA's that neither of these ratings was accurate, as they did not take into account the severity of the bank's problem loans and other problem assets and their potential impact on the bank's earnings and capital. During the workshop it was made evident that the inspectors' ratings for the various components were poorly supported and not realistic based on the bank's present financial condition. RA Stroud and the IMF Advisor working at the NBG at that time both felt an overall rating of at least a 4 was more appropriate for the bank. This bank was later placed into temporary

administration and its assets and liabilities were sold to another healthy Georgian bank.

The analysis performed by the inspectors on the second bank was better and more comprehensive than the work on the first one. It was written better and more supported than the previous one. The overall rating assigned by the on-site staff was a 4 and for the most part the RA's agreed with this. However, there were a number of significant issues in this inspection that required the COP to address with the President of the NBG. One major item of concern was that the bank was technically insolvent but was not declared as such. This was due to several political issues that still needed to be resolved after the completion of the report. Later, it was confirmed that this particular bank was insolvent and was subsequently liquidated.

The above workshops and others in the future were also intended to stress the importance of the communication process and working relationship between the on-site and off-site staffs.

- In the early summer of 2000, it was discovered that the first bank noted above was undergoing an external audit. The NBG requested a copy of the audit and the preliminary draft copy indicated the bank had severe operating and liquidity problems. As noted above, this particular bank caused a major concern when the inspectors rated the bank a two and the RA felt very strongly that a four rating was more appropriate for this bank, based on the information used by the inspectors. The results of the above-mentioned draft audit report confirmed the resident advisors' assessment of the bank's operations. The audit report also indicated the bank to be insolvent under the international accounting standards. The Project¹ recommended to the Director of the Bank Supervision Department and the appropriate Vice-President that some type of regulatory response needed to be taken immediately, based on the information contained in the audit report.
- As a result of the above noted deficiencies and problems with the quality of the inspection reports being used by the on-site staff, the Project amended the format of the inspection report. The changes were intended to make the written report more comprehensive and add more clarity to the comments and analysis made by the inspectors. Several discussions were held to solicit approval for these changes from the Director of the Banking Supervision Department.
- In the initial stages of Phase I, an inspection on the 2nd largest bank (as ranked by assets) commenced. The Project spent a substantial amount of time at the commercial bank working with the inspectors until the inspection report was substantially completed. During the process of completing the inspection, the COP held numerous meetings with the inspectors to discuss the following items:

¹ The term "Project" has been used interchangeably for the COP and/or the advisor responsible for a given component in this USAID Project.

- A review of the bank's internal audit program and the scope of work revealed the internal audit function to be in need of substantial improvement;
 - Reviewing the bank's calculation of its liquidity ratio and position revealed that the management had included two large deposits held in a bankrupt Russian Bank as liquid assets. The RA's attempted to explain that these assets could not be counted as liquid assets, and indeed needed to be charged off and/or fully reserved. However, the existing asset classification regulation did not allow this;
 - There were extensive discussions on how to classify several large loans. It was later discovered that some of the loans were no longer loans as the bank had foreclosed on the collateral securing the loans;
 - The inspectors were of the opinion that the bank had violated several economic normatives, including the amount of fixed assets that the bank could legally invest in or own. Of the 12 economic normatives that the bank were required to calculate, 6 were prepared incorrectly by the bank's management and had to be amended by the inspectors;
 - The Project was able to ascertain that the bank was not using the accrual method of accounting on either the asset or liability side of the balance sheet. The bank's management and the inspectors had insisted that the bank was utilizing international accounting standards.
- At a meeting between the bank's management and the NBG's inspectors to discuss some of the more controversial issues, the bankers were able to intimidate the inspectors into changing several of their conclusions. The RA later met with the management of the banking supervision department to discuss this matter and to ensure that these types of situations are better handled in the future. Notwithstanding these problems and shortcomings, the inspectors and RA Stroud met with the subject bank's supervisory council to present the findings of the report and to go over the corrective actions needed to be implemented.
 - The COP expressed to the President of the NBG his concerns over the quality of an enforcement document that was entered into with a commercial bank that had just undergone an on-site inspection. Legal Adviser (LA) McCormack and the IMF Advisor also attended this meeting. Both agreed with the poor quality and wording of the document and that the document's enforcement provisions were weak. As a result, it was agreed that RA Stroud would take the initiative in drafting a new more stringent document in which the NBG could exercise more control and restraint over this severely troubled bank. As a result of these concerns, RA Stroud drafted an enforcement document (Cease and Desist) to deal with this bank's specific issues and problems. The document was given to the IMF Advisor and to the NBG President.

- In the summer of 2000, the Project held extensive discussions with regard to a large, high profile troubled bank. These discussions held, included the President and Vice President of the NBG, representatives of the EBRD and the management of the subject bank. The commercial bank's President and the EBRD usually initiated the meetings in order to detail the extent of the bank's problems to the NBG's senior managers. The Project asked the President of the NBG to attend these meeting to help address their concerns, and ultimately, to assist the NBG in finding a solution to the problems of this bank. According to the commercial bank's management, the bank was hopelessly insolvent and the current American and Georgian shareholders had no intention of injecting any new capital into the bank. In addition, the EBRD has no intention of providing any new sources of capital at this point. As a result of these meetings and the materials presented by the bank's managers, RA Stroud offered a letter of recommendations to the NBG's President on the regulatory actions that could be taken.

One of the objectives of the first year was also to review and to obtain a better assessment of the financial condition of the banking system as a whole by participating in the inspections of the large commercial banks. This assessment phase of our work was accomplished to a large extent by having the RA's participate in the inspection of each of the large banks. As a result of the knowledge gained from the experience of inspecting the individual banks, the RA's began the process of trying to address the problems of certain large and prominent banks. These banks were experiencing various degrees of financial problems but the real challenge was to keep the problems of few selected banks from impacting the overall banking system and creating a banking crisis.

The following information is provided to illustrate the type of issues that were reviewed and discussed with the supervisory staff during the second year of working with the on-site inspectors.

Non-rated	1
"1" Rated Banks ("Sound" Banks)	1
"2" Rated Banks ("Satisfactory" Banks)	4
"3" Rated Banks ("Fair" Banks)	2
"4" Rated Banks ("Marginal" Banks)	3
"5" Rated Banks ("Unsatisfactory" Banks)	1
*Total Inspected Banks in 2001	12

*The non-rated inspection was a limited scope and a composite rating was not assigned.

- Due to numerous staffing issues and other problems with the slow pace of actions being taken on the recommendations of the resident advisors, during the first year of the project, the COP met with the NBG's President to discuss several reorganization issues. The primary objective for the meeting involved

the need to replace certain managers, including the Director of the Banking Supervision Department.

Additional details on this matter are included in the impediments section of this report; however, the primary problem centered around the Director of the Supervision Department and her unwillingness to consider most of the information and recommendations provide to her by the RA's on this project. She was appointed to this position in the spring of 2000. Prior to that she had no experience as a banking regulator and her knowledge of international supervisory practices is minimal.

- As a result of working with the inspectors in several large banks for the previous year, some issues and concerns were beginning to emerge in early 2001. The inspectors were having a difficult time reconciling the bank's capital position and other major balance sheet accounts using the new chart of accounts. They were also having a difficult time with other parts of the inspection due to the new chart of accounts and their lack of understanding of international accounting practices, such as the procedures for accruing interest on loans and deposits. As a result of these concerns, RAs met with a PricewaterhouseCoopers (PwC) advisor who was working in several of the Georgian Banks. The purpose of the meeting was to provide the contractor our assessment of the problems with commercial banks. The PwC advisor confirmed he was also experiencing the same type of accounting problems with the commercial bank's accounting staff. He was also concerned and inquired about the technical aspects of the new asset classification regulation and how the accounting aspects of this regulation were to be applied. He felt that most of the banks did not fully understand this regulation either. The PwC contractor is intimately involved with the largest bank, as ranked by assets, and he indicated that this particular bank is struggling with the internal classification of its assets, and the bank's accounting systems are in need of substantial improvement before they can be considered accurate and reliable.
- A review of the inspection reports on two banks were finished and a written assessment on the quality of the reports was given to the National Bank's Vice-President in the first quarter of 2002. The ratings for one of the banks were not properly supported and the reasons for this were clearly communicated in the above noted assessment provided by the RA. The Project identified deficiencies in and concerns over the inspection reports to the Vice President and the Director of Supervision along with the inspectors who worked on these reports. The two banks were both rated a Composite CAMEL of "5", but their risk profiles as identified in the inspection reports are quite different. Specifics were brought to light that made it obvious that the analysis prepared by the inspectors did not support the ratings, especially as it pertained to one of the banks. The RA also stressed the need for consistency of the ratings assigned by the inspectors among the different banks.

- The Project assisted the inspectors on the inspection of the 2nd largest bank (as ranked by assets) until the report was completed. The initial draft of the report was in excess of 175 pages. Many sections of the report were poorly written as the inspectors failed to clearly state the bank's problems and the reasons for them. The RA continued to help reformat and rewrite the report to make it logical and coherent. This report was to go to several international donors including the EBRD and the IFC and therefore all comments were carefully reviewed and edited. The ratings on the CAMEL components needed to be better supported with specific examples, recommendations and definite conclusions.
- The Project also reviewed, with a representative of the EBRD, the findings of the inspection on the above noted bank. The EBRD was the largest shareholder and one of the largest creditors of the bank. The EBRD was concerned about the quality and reliability of the bank's accounting systems and was concerned that the bank's financial statements were not a true reflection of the bank's financial condition.
- The Project determined that the bank, which recently acquired the assets and liabilities of a troubled bank, did not understand how to account for the acquisition of the troubled bank's assets and liabilities. The RA's helped the bank obtain the services of one of the international accounting firms to assist the bank's management in the mark to market valuation of the assets and liabilities recently acquired.
- During the month of May 2001, inspections were completed on the largest and the fifth largest banks as ranked by assets. The inspection report required a substantial amount of editing due to the poor analytical and writing skills of the inspectors.
- RA Stroud helped rewrite the report on the bank due to its importance in the banking system and explained it to the Head of the On-site Department. He was in agreement with the changes that were made.
- RA Stroud and AA Lee met with two consultants from PricewaterhouseCoopers (PwC) on the large bank noted above. The meeting was to discuss the results of the inspection report and the need for the bank to substantially increase its reserve for loan losses and some issues involving the bank's accounting practices. The PwC consultants had not seen the inspection report in its entirety even though the report had been submitted to the bank over a month ago. It appeared that the bank's management was trying to conceal the findings of the report from their external auditor. The RA strongly urged them to obtain a copy of the inspection report (from the bank) so that they could become more familiar with the reasons for the increase in reserves.

- A concern regarding the actual booking of reserves (in the large bank noted above) was brought to the attention of the RA. Apparently the subject bank's management did not actually establish the reserves as identified by the NBG inspectors. This process was reviewed and discussed with the NBG's inspectors and it was mutually agreed to send the inspectors back to the bank to analyze the reason(s) for the failure to establish the required level of reserves. The RA assisted the inspectors with the goal of preparing a limited scope inspection. The limited inspection did confirm the fact that the bank's management did not establish the amount of reserves as required during the previous inspection. To ensure this did not happen during the limited scope inspection, the RA attended several meetings with the NBG's banking supervision staff and the senior management of the commercial bank. The meetings were for the purpose of discussing the inspectors' classification of several large loans, which the commercial bank's management did not agree upon. The bank's management has resisted establishing the necessary reserves on these groups of loans for several months now. RA Stroud, in very strong terms, advised the NBG's inspectors to hold firm in their decision on the establishment of these reserves. In fact, the RA visited the actual construction site for the apartment complexes that are serving as collateral for these loans. This visit confirmed that these loans were problematic as the construction was significantly behind the completion schedule that the bank's management was indicating to the NBG. The primary source of repayment for these loans is the sale of the apartments and with the construction behind schedule; it is logical to conclude the latest repayment schedule will not be met. As a result of this meeting and other discussions with one of the bank's creditors, the bank's management did finally agree to classify the assets appropriately and to establish the necessary reserves.
- Extensive discussions were held with the NBG's management in which the Project had to convince the senior management of the supervisory department on the importance of ensuring that the above noted commercial bank complied with the requirements of the asset classification regulation. This matter was also discussed with the EBRD, since the EBRD is one of the bank's largest shareholders and has a representative on the bank's supervisory board. The EBRD's representative on the supervisory board is very concerned about the bank's financial condition, the management's hostile attitude and lack of cooperation with the NBG on the establishment of these reserves.

The following items are intended to illustrate the working relationship that this program has had with other international organizations including the IMF, IFC,

EBRD, World Bank, and other international donors and financial institutions involved in the commercial banking system in Georgia.

- Throughout the first year of this program, RA Stroud maintained ongoing communication with Resident EBRD Representative (Eyvand Alnaes) to discuss the particulars involving two banks in which the EBRD had a credit facility or outright ownership interest in the bank. The goals and objectives of the USAID banking supervision program were explained to Mr. Alnaes. Mr. Alnaes was clearly interested in the results of the inspections on these two banks and inquired as to the possibility of our project providing him with an English copy of the inspection reports. An agreement was reached with the President of the NBG to do this and it was agreed that the Project would continue to communicate more closely with the various EBRD Resident Advisors on our future work and cooperation on these two banks.
- This type of cooperation and dialogue was continued throughout the fall of 2000 with the officials of the EBRD (Jurgen Schramm, Hildegard Gacek, Charles Wrangham) on the issues involving the credit lines that the EBRD has with several of the banks. One of the banks appeared to be in technical default on the repayment schedule to the EBRD. This same bank was a deeply troubled bank and one that would eventually require the NBG to appoint a temporary administrator.
- RA Stroud also held numerous discussions with representatives of the IFC regarding their strategy in dealing with a troubled bank in which they have a credit line. The IFC apparently was going to slowly withdraw their financial support for this bank and was inquiring as to the NBG's strategy for reacting to this bank's problems. The IFC was fearful that this bank would be put into receivership and their investment would be lost. The IFC's specific concerns were that some of the loan repayments from their sub-borrowers were being diverted for other purposes that appear to benefit a selected group of shareholders. After several other discussions, a tentative solution was arrived at in which a special account would be established at the NBG in which all monies received from the IFC's sub-borrowers would be placed in this special account. This bank was eventually placed into the temporary administration program and was eventually liquidated.
- During one of his many visits to Georgia, Mr. Martin Slough of the World Bank provided RA Stroud with the World Bank's assessment of eight commercial banks in which they have lines of credit or other financial arrangements with the bank. Mr. Slough had left this assessment with RA Stroud and asked for his assessment of the banks to verify if the World Bank's opinion was accurate. In response to this, the RA discussed with Mr. Slough and other members of his team in Washington each of the banks and their future viability. Mr. Slough arranged discussions with the IMF and the IFC. These meetings were an attempt to develop some common grounds and

approaches to dealing with the problems in the Georgian banking sector. Specific attention was paid to the problems of several of the large banks and the possible solutions and remedies to resolving these issues. The consensus of the group was not to allow the problems of select few banks to have a negative impact on the remaining banks.

- At the request of the NBG's President, RA Stroud had participated in the review process of the IMF/World Bank Financial Sector Assessment Program. The RA was asked to help draft a response to several of the issues and weaknesses noted in the assessment program. As requested, RA Stroud finished his review and analysis of the Aide-Memoire and a 6-page letter detailing specific recommendations was provided to the President and Vice President of the NBG.
- At the request of the NBG's President, the COP also met with the EBRD's President and several of his Vice Presidents to discuss the current situation in the Georgian banking system. The EBRD's President indicated that the EBRD was interested in continuing to invest in the Georgian banking sector. The RA provided his views on the current state of the Georgian banking system, and specifically, on the specific questions asked of him. The EBRD President was personally aware of the specifics of several banks and asked the NBG to resolve the problems of two of the largest banks as quickly as possible. After these problems were resolved, the EBRD would entertain the prospects of additional investments in Georgian Banks.
- RA Stroud reviewed and commented on an agreement drafted by the EBRD London office. The document was in connection with the recent merger of the large troubled bank with a relatively healthy bank. The document involved the conversion of EBRD's debt into an equity position and a possible injection of an additional \$1 million in cash. Certain provisions in the document raised questions regarding how serious the EBRD was to providing additional equity in this bank.
- At the request of the NBG's President, RA Stroud participated in a meeting involving a joint Mission of the IMF and the World Bank. This Mission involved a major review and assessment of all major areas of reforms involving the financial sector in Georgia. The RA attended three separate meetings between the Mission Staff and the National Bank's supervisory staff for the purpose of clarifying various questions and issues.
- RA Stroud, along with USAID Tbilisi officials met with Edward Coll, the new EBRD Representative, who would be working full time in the largest bank (as ranked by assets) in Georgia. The EBRD is the largest shareholder in this bank and Mr. Coll was to work closely with the bank's management to improve their operations. During this meeting, concerns and problems of this bank were explained in detail to Mr. Coll. It was also a chance for Mr. Coll to

ask questions and to provide us with a brief overview of his strategies and objectives from the EBRD's perspective.

Off-site Surveillance

The following information is provided to illustrate the type of issues that were reviewed, discussed, and implemented in the off-site department.

- Upon arrival at the NBG, the resident advisors discovered that the off-site department was divided into two sections. The first group of analysts was simply responsible for ensuring the monthly reports were submitted by the commercial banks on time. The second group of analysts was responsible for checking the mathematical accuracy of the reports. Neither of the groups performed any type of investigative or financial analysis on the information that was being submitted by the commercial banks. As a result of this problem, the RA's Stroud and Shandony set about to implement a number of changes. These changes not only involved changes in the formatting of reports but also included major changes in the way the off-site department functioned and operated.
- In conjunction with the problems regarding the off-site function and the lack of any meaningful analysis, a new off-site surveillance report format was developed. There was initial reluctance to adopting the new report by the managers and staff, but after many meetings it was finally agreed that the new report format would be used on a trial basis. As a result of tentative agreement, each of the off-site analysts was required to submit an example of a write-up on selected banks using the new format. The initial form needed some small modifications but eventually it was implemented. The new report format and the kind of information to be provided confirmed the problem that each analysts lacked the skills to produce a clear, risk-based focused report which could serve as a regulatory tool for identifying trends and problems of the banks.
- As a result of the development of the new form, it was introduced to the Director of Supervision and the Head of Off-site Supervision. While this format was originally proposed in March of 2000, the Supervisory Division was initially reluctant to adopt it. Final adoption of the new format required the following actions:
 - Annuling a 1999 Decree that orders the use of old reporting system;
 - Approving a new Decree for the use of the new form;
 - Preparing instructions for its use, and;
 - Re-writing the Off-Site CAEL (modified from the older CAMEL) Manual.
- The quarterly off-site reports were substantially modified. The old format included a rating for the Management component and each of the resident advisors felt this needed to be changed. In addition, the NBG's practice to have

the quarterly Off-Site CAMEL Reports and Ratings transmitted to the commercial banks as the official CAMEL ratings needed to be discontinued to only transmit the ratings produced from an On-Site Inspection as the Official or Formal Rating. It was recommended that the Off-site ratings should be used for internal supervisory purposes only. The recommendations were eventually accepted after many months of discussions. **The President of NGB approved the new Quarterly Off-site CAEL Report Forms and Manual in August 2000.**

- As a result of the recommendations and changes noted above involving the introduction of the CAEL system, the NBG's previous practice of using the Off-site Rating as the current rating for the Commercial Banks was discontinued and going forward from September 2000, only the on-site CAMEL rating were transmitted to the banks.
- Ten Quarterly Monitoring and Surveillance Reports, using the new CAEL System and Manual, were submitted to the RA's during the second half of the year 2000. A review of these reports indicated that the analysts are beginning to understand what the reports are intended to do and how they should be written. However, in a number of cases, the written report and figures did not properly support the ratings. One problem was the analysts did not feel they could deviate from the ratings given by the on-site inspectors, even though they did not believe the on-site ratings were supported accurately either. A second and more difficult problem involved the fact that the inspectors/analysts relied on what the commercial bank's management was told rather than using the actual facts and figures submitted by the banks.
- In addition to meetings once a month with each of the analysts to discuss their respective monthly write-ups, RA's Stroud and Grimditch presented a number of workshops comparing two similarly sized and rated banks that had remarkably different risk profiles. The purpose of the workshops was to show the analyst that the facts and the financial data submitted by the banks each month should support the CAEL ratings.
- During the early part of 2001, the RA's Stroud and Grimditch finished designing the proposed Bank Performance Report. The figures in the Report were based on and calculated from the line items filed in the financial reports and the new, yet to be approved (at that time) Supervisory Reports. The banking supervision's IT Department has been provided a soft copy of the Report in an Excel format.
- Due to the lack of expertise in the NBG's IT department, the COP supported the option of obtaining temporary assistance for the programming and implementation aspects of the FinA project and requested that the NBG provide a proposed budget for the additional help. A sum of \$3,400 was proposed by the NBG's technical staff, however, this budget included the hiring of three persons to assist in the project for two months. Subsequently, at the COP's insistence this

number was reduced to one additional programmer, at a cost of \$1,300, with the Banking Supervision Project's two Financial Analysts assisting him.

- The process of inputting the financial data to the FinA software began in April 2001 and the process was conducted through a data converter and took longer than originally estimated to complete. Financial information as of April 30, 2001 was transferred from Excel spread sheets to the FinA program for approximately 15 banks. During the input of the data certain problems were revealed relating to the converter itself, as well as to the program's software. The converter problems are being resolved by the staff of the NBG's IT Department, and the problems regarding the software have been sent to First Irish, the group who developed the software. The latest version of the program that incorporated these changes was received in the beginning of July 1, 2001.
- The Project finished the recommendations regarding the modifications to the UBPR. Several of the RA's, along with the local staff reviewed the UBPR and checked the accuracy of the formulas and calculations. As a result, a detailed letter was prepared and submitted to the NBG Banking Supervision Department and a follow-up meeting was held with the NBG representatives to discuss errors regarding some of the ratios and formulas contained in the UBPR. In addition, a Guide for Calculation of Data for the UBPR was prepared, which should assist the Banking Supervision Department in selection of the methods for computing different peer group data, percentile ranking, and other miscellaneous data.
- A written recommendation to combine the regulatory and supervisory reports was presented to the NBG Banking Supervision Department. Previously, the commercial banks submitted two packages of information (Supervisory and Financial Reports), which was inefficient and confusing to the commercial bankers. This issue was eventually resolved after several months.
- The various recommendations and work on the UBPR were finished in December 2001. As a result, a detailed letter with our comments and recommendations was prepared and submitted to the NBG Banking Supervision Department. A recommendation combining the regulatory and supervisory reports was prepared and submitted to the NBG Banking Supervision Department. A written response was received from the Deputy Head of the Bank Supervision Department on the UBPR and Regulatory reports and for the most part, he agreed with our suggestion. Several reviews were held with the employees of the NBG Policy Department. All recommendations of USAID Bank Supervision and Enforcement Project were considered and enacted.
- Some programming changes needed to take place to ensure that the UBPR was fully functional and that the changes would be implemented correctly.
- RA Stroud and two of the local professional staff met with three members of USAID Washington to discuss the status of the FinA project. The programming

for the system was completed and the loading of data for the system began. The USAID staff was informed that final approval had been completed and the final version will be sent to the commercial banks with the intention to use the new format beginning February 1, 2002.

- The process of loading the financial information for the largest 8 banks into the UBPR served as a testing process for checking and verifying the formulas of the system.

Problem Bank Resolution

During the latter part of the first year (2000) of this program, the RA's became involved in implementing supervisory solutions to several large banks. Actions taken during this period included the issuance of several Cease and Desist Orders ("Orders"), Memorandums of Understanding (MOUs), Capital Calls, the appointment of Temporary Administrators, Revocations of License, and Liquidation Proceedings.

The following items are intended to illustrate the work that was carried out with regard to the resolutions of several large problem banks during the 4th quarter of 2000 and the first quarter of 2001. After the first quarter of 2001, the USAID's RAs involvement in the resolutions of trouble banks was significantly reduced due to the EBRD's decision to place a full time resident advisor in the NBG to assist with the appointment of temporary administrators and other issues involving troubled banks. Notwithstanding this, the USAID RA's contributed the following assistance.

- The Project reviewed a copy of Regulation No. 263, which is the NBG's attempt to deal with establishing written procedures on how to supervise and monitor problem banks. The initial review of the document revealed it to be poorly prepared and lacking the language necessary to address the major problems of the banking system in Georgia. This document was later replaced with revised procedures on how to deal with problem banks based on a set of more comprehensive procedures that are based on international standards.
- At the request of the NBG, the Project reviewed two enforcement documents drafted by the NBG staff for two troubled banks. The documents were drafted and signed by the commercial banks in July 2000. The documents were originated by the NBG and signed by the commercial bank's supervisory board without the knowledge or input from any of the resident advisors. The quality of the documents needed improvement. NBG's Vice-President agreed that the RA's input and advice would be solicited before other documents of this type would be issued to the commercial banks.
- RA Stroud drafted several written strategies to the NBG's President regarding the need to take a more active stance with regard to three large troubled banks. The problems of these banks needed to be addressed and a final solution needed to be formulated with regard to each of these banks.

- Supervisory strategies and options with regard to two troubled banks were discussed with NBG's President, the Vice-President and the Director of the Banking Supervision Department. The strategy with regard to one of the banks was to issue a Cease and Desist Order. It was anticipated that the President would sign this Order as quickly as it could be drafted by the RA's and approved by the NBG's legal staff. The issues involving the other bank included the possible appointment of a temporary administrator and the scheduling of an on-site inspection to determine the bank's "true" capital position. Several additional discussions were held with the Vice-President and the Director of the Banking Supervision Department to go over the requirements of the Cease and Desist Order that was ready to be issued. Later, the Vice-President invited the President of the subject bank to the NBG to discuss the Order and asked that the bank's management agree to and sign the document. Discussions were held with the President of another troubled bank to deliver and discuss the requirements of the recently signed Cease and Desist Order, and to establish the procedures for complying with the requirements of the Order.
- A second series of discussions were held with the ownership group of another large troubled bank to allow the owners to explain face-to-face with the staff of the NBG their plans for recapitalizing the bank. The bank's proposals were rather vague and short on specifics. Subsequently, the Project prepared a written response to this bank's proposals and urged the President of the National Bank to take some type of regulatory action on this bank. Two alternatives were provided in the written recommendation.
- Several discussions were held with the senior management of the NBG to review and discuss the supervisory strategy with regard to another troubled bank. The inspection confirmed the bank to be insolvent and therefore the need for a strong supervisory response was warranted. During these discussions it was decided a temporary administrator should be appointed and this action was consummated on January 16, 2001.
- The Project assisted the President of the NBG in establishing an agenda for a creditors meeting of the international donors for the above bank, which was placed under the supervision of a temporary administrator. The meetings were designed to allow the NBG and the international donors to exchange information on the bank's financial condition. The creditors present at the meeting included the EBRD, the IFC, the World Bank, Dresdner Bank, Triodos Doen Bank and the Black Sea Bank of Georgia. The discussions revolved around the fact that the bank was hopefully insolvent and that none of the creditors would probably ever be repaid their loans or the losses on their stock purchases. However, one of the creditor's reactions to this conclusion was particularly inflexible in that the creditor demanded to be repaid his loans immediately. Some of the other meetings were laced with contentiousness.

- The COP also met with the Temporary Administrator to discuss his role in managing the bank's affairs. The person selected for this assignment was one of the best inspectors from the on-site department; however, he had never served as an administrator for an insolvent bank and had no guidance for the NBG on how to proceed with his job. As a result, the RA worked with EBRD to secure technical assistance to support the future appointments of this type. The London staff of EBRD agreed to support and fund such a project.
- The Project spent a great deal of time and effort toward the rewriting and editing of the inspection report on the above bank that was placed under Temporary Administration. The inspection report clearly indicated that the bank was insolvent and that the bank's owners and management had defrauded the bank of several million dollars. The revised English version of the report was then sent to all of the bank's creditors for their consideration. The inspection report was needed to prove that the bank was insolvent if any of the original investors (local or foreign) or any of the many creditors decided to challenge the NBG for taking over this bank.
- In January 2001, RA Stroud met several times with the NBG's President to go over the strategy for recapitalizing one of the large troubled banks. The President of the NBG asked the RA to meet with the President of the troubled bank to discuss the recapitalization plans that the bank is currently pursuing. There was also a discussion regarding the NBG's issues and concerns with the EBRD.
- During the months of February and March 2001, a large majority of RA Stroud's time was spent on trying to resolve the issues of another large troubled bank. RA Stroud met with the President of the National Bank and the other Senior Staff of the Supervision Department to discuss the possible actions that could be taken with regard to the bank. This particular bank was a very prominent bank in the Georgian Banking sector and it had a majority of foreign ownership, and therefore, the National Bank was being very cautious in dealing with any possible solutions to this bank's problems. Later in the month, the Resident Advisors, along with the Senior Managers of the Supervision Department, met the president of the bank to discuss several possible recapitalization issues. Also, in attendance was a potential investor who had expressed some interest in recapitalizing the bank. Two main issues were reviewed and discussed. These issues involved the legal structure of their proposal and whether it could be done under the existing Georgian law. The second issue involved the timing and the amount of the new capital injections.
- A second meeting with the above noted representative of the investor group took place at the National Bank. The bank's management was working with an investor group who indicated a willingness to put \$5 million in capital into the bank over several months. In addition, EBRD was scheduled to convert \$1.5 million of their debt to equity according to the investor group. RA Stroud and LA McCormack supported the structure of the deal, but the IMF Advisor was

adamantly opposed to the transaction. After numerous meetings on the legal and economic aspects of this transaction, it was finally approved and a Temporary Administrator was appointed for the bank. Some court filings and approval of the Georgian Courts were needed before the deal could be legally consummated.

- Because of the issues noted above, the Project continued working with the temporary administrator on the bank and its problems. Numerous discussions were held with the bank's staff and clients in an attempt to calm the situation and to prevent a panic or run on the bank's deposits. Later, a decision was made to freeze the bank's accounts due to the bank's lack of liquidity. The COP also had several discussions with the NBG's President and the senior managers of the commercial bank to go over numerous logistical matters involving the bank's operations. There were also several discussions between the COP and LA McCormack on the situation involving Visa International and how this bank's relationship with the credit card company could continue. The relationship with Visa International needed to be preserved, seeing as it was the bank's most valuable asset at the time. This was the only bank in Georgia that is licensed to issue Visa Cards and this agreement needed to be maintained so it could be passed on to an acquiring bank.
- RA Stroud held several discussions with the senior management of the National Bank and several representatives of Visa International to ensure that the Visa membership will transfer to the bank that acquired the troubled bank. At the conclusion of these discussions, there did not appear to be any obstacles to prevent the acquiring bank from resuming the credit card operations.
- When the first investor group failed to inject the necessary capital for this troubled bank, RA Stroud discussed with the NBG's President another Georgian Bank that was a suitable acquirer for this bank. RA Stroud prepared a spreadsheet, which provided the financial projections and the capital needed for combining this troubled bank with a healthy one. Based on these projections, it was decided that only 3-4 banks in Georgia could meet the financial requirements for acquiring this bank. Projections were reviewed with the NBG's President and a potential merger candidate was identified. A preliminary meeting was held with the bank's senior managers to discuss the possible acquisition. Later, a copy of the projections was sent to the London staff of the EBRD and telephone communiqués were held with the staff of the EBRD to discuss this proposed merger and the EBRD's potential involvement in the deal. All parties seemed interested in continuing the process based on financial projections provided.
- As a result of the likelihood that an acquisition of this troubled bank's assets and liabilities was going to take place, RA Stroud had several additional meetings with the Temporary Administrator of the troubled bank and again advised him of the need to prepare a balance sheet, which indicates the true financial condition of the bank. This document was needed if the action taken by the National Bank was ever challenged in court. This process needed to be completed no later than

prior to the acquisition date. The fact that this problem bank's assets and liabilities were sold to a healthy bank saved a loss in excess of \$10,000,00 in hard currency deposits of several international organizations and local depositors.

- At the request of the NBG's Vice-President, the Project reviewed a draft Memorandum of Understanding with regard to the operations of another problem bank. This particular bank had gone to court to set aside the composite CAMEL rating assigned by the NBG inspectors. As a result of these actions taken by the bank's management, another full scope inspection for this bank was performed.
- On December 28, 2001 one of most controversial and troublesome commercial banks was finally placed under the control of a Temporary Administrator and was subsequently liquidated in early 2002.

Legal

Legislative Tasks

- Analyses of Georgia's two banking laws, the NBL and the CBL were completed in February 2001;
- Analyses of other relevant laws were completed during February 2001, improving their Implementation Timeframes;
- The drafts were sent to the appropriate Ministries, the banking community, and the Georgian Parliament in July and August 2001, and;
- The final NBG drafts of both the NBL and the CBL, approved by the NBG Council, were presented to relevant Parliamentary Committees and submitted to the full Parliament in September 2001. The amended NBL and CBL were enacted into law on October 23, 2001, and became effective on November 22 and November 7, 2001, respectively.

Regulatory Tasks

- The Regulation on "Asset Classifications and Loan Loss Reserves" was officially delivered to the NBG Director of Supervision in December 2000. It was actually issued in January of 2001, being partially effective that month and finally effective on April 10, 2001.
- The Regulation on "Conflicts of Interest and Transactions with Related Parties" was officially delivered to the NBG Director of Supervision in August 2000. It was not actually issued by the NBG until May 2001 due to extensive time-consuming internal comment and debate at the NBG, much of which was duplicative.

- The Regulation on “Internal Audit Requirements” was officially delivered to the NBG Director of Supervision in July of 2000. Due to a year-long delay at the Ministry of Justice, where it was obliged to be sent for legal expertise and registration, coupled with significant internal delays, occasioned by the personal handling of the former Director of Supervision, it was not actually issued until December 2001. These causes of endless procrastinations were constantly addressed throughout this eighteen-month period. USAID provided close support to the Project Advisors, but political changes within the Ministry of Justice, coupled with the unrelenting bureaucracy, inflexibility, and structural changes within the NBG, caused unacceptable issuance delays.
- The “Regulation on Capital Requirements of Banks” was officially delivered to the NBG Director of Supervision in March 2001. Due to internal factors at the NBG, which resulted in many fundamental structural changes in the Department of Supervision, the regulation was delayed for over 1 year.
- The “Regulation on Prompt Corrective Actions” had been designed and prepared but its approval by the Ministry of Justice has been delayed until May/June 2002.
- The “Regulation on Mergers of Banks and of Persons Who Control Them” was postponed until August 2002 or beyond for the tactical purposes of both awaiting the specific jurisdiction over persons who control banks conferred by the amended banking laws, and allowing the NBG some experience time in learning to exercise this new power. It was also felt that all mergers in the industry as presently constituted would be rescue mergers rather than voluntary mergers for the foreseeable future.
- The “Regulation on Credit Concentrations and Large Exposures” was officially delivered to the NBG Director of Supervision in September 2001.
- The “Regulation on Liquidity Requirements of Banks” was designed for timely delivery on its Scheduled Delivery Date, but work on it was suspended in June 2001 due to the critical need to concentrate exclusively on legislative priorities during the 2001 spring-summer-fall time frame.
- The “Regulation on Fixed Asset Limitations” was officially delivered to the NBG Director of Supervision in February 2002. The regulation was approved by the NBG and it is in the process of being reviewed by the Ministry of Justice.
- The “Regulation on Licensing and Branching” has been drafted, but was not yet submitted to the NBG’s Supervision Department for review.
- The “Regulation on Foreign Exchange Exposures” was officially delivered to the NBG Director of Supervision in March 2002 after it was decided by the Project Chief of Party to avail the Project of a foreign exchange expert, who came to Georgia in March 2002 to teach a week-long seminar to the NBG Examination

Staff on open foreign exchange exposure management. The expert's help turned out to be very important in the drafting of the regulation.

- The "Regulation on Securities Activities and Investment Classifications" was postponed indefinitely with the concurrence of USAID until such time as the capital markets of Georgia are more developed.
- The "Regulation on Holdings and Activities of Persons who Control Banks" was suspended to permit the NBG to acquire some experience in planning ways of beginning to exercise its new jurisdiction over persons who control banks and in the meantime to begin to develop with the NBG regulatory policies which will govern all of the areas affected by this vital new power conferred by the amended banking laws such as licensing, inspections, and corrective actions. Work on this regulation was also suspended pending the issuance of the new "Regulation on Criteria for Fit and Proper Managements of Banks," (see below) which is directly tied to the NBG's new jurisdiction over persons who control banks.

Regulations not in the original Work Plan which were delivered during Phase I of the Project

The following two Regulations were not foreseen as deliverables in the planning of the Project's Phase I and hence did not appear in the Work Plan. They were mandated for delivery respectively by the amending law portion of the NBL and by international best practices in accounting.

- The "Regulation on Fit and Proper Criteria for Bank Managements" In a surprise mandate contained in the "Amending Law" portion of the CBL, as amended in October, Parliament had asked that a regulation on fit and proper criteria for managers be issued before May 7, 2002. It was officially delivered to the Director of Supervision in February 2002, three months before its mandated due date for issuance.
- The "Regulation on Accounting and Other Records and Internal Controls Systems" was officially delivered to the NBG Director of Supervision in February 2002. This regulation was mandated by the perceived critical need to render bank accounting and reporting consistent with IAS as quickly as possible. In February 2002, three Guidelines supporting the regulation were officially delivered to the NBG Director of Supervision.

Administrative Law TA

- Project Advisors worked closely with the NBG Department of Supervision and the NBG Legal Department as well as the USAID Rule of Law Program and the Parliament began resolving issues involving the General Administrative Code as it impacted the amended NBL. The resolution of these issues constituted technical assistance because it took the form of highlighting the dangers of violating the new General Administrative Code in terms of how the regulation

process at the NBG must be accomplished in light of that law. The result was new consciousness of and compliance by the NBG with that law.

Judicial Task

- Project Advisors were invited by ABA/Ceeli and the World Bank funded Judicial training Center in Tbilisi to give seminars to judges during Phase II of the Project. The invitation results from the analysis and discussions of the Project Advisors with USAID and others in the special need for accurate, impartial, and swift enforcement of the NBG's corrective actions. It will focus in particular on the administrative law doctrine of judicial review described above in Section I-C of this Final Report.

Institutional Training and development of the NBG Legal Department

- The Deputy Head of the Legal Department and several staff participated actively as voting members in the deliberations of the Legislative Working Group, which developed the amendments to both banking laws over a number of months. In addition, the above individuals were brought in to be actively involved in the resolution of many regulatory and transactional issues over the two-year period. In this way, daily on-the-job institutional development of the Legal Department was accomplished.
- As in the case of the Legal Department members of the Department of Supervision were brought in to be actively involved as voting members of the Legislative Working Group, which developed the amendments to both banking laws.
- The legal development and raising of legal consciousness of the Department of Supervision was successfully accomplished through the daily transactional, legislative and regulatory policy issues, which were discussed with them in depth by the Project Advisors in their advisory capacities.

Accounting Methodology – NBG

To assess the accounting needs of the commercial banks, USAID commissioned a diagnostic study for the purpose of evaluating the commercial banks IAS and IT needs. The diagnostic studies were carried out in seven commercial banks in May 2000. A primary purpose of the IAS study was to ascertain the degree of progress made towards the conversion from Gosplan accounts data to an IAS system by January 1, 2001 as required by the accounting law and a decree of NBG. The purpose of the IT study was to assess how prepared banks' data processing systems were for the conversion process.

The principal findings of the IAS study were as follows:

- None of the banks visited have developed IAS-compliant accounting policies and procedures or IAS-based financial reporting;
- NBG had not exercised aggressive leadership in defining what was expected to be achieved in each bank and developing the specific instructions and timeline to achieve that goal, and;
- Conversion process needed to be supplemented with sector-wide training.

The principal findings of the IT study were as follows:

- The banks are ill prepared for the IT aspect of IAS conversion;
- The banks do not understand the full impact of the conversion;
- The banks have not analysed the work required, and therefore, have no implementation plan, and;
- IT departments of the commercial banks are still awaiting final instructions from the accounting departments.

In response to the above findings, and sector reviews prior to the diagnostic studies, the project brought in an accounting advisor (in June 2000) to support the accounting methodology function at the NBG responsible for commercial banks. In January 2001 additional accounting consultants were added to support accounting reform activities in six selected commercial banks. Four local staff accountant (LSA) were recruited to support the consultants and for local capacity skills development. From March 1, 2001, this team replaced an EU TACIS Help Desk project that ceased on that date.

- As a result of project proposals submitted to NBG's senior management, follow-up discussions, and implementation assistance (staff recruitment, organizational design and job descriptions issues), a new Accounting Methodology Unit was formally created in the fall of 2001 within the Banking Supervision Department. The new unit was given the responsibility for promoting and supporting, IAS accounting reform in commercial banks, and monitoring and enforcing IAS compliance. Heretofore, responsibility for accounting methodology issues for the whole banking sector, including the NBG, was vested in a unit within the accounting department of NBG. From now on, the accounting department will focus solely on accounting issues pertaining to its own organization. Bank Supervision Department, through the specialized accounting unit, will drive accounting and reporting developments towards full IAS implementation in all commercial banks.

In Phase 2 of the project it is envisaged that the new unit will be proactive in IAS enforcement, using new powers granted to NBG under the revised banking laws. To accomplish this, the initial focus will be on developing the analytical skills of new accounting staff so that non-IAS compliant practices can be identified following the review of financial reports submitted by the commercial banks. The new accounting unit will also provide back-up support to enhance the effectiveness of the other supervisory functions: off-site surveillance and on-site

inspections. This organizational design development is significant and the new arrangement reflects one of the best practices in bank supervision.

- A chart of accounts for commercial banks, under consideration by NBG for a considerable period prior to the commencement of the project was finalized and approved by NBG, and was eventually registered in the Ministry of Justice as required under existing legislation. The chart's design supports the maintenance of accounting records in accordance with international accounting standards (IAS) and generally accepted accounting principles (GAAP). It is similar to those charts promoted by bank regulators in other FSU countries. It has been in use in commercial banks since January 1, 2001.
- An Accounts Descriptions Manual, detailing accounting practices for the new chart of accounts, was completed, approved by NBG and registered at Ministry of Justice. The accounting advisor provided guidance and assistance to the accounting staff responsible for the development of this resource, enabling its completion prior to the scheduled commencement of new chart of accounts from January 1, 2001. Both the Chart of Accounts and Accounts Description Manual were printed, in book form, and issued to all commercial banks.
- The transfer of general ledger accounts data from the old Gosplan chart of accounts to the new IAS-based chart, that commenced in January 1, 2000 was finalized by January 1, 2001. The USAID accounting advisor provided support to NBG, from the time of his arrival in June 2000, in developing solutions to the practical problems that arose during this period. A paper, *Guidance to Commercial Banks on Conversion Issues*, was developed to facilitate this process. The conversion process in commercial banks was supported by a EU TACIS project team, formed in March 1999 and ceased in March 2001. The accounting advisor collaborated with this team and frequently initiated NBG responses to remove conversion impediments. Commercial banks maintained parallel accounting systems during the second half of year 2000 in accordance with NBG guidance on the approach to the conversion process. By the end of the first quarter in year 2001, all commercial banks had dropped the old Gosplan chart and were using the new IAS-based chart to maintain accounting records.
- The design of the financial statements for commercial banks was revised reflecting IAS requirements for financial information disclosure. The new format for income statements and balance sheets reflects best practices internationally for commercial banks. These statements were also designed to be consistent with bank supervision reporting requirements. A guide to the preparation of financial statements of commercial banks from the IAS-based chart of accounts was developed to assist the accounting employees to acquire the technical skills needed to prepare financial statements. The accounting advisor developed the new formats and financial statement guide that were approved by NBG.

- The revision of banking laws, and all supervisory regulations proposed to NBG, includes accounting provisions that mandate adherence to international accounting standards.
- A report on non-IAS compliant foreign exchange reporting practices in commercial banks was presented to NBG in September 2000. Following representations to commercial banks by NBG, all but one, made the appropriate corrections. NBG plans to develop a regulation and an accounting guideline designed to assist commercial banks to better manage, control, foreign exchange risk.
- A report on the efficiency of the accounting methodology unit, then located in NBG's accounting department, with regards to its support for commercial bank accounting reform was completed. The report covered the performance of the division since it was established in 1999. The report recommended the creation of a specialized unit, within the bank supervision department, focusing on commercial accounting developmental issues.
- Over the contract period, the accounting advisor dispatched to NBG 41 formal letters/memoranda on a wide range of commercial bank accounting issues; 17 of these were responses to NBG requests for assistance in preparing replies to accounting enquiries from commercial banks and 24 related to NBG's own enquiries on accounting matters.
- The accounting advisor coordinated the response of NBG to a series of proposed amendments to the Law on Accounting and Reporting as well as alerting other interested parties to the proposals. The amendments were developed following a Presidential Decree that required a review of the accounting law for the purposes of incorporating provisions that would give the state greater control over accounting and reporting activities for all sectors. Three main changes were proposed: (a) an introduction of national accounting standards and the subordination of international accounting standards to it; (b) greater self-regulation over non-government owned enterprises and (c) the re-introduction of regulations to standardize the recording of accounting data. The proposed amendments were contrary to the thrust of accounting developments in recent years and were very much opposed by many parties supporting the reform program.

As a result of the representations opposing the rollback initiative, the proposed amendments never proceeded and the accounting reform process continues to remain focused on the full implementation of IAS.

- The following accounting regulation and accounting guidelines were delivered to NBG:
 - Regulation on Accounting and Other Records and Internal Control Systems;

- Guideline No. 1 Accounting procedures during IAS implementation phase;
- Guideline No. 2 Accounting for Repossessed Moveable and Immoveable Assets and Abandoned Property, and;
- Guideline No.3 Year-End Accounting and Reporting Activities.

The accounting regulation stipulates the minimum standards in relation to a commercial bank's compliance with a statutory provision 'to conduct operations in accordance with sound administrative and accounting procedures...' The new regulation is modeled on similar pronouncements from internationally recognized bank regulators.

The accounting guidelines were developed in response to frequent requests from commercial banks for NBG guidance and direction on the application of IAS to commercial bank activities. The dispatch of accounting and reporting guidelines is a common international feature of the relationship between the regulator and commercial banks. NBG has been constantly encouraged to adopt and promote this practice. A further series of guidelines have been developed and are available for delivery to NBG at an appropriate time.

- The discussion papers, listed below, covering contemporary commercial bank accounting issues were developed by the accounting advisor, discussed with the staff of the accounting unit, and delivered to NBG. Each discussion paper outlined the relevance of the subject matter to commercial bank accounting and reporting activities, explained the related IAS requirements and how compliance is accomplished, and made a recommendation on the policy position that NBG should adopt in instances where different accounting methods can be applied. It is envisaged that accounting staff will use discussion papers to develop an NBG accounting pronouncement when this is considered necessary and when formulating responses to commercial banks accounting enquiries. Additionally, there will be learning resources for existing and new staff, and they will be available to employees of off-site and on-site divisions engaged on monitoring and inspection activities.

- No. 1 Account Reconciliation Procedures
- No. 2 Forward Foreign Currency Contracts
- No. 3 External Audit Adjustments
- No. 4 Loan Loss Provisioning
- No. 5 Accounting for Profit Tax Expense
- No. 6 End of Year Accounting and Reporting
- No. 7 Off-Balance Sheet Accounts
- No. 8 Guide to Accounting and Reporting for Interest Income
- No. 9 Reserve Accounts
- No. 10 Accounting for Share Capital Contributions

- Recognizing the importance of increasing the number of employees engaged in bank supervision activities with IAS accounting expertise, the accounting advisor

promoted the internationally recognized ACCA training program that leads to professional IAS accounting accreditation. So far, one local project staff member has successfully completed the program and gained full membership of the professional body. Four more persons have made examination progress and are at various stages of completion.

- Training of the accounting staff, responsible for commercial bank accounting developments, was ongoing over the duration of the project. As well as formal seminars, the other methods employed to enhance understanding of IAS requirements, were informal meetings with accounting staff on an individual or group basis, review of accounting issues papers when requested and the provision or identify of resources pertaining to western accounting practices. The staff of the NBG commercial bank accounting unit frequently attended the accounting seminars arranged for commercial bank accounting staff.
- An Internal Audit Manual, supporting the implementation of the Regulation on Internal Audit Requirements for Commercial Banks, was developed and distributed to commercial banks whose staff attended a training seminar on this subject. The regulation obligates all commercial banks to establish an internal audit department that reports to an audit committee formed under corporate governance provisions stipulated in banking laws. The manual contains examples of internal control questionnaires, applicable when evaluating internal control systems and audit programs that describe audit procedures for significant banking activities. The manual was reviewed for commercial bank accounting staff during a seminar in February 2002.

Accounting Technical Assistance-Commercial Banks

On-Site Direct Assistance to the Pilot Banks

- In coordination with the NBG Bank Supervision Department (BSD), the project team identified six commercial banks during the month of December 2000 and added a seventh bank in May 2001 for on-site direct assistance in the implementation of International Accounting Standards, based on the following criteria:
 - One of the largest ranked by assets, covering 63% of the total assets at March 1, 2001, 65% of the total assets at May 1, 2001 and 60% of the total assets at January 1, 2002;
 - An overall CAMEL rating of 3 or better;
 - Meets the 'going concern' assumption, and;
 - Under Georgian control, and;
 - A demonstration of commitment to accounting reform and a formal expression of an interest in receiving such assistance.

- The Accounting Advisors (AAs), together with the NBG representatives, met with each and every selected bank to present the project objectives and discuss the requirements and necessary coordination. Some banks required more than one visit to finalize the agreements. The project received approval for work at these pilot banks from the President of the National Bank of Georgia. The NBG obtained written invitations from the pilot banks confirming their desire for assistance and their willingness to provide office space and other facilities as requested.
- During the project, NBG requested an additional bank to be added to the pilot bank program as the bank became significant in terms of the asset size with the acquisition of a troubled bank assets and assumption of the deposit liabilities. The project began providing the on-site assistance in May 2001, which included the issues on business combination, asset and liability valuation, and goodwill accounting.
- During the project, one of the original six pilot banks was removed from the on-site direct assistance program in August 2001 as it became a troubled bank based on the NBG annual examination. It received an overall CAMEL rate of 4 and the bank's prospect as a going concern became doubtful. The project team changed its direction to assist the NBG inspectors on examination of this bank by providing financial analysis and on-site assistance in evaluation of the bank's internal controls and accounting information process.
- The AAs and the Local Staff Accountants (LSAs) conducted meetings throughout March, April, and May, 2001 with each pilot bank senior management, financial reporting department, accounting department, chief accountant and/or internal auditors to perform an initial assessment of the status of the IAS conversion and implementation of the new Chart of Accounts at the transaction level. The project team obtained and reviewed the available current accounting information, prior year audited IAS financial statements, and annual reports. The team also reviewed off-site reports and available on-site inspection reports.
- The project team also obtained and reviewed the pilot banks' January 1, 2001 opening trial balances, using the December 2000 IAS financial statements to assess the cross over conversion and booking of the IAS audit adjustments. Almost all banks had not booked the external auditors' adjustments in the banks' accounting records as of our review in March to May 2001.
- The Accounting Advisors met with the senior management of the NBG periodically and on a scheduled basis to provide the status of the commercial banks' conversion to IAS COA and implementation of IAS accounting at the transaction level. The responsibility of the NBG overseeing the commercial bank accounting conversion changed from the Vice President of the Accounting to the Vice President of the Bank Supervision, during the project. The project team

accordingly responded, and changed the reporting and updated activities to the Vice President of the Bank Supervision.

- *A Profile of and Initial Assessment of the IAS Conversion at the Pilot Banks* was developed. It documents each bank's strengths, weaknesses, IT environment, Annual External Audit, IAS conversion, cross-over adjustments, current accounting practices and the bank's request for assistance for all seven pilot banks, including the new pilot bank added in May 2001.
- Made arrangements with the pilot bank management to spend significant amount of time on-site, as warranted, at each of the pilot banks to determine in more detail the actual progress of the conversion to International Accounting Standards, and to provide on-site direct assistance and training as needed in addition to the formal training scheduled to ensure full implementation and conversion. The procedure included detail review of individual transaction entries, monthly accrual and valuation adjustments. The actual assistance for each individual pilot bank varied, depending on the level of expertise of those responsible for financial reporting, the size of the bank, types of transactions, and organizational structure.
- The Accounting Advisers (AA) and the local staff accountants (LSA) for the project provided on-site assistance to the pilot banks

<u>Bank</u>	<u>Days</u>	<u>AA</u>	<u>LSA</u>
No. 1	Wednesdays & Thursdays	Kwi-Yong Lee	Ivane Bjalava Irina Tsikhelashvili
No. 2	Tuesdays	Kwi-Yong Lee	Ivane Bjalava
No. 3	Wednesdays	Kwi-Yong Lee	Irina Tsikhelashvili
No. 4	Tuesdays & Thursdays	Kwi-Yong Lee	Avto Sumbadze Irina Tsikhelashvili
No. 5	Tuesdays	Raymond Mino Kwi-Yong Lee	Irma Kikvidze Maka Gureshidze
No 6	Wednesdays	Raymond Mino Kwi-Yong Lee	Irma Kikvidze
No. 7	Thursdays	Raymond Mino Kwi-Yong Lee	Irma Kikvidze

- Beginning each month, the project team obtained the monthly regulatory reports submitted to the NBG by the pilot banks and performed comparative analyses of

detailed trial balances of the pilot banks to identify potential non-compliance with IAS, issues related to accounting policies and procedures, possible weaknesses in internal controls, and unusual transactions. The issues identified were subsequently discussed with the respective banks' accounting personnel and, where necessary, with the senior management. Many accounting issues were also addressed on the basis of the banks' inquiries. Frequently discussed topics were as follows:

- Accrual basis accounting;
 - Accounting for current and deferred income taxes;
 - Goodwill;
 - Year-end IAS audit adjustments;
 - Fixed Asset classification and depreciation method;
 - Foreign currency transactions vs. translations, and related gains and losses;
 - Reversal of the interest receivable accrued in prior period on non-accrual loans;
 - Equity and reserves;
 - Other Real Estate Owned (OREO), pledged and foreclosed other assets;
 - Commitments and contingencies;
 - Off-balance sheet vs. on-balance sheet items;
 - Consolidation of branches;
 - Inter-branch transactions;
 - Preparation of cash flow statements;
 - Internal Accounting Policies and Procedures, and;
 - Internal Audit Policies and Procedures.
- The project team obtained copies of audit adjustments by the external auditors from the five out of seven pilot banks. One pilot bank did not complete the audit process and one pilot bank could not get the detail list of the adjustments from the auditors. We evaluated the audit adjustments as a part of our initial evaluation of the opening balances for the year. It was concluded that only one pilot bank had the January 1, 2001 opening balance sheet in agreement with the ending audited IAS balance sheet at December 31, 2000. The evidence showed that the other pilot banks have not booked the year-end audit adjustments and the banks' accounting records were not in line with the IAS financial statements published at December 31, 2000. During the on-site assistance, the LSAs and an AA convinced one pilot bank to undertake the booking of the audit adjustments and reviewed the detail adjustments for propriety. The project team facilitated the discussions with the auditors and the senior management and assisted in granting approval of the NBG in principle and in receiving approval from the bank's supervisory board in September 2001. The process was extremely cumbersome and time consuming as the bank's senior management and NBG officials did not understand the necessity and implication of the transaction.

- At the end of six months of the project, the team completed a comprehensive analysis of nine (9) months financial and accounting information for the seven (7) pilot banks. The purpose of the analyses was to identify indicators of possible accounting irregularities and to communicate the findings and recommendations to the pilot bank management and NBG. A complete analysis package contains:
 - Summary of significant accounting issues identified from the trend, ratio, and correlation analysis;
 - Graphs indicating significant unusual trends related to general ledger account data;
 - Table of ratio and yield analysis on selected assets, cost of funds, interest margins, efficiency, return on assets, return on equity, etc.;
 - Table of formula used in the ratio and yield calculation;
 - Table of average balance sheet used in the ratio and yield calculation;
 - Selected graphs depicting poor correlation of income/expenses to the underlying assets and liabilities;
 - Comparative Balance Sheet and Income Statement, and;
 - Detailed Trial Balances at the General Ledger account level;

- For a pilot bank, which had significant number of potential errors and irregularities in the accounting information, the project team performed the following:
 - Presented the analysis to the Chairman of the bank in detail alerting him of the weaknesses in the bank's accounting process and provided recommendations, and;
 - Presented the analysis to the NBG Accounting Methodology Division as an example of the issues present at the commercial banks in Georgia. Provided the training on how to recognize the accounting irregularities from the financial information based on the knowledge of the bank, its activities and general banking sector in Georgia.

- On another large pilot bank, which indicated serious irregularities in the accounting information, the project team performed the following:
 - Provided the analysis package to the Chairman, Vice President of Finance and Chief Accountant of the bank for review, the possible weaknesses identified in the bank's accounting process. The bank management was reluctant to address the issues identified;
 - Presented the same analysis package to the NBG senior management at the presence of the bank management. The bank was to provide justification, verification, and plan for improvement to the NBG and to request for assistance on a later date. To date, the project had not received request for assistance and the NBG has not followed up with the bank for resolution, and;

- Presented the analysis package to the NBG Accounting Methodology Division as an example of the issues present at the commercial banks in Georgia. Provided training on how to recognize the accounting irregularities from financial information based on the knowledge of the bank, its activities, and general banking sector in Georgia.
- The accounting issues identified in the analyses of two large pilot banks were presented to the NBG inspectors prior to the commencement of the NBG's annual inspection of these banks. It served as planning analyses for the NBG inspectors, the process which the Bank Supervision Program has been trying to implement for the On-Site inspection.
- At the end of the nine months (9) period, the project team also completed the update profile and assessment of the IAS conversion for the pilot banks.
- Mini-training and direct assistance was provided at two pilot banks in the preparation of cash flow statements. For this purpose, our team developed a worksheet for cash flow statement preparation, trained the banks' accounting personnel in the mechanics of calculation, reconciliation and presentation of cash movements from operating, investing and financing activities, and provided direct assistance in the preparation of cash flow statements. As a result, the banks' accountants were able to prepare quarterly cash flow statements on their own. These statements were presented to our team for review and additional explanations and training was provided as needed. On the basis of these activities, a cash flow training package was developed and presented to commercial bank accountants during the 4th quarter seminar.
- The project team read and analyzed the tax laws of the Republic of Georgia and identified areas causing temporary differences in calculating current and deferred taxes. In accordance with IAS, it is necessary for banks to identify the temporary and permanent differences between IAS and tax accounting. In this way, appropriate tax liabilities and deferred taxes can be recorded in the general ledger under IAS. The analyzed materials were incorporated in the 3rd quarter training seminar in November 2001.
- An LSA visited three pilot banks and presented the methods to estimate, calculate, and provide for current and deferred income taxes for selected pilot banks. The assistance included the bank specific pro-forma calculation based on the financial data obtained during the on-site assistance. The team developed a training package including examples of bookkeeping entries, calculation of current and deferred taxes, and reconciliation and disclosure required by IAS 12 *Income Taxes*. The IAS 12 training materials developed were also used in the 2nd quarter seminar for commercial bank accounting personnel.
- An AA and an LSA reviewed the accounting policy statements drafted by a pilot bank and provided comments on the propriety of the bank's accounting policy and

the adequacy of presentation of the policy statement. The details of our comments were discussed with the bank's Head of Accounting, Planning and Analysis Division on an on-going basis throughout the development of the accounting policy statement.

- An LSA reviewed the year 2000 annual audit and year 2001 draft financial statements for the propriety of presentation and provided comments to the bank's Head of Accounting, Planning and Analysis Division.
- An AA and LSAs provided direct assistance to a pilot bank in the development of accounting policy for fixed and intangible assets, as well as subsequent calculation of depreciation and amortization expenses and IAS adjustments.
- An AA and an LSA reviewed and provided recommendations on a pilot bank's procedures for accounting control through reconciliation of accounts balances.
- The LSAs visited their respective pilot banks during the months of December 2001 and January 2002 to advise on the year-end closing process. The discussions included the general ledger account reconciliation technique, cut-off statement of bank accounts at the corresponding banks and NBG, review of accruals, amortizations and depreciations and preparation of the draft IAS financial statements for the external auditors.
- The 4th Quarter training on February 18 to 20, 2002 covered the role, processes, and reports of external and internal audits, annual IAS financial statements, audit adjustments, and related responsibilities of the management.
- Except for two banks, the other pilot banks have not booked the prior year IAS audit adjustments. The current year accounting records do not reflect the recommendations of the auditors for these pilot banks.
- Two non-pilot banks visited the project office at the NBG and received more detailed instructions on how to prepare the statement of cash flows. The State Tax Department is requesting a set of basic financial statements for the year, which includes Balance Sheet, Income Statement, Statement of Cash Flow, and Changes in Shareholders' Equity.
- Working with the National Bank off-site inspection staff and Resident Advisor, the project team followed up on the preparation of monthly financial reports and schedules to NBG by the pilot banks. The LSAs assisted pilot bank personnel in areas of difficulty in interpreting preparation instructions. The team met with the NBG Off-Site analysts responsible for the pilot banks and confirmed that the banks are submitting the monthly regulatory reports on a timely basis, the form is generally complete, and the information contained in the report appears to be reasonable. The LSAs reviewed the CAEL report prepared quarterly by the NBG Off-Site based on the monthly regulatory reports and noted that the analyses were

basically restatement of the information contained in the regulatory reports and did not provide additional insights on the financial state of the banks.

- Based on the insight gained from working with the seven pilot banks and through the issues addressed by the project Help-Desk, the project team provided necessary improvements and revisions to the chart of accounts and to the National Bank's instructions to commercial banks on the NBG Accounting Methodology. The NBG's instruction at the beginning of the year on conversion to the new COA was not comprehensive and did not come with sample procedures to follow.
- During the initial assessment process and on-site direct assistance, the project team conducted an assessment of the pilot banks' internal control environment and internal control structure over the financial reporting cycle for adequacy and effectiveness. The procedures included reviews of accounting policies and procedures for adequacy and effectiveness, its compliance with the IAS, and approval by the bank's board of directors. The existence and quality of the accounting policies and procedures were greatly different among the pilot banks. Upon review and discussions with the management, it is concluded that the existing policies and procedures are grossly inadequate. In addition, there was no functioning internal audit department at any of the banks for proper monitoring and enforcement over the banks' compliance with the existing internal policies and procedures. There was no additional effort made to assist the banks on this area as the banks were clearly not equipped to address the internal control issues because the immediate accounting irregularity issues occupied the available time and resources.
- Working with the National Bank's proposed draft regulation on Internal Audit Requirements for Commercial Banks, the project team performed a review of the pilot banks' current internal audit function for possible compliance with the regulation. Assistance was offered, where requested by the pilot banks, in interpretation and implementation of the regulation upon issuance. The current internal audit functions at the various commercial banks do not meet the requirements of the NBG regulation and international standards. In most cases, the banks' Internal auditors are reporting directly to the banks senior management, which compromises their independence. There are no effective audit committees in place for most of the commercial banks in Georgia.
- The LSAs spent a great deal of time during the month of January and February 2002 editing and reviewing the translations of the proposed 205 page Internal Audit Manual, which to be issued by the NBG upon completion. The manual in English and Georgian was presented to the NBG in February 2002. The draft manual was presented to the commercial banks at the 4th quarter training on February 20, 2002. This training also included the presentation of the NBG regulation on the internal audit requirements, standards on internal audit and organization, and qualifications of the internal audit director and staff. The hard copies of the draft internal audit manuals were handed out to the participants of

the seminar and delivered to the banks, which did not participate in the training. Some pilot banks requested and received electronic copies of the draft manual in English and Georgian with the permission from the NBG.

- Based on numerous discussions with the pilot banks' management, internal audit department directors, and staff, it is concluded that the banks do not understand the role of an effective audit committee, definition of independence, or the role of the internal and external audit. The team responded to numerous inquiries on the reference materials and interpretation of the NBG regulation. An AA provided the project team members and the pilot banks with a reference booklet on the Audit Committee from US, which contains the following information:
 - Audit Committee responsibilities, which includes:
 - Assessing the processes related to the company's risks and control environment;
 - Overseeing Financial Reporting;
 - Evaluating the Internal and External Audit process;
 - Creating an effective Audit Committee, which covers the committee; charter; independence qualification of the members' skills and training, meetings, reports, compensation and benefits and evaluation;
 - Sample charter;
 - Recommendations of the Blue Ribbon Committee, formed by the US SEC in 1998, on improving the effectiveness of audit committee;
 - Guiding principles for audit committee best practices of the Blue Ribbon Committee;
 - Recommendations of the US National Commission on Fraudulent Financial Reporting (1987);

Help Desk Assistance

- The IAS Help Desk was set up to provide assistance to all commercial banks in Georgia on IAS COA conversion, IAS interpretation, implementation and financial reporting issues. The Help-Desk received inquiries from the pilot and non-pilot banks in the following ways:
 - During On-Site assistance,
 - By visiting the Help Desk office at NBG,
 - During training seminars,
 - Via email to IASadvisor@caucasus.net, and;
 - Facsimile and Telephone.

This vehicle was also used to train the local staff accountants in (a) research techniques, (b) oral communications, (c) structure of written opinions and (d) maintenance of adequate filing system and documentation for future reference.

Total number of inquiries responded to total 272 from 17 participating commercial banks during the year. The frequently asked questions and topics from the non-pilot banks were similar to the areas listed above for the pilot banks.

- A mini-training and direct assistance in the preparation of the statement of cash flows was provided to accountants of two non-pilot banks at the Help-Desk office at NBG using the Cash Flow training materials from the 4th quarter seminar.

NBG Inspections

- During eight (8) on-site inspections of six (6) pilot banks, the Commercial Bank Project team provided on-the-job assistance to the NBG inspectors in the review of accounting related matters, identification of non-compliances with IAS, and NBG regulation on accounting and development of related report comments. At the completion of the inspection fieldwork, the team followed up with the subject bank to assist the chief accountants with the accounting deficiencies noted during the inspection and plan for improvement. Specific areas in which assistance was provided varied from pilot bank to pilot bank. Two pilot banks were examined twice during the year and one bank's examination fieldwork was postponed until the management completes the purchase accounting and valuation of the assets and liabilities. The commercial bank team's involvement was mainly in the areas of accounting, record keeping, and internal controls with the following activities:
 - Review of the prior examination reports on the Accounting, Record Keeping and Internal Controls section of the report;
 - Assist the inspectors with the internal controls questionnaires;
 - Interpretation and explanation of IAS accounting requirements on significant transactions;
 - Facilitate the meetings of the NBG inspectors and the bank management on accounting and financial information areas, and;
 - Review and comment on the draft examination reports.

Development of Local Accounting Professionals

- The project recruited Local Staff Accountants with diverse background, training and experience. The purpose was to transfer the knowledge among the team members, learn from each other and provide different perspective. Skills among the LSAs:
 - Completed the UK based Association of Chartered Certified Accountants (ACCA) qualification program in English - One of the first two Georgian nationals successfully completed the study and passed the 14 examinations;
 - Experience in enterprise accounting conversion to IAS;
 - Teaching of IAS accounting to ACCA students in Georgia and Azerbaijan;
 - Advance level in ACCA program in English. Passed 7 examinations;

- Experienced in NBG accounting;
 - Entry level ACCA program in English;
 - Worked in the NBG Supervision Department;
 - Experience in commercial bank accounting;
 - External audit of financial statements at a local accounting firm, and;
 - Worked as an Internal auditor at a commercial bank in Georgia.
- The main vehicle of the LSAs' development is the On-the-Job Training with the Accounting Advisors. All LSAs participate in the consultation of the pilot banks, responses to the Help-Desk inquiries, and presentation at the training seminars as instructors.
 - The LSAs level of participation on the training seminars gradually increased as their technical knowledge and presentation skills improved:
 - **1st Qtr - 2001** LSAs assisted the Accounting Advisors in preparation of the training handouts in Georgian
 - **2nd Qtr – 2001** LSAs participated in the presentation of selected exercises and solutions
 - **3rd Qtr – 2001** LSAs researched the technical issues and prepared and presented in Georgian the seminar materials under the close supervision of the Advisors
 - **4th Qtr – 2001** LSAs, as a cohesive team, planned the training agenda, communicated to the commercial banks and NBG, coordinated the arrangement of facilities and other administrative needs with the project office management, topics and exercises were researched, prepared, presented the entirely by the local staff with minimal supervision by the Advisor. The process included cross review of each others work, preparation of the material in English, obtaining approval from the Chief of Party, review of translations to Georgian, presentation to NBG for review and comment, communicating to the commercial banks, obtaining advance confirmation of the attendees, reproduction of participant materials, and all related administration during the seminar. The training was well received by the participants and more information was presented within the available time, as there were no translations from English to Georgian needed.
 - All LSAs are required to continue self-study and have completed or are actively in the process of the ACCA qualification process. There were a total of twenty-eight (28) technical topics studied, summarized and presented by the local staff during the scheduled weekly one-hour sessions. These presentations included overview of IAS requirements, related current regulations, proposed regulations and applicability to the commercial banks in Georgia. The weekly one-hour

sessions were for the development of the local staff in the IAS and regulatory issues as well as research, writing, and presentation skills. The local staff also learned the use and availability of reference and technical materials. The topics reflected frequently asked questions by the pilot bank personnel. After the presentation of the summary by the staff, there were discussions, questions, and input from the Accounting Advisors. Attendances to these weekly sessions were mandatory for all commercial bank project staff and open to the Bank Supervision Program Analysts and NBG Accounting Methodology staff.

Other

- Coordinated the transition of accounting technical assistance provided by the TACIS project. Considered and interviewed all TACIS Georgian accounting professional staff members expressing an interest in joining the USAID project. Obtained all documentation and information available on the six pilot banks and IAS accounting issues in general. Numerous discussions and meetings were held with the resident manager of the EU TACIS project during January and February 2001. The discussions included the current state of the IAS implementation at the commercial banks, receipt and review of the EU TACIS monthly status reports, and recruitment of the EU TACIS project local staff to the USAID project. The USAID Project retained two accounting staff and a translator/interpreter from the EU TACIS project after the interview and evaluation process. One staff had NBG accounting experience and another staff had NBG Supervision and commercial bank experience prior to the EU TACIS project.
- An Accounting Advisor met with the USAID Georgia Enterprise Support project personnel, and discussed the status of the accounting reform at the enterprises in Georgia. By the time the meeting took place, the project's accounting reform portion had ended. No additional interaction took place subsequently as the project no longer had personnel in Georgia.

6. Training Initiatives

According to the Work Plan concluded between the USAID and the NBG, the Banking Supervision and Enforcement Project was required to provide periodic training courses and seminars for the staff of the NBG and the commercial banks to assist them in implementing reforms, ensuring compliance with internationally accepted practices and standards, strengthening banking supervision and enforcement areas, and sustaining and institutionalizing the overall supervision function. To help achieve this, an accreditation program was developed for the inspection staff. The program consisted of five courses in which four were presented during Phase I.

The following seminars have been conducted for the NBG staff as part of the Accreditation Program:

- | | |
|--------------------------------------|----------------------|
| • International Accounting Standards | June 12-17, 2000 |
| • Financial and Credit Analysis | October 2-6, 2000 |
| • Risk Management | March 12-16, 2001 |
| • Foreign Exchange Management | March 11-15, 2002 |
| • Banking Simulation Program | Scheduled- July 2002 |

Specifics for each of courses presented to date are detailed below:

- The staff of both the on-site and off-site departments participated in a week-long seminar-involving introduction to International Accounting Standards. This was the first course of five that make up the accreditation program for the NBG's inspection staff. Thirty-three people attended the seminar and thirty-two people took the required test. Of these thirty-two, four did not post a passing test score.
- The staff of both on-site and off-site departments participated in the week-long Credit Analysis Seminar, which was the 2nd course in the accreditation program for the inspection staff. Approximately 30 inspectors were in attendance during the week from both the on-site and off-site departments. 29 of the inspectors took the test and 27 passed.
- The staff of both the on-site and off-site departments participated in a weeklong seminar-involving an introduction to Asset/Liability and Risk Management. This was the third course of five that made up the accreditation program for the NBG's inspection staff. 28 people attended the seminar and 24 took the required test and everyone passed.
- The staff of both the on-site and off-site departments participated in a week-long seminar-involving introduction to Foreign Exchange Management. This was the fourth course of five that make up the accreditation program for the NBG's inspection staff. 20 took the required test and everyone passed.

The following three-day seminar was provided at the **Bankers Training Center** to enhance the inspectors' analytical skills, but was not part of the accreditation program:

- Accounting and Financial Analysis October 22-24, 2001

Accounting Seminars for Commercial Bankers:

- International Accounting Standards Seminar # 1 January 29, 2001
- International Accounting Standards Seminar # 2 April 25, 2001
- International Accounting Standards Seminar # 3 August 14-16, 2001
- Seminar for Commercial Bankers and Tax Inspectors November 7-9, 2001

- International Accounting Standards Seminar # 4 February 18-20, 2002

Accounting Methodology Training

The accounting advisor organized the following IAS accounting seminars, attended by NBG accounting staff:

<u>Month</u>	<u>No. of Days</u>	<u>No. of Participants</u>	<u>Principal Recipient Entity</u>
October 2000	10	56	Commercial Banks
December 2000	7	43	Commercial Banks
January 2001	2	29	NBG Supervision and Accounting Staff

Post January 2001, Commercial Bank assistance team consultants arranged IAS seminars.

Training of Commercial Bankers and Accountants

- Conducted four (4) training seminars for chief accountants of the banks IAS concepts and related standards on below listed areas, frequently asked questions (FAQs), issues considered complex and relevant in implementation of the new chart of accounts, and issues arising from the compliance with the new regulatory reports. The Representatives of NBG On-Site, Off-Site, and Accounting Methodology department were present at each training session. Selected IAS concepts and areas covered:

<u>Quarter Date</u>	<u>Topics</u>	<u>No of Banks</u>	<u>No of Persons</u>
Q1-April 5, 2001	Introduction to IAS and Accrual Accounting	20	20
Q2-August 14-16, 2001	Fixed Assets & Depreciation Loan Accounting Audit Adjustments Deferred Taxes	22	32
Q3-November 7-9, 2001	Taxation of Commercial Banks	26	39
Q4-February 18-20, 2002	External and Internal Audits	21	41

- The Commercial Bank Project team also assisted in preparation and presentation of accounting related topics for the seminars to the NBG inspectors for the following sessions:
 - January 2001 - Introduction to the New Chart of Accounts and IAS Concepts
 - October 2001 - Financial and Accounting Analyses

7. Program Aspects in Progress as of the end of Phase I

On-site Supervision

- The inspection of a troubled bank was not completed by the end of Phase I for the RA's to review it in its entirety; however, this report will be a priority in the initial stage of Phase 2 due to the need to implement some type of remedial and/or enforcement regime for this bank.

Off-site Surveillance

- The training used for the off-site analysts on the FinA system has been identified but not yet commenced since the system was only finalized in early April 2002. The staff is currently using the system but significant training on how to use the information is needed. This training will take place during Phase 2 of the program. It is anticipated that the training will start to take place in June 2002.

Legal

Legislative Tasks

- Work is currently in progress on a new request received in March 2002 from the NBG and IMF to seek new amendments to the CBL, which would extend the fit and proper criteria for bank managers to bank Supervisory Councils and persons who control banks.

The CBL has been analyzed and the appropriate language is being prepared to deliver to the IMF during Phase II in time for the next session of Parliament.

- Work is currently in progress designing amendment language for relevant non-banking laws, i.e. the "Companies Act," the "Civil Code," the "Criminal Code," the "Administrative Violations Code," the "General Administrative Code," the "Administrative Procedures Code," and the "Law on the Capital Markets."

Regulatory Tasks

- Follow-up work continues with the NBG Supervision Department on the "Regulation on Capital Requirements of Banks" which involves final points that

are near resolution including taking into account comments of the IMF on embedding in the Regulation special protections against "market risk" and "foreign exchange risk". The Project Advisors believe that these issues will be resolved quickly and that the regulation will be ready for issuance in April 2002.

- Project Advisors have advised the NBG Department of Supervision that they may bypass the Ministry of Justice for legal expertise based on new independence achieved under the amended NBL. This advice has been emphasized in view of the critical need for near-term issuance of this crucial regulation.
- Follow-up work continues with the NBG Department of Supervision on reconstructing the draft "Regulation on Liquid Assets". The Project's Chief of Party and its Legal Advisor will complete this work in April 2000. It consists of evaluating several proposed ratios, streamlining language, and eliminating inapplicable or unworkable portions of the draft.
- Follow-up work continues on the draft "Regulation on Foreign Exchange Exposures" working with Department of Supervision staff on ways of combining and reconciling the delivered regulation with existing Decree 297.
- Design work continues on policy development in connection with the planned delivery of the "Regulation on Holdings and Activities of Persons Who Control Banks" in mid-2002.
- Transactional work continues in connection with legal advice and assistance to the NBG in connection with failed or failing banks.
- Follow-up work continues on the review and legal approval of various Accounting Guidelines being developed to support the "Regulation on Accounting and Other Records and Internal Control Systems."
- Follow-up work continues with the NBG Director of Supervision on improving the internal comment process at the NBG with respect to draft regulations in order to avoid unacceptable delays in approvals and issuances of regulations.

Judicial Tasks

- Preparation continues of the creation of course materials to be used at the Judicial Training center in the training of judges on banking issues scheduled for May 2002.

Accounting Methodology – NBG

Completed Work – Not Yet Delivered to NBG

- A report detailing a strategy for the accounting methodology unit, established by NBG in October 2001, has been developed. The report defines goals and tasks for the new unit, its relationships with other organizational units with supervision responsibilities and a work program covering a two-year planning horizon. It is envisaged that NBG will incorporate the proposals in a revised charter for its bank supervision department. Delivery to the NBG is envisaged once submitted proposals on other regulatory issues have been processed and officially approved.
- The following accounting guidelines have been developed and await delivery to NBG:
 - Guideline No. 3 Year-End Accounting and Reporting Activities
 - Guideline No. 4 Account Reconciliation Procedures
 - Guideline No. 5 Accounting for Loan Loss Reserves and Provisioning

It is envisaged that NBG will approve these guidelines that support IAS implementation activities in commercial banks. As indicated above, commercial banks seek direction and guidance from the NBG on applying statements on IAS to banking activities. Generally, IAS statements do not, in a detailed manner, describe the accounting methods to be applied to achieve compliance with a prescribed accounting policy. Accounting guidelines are designed to address this problem.

- A Tax Reconciliation Form, and explanatory notes, specific to the banking sector has been developed. The current form in use is applicable to all enterprises and because of the unique activities of the banking sector its use is limited. The new design addresses these limitations. The new form requires the approval of Tax Department of the Ministry of Revenue. It is envisaged that NBG will initiate this approval process on receipt of project proposals and, following its approval, issue it to the commercial banks.
- Consultants, assisting pilot banks in IAS implementation, have developed skills in desk-based analysis of commercial banks financial reports using an application software package developed specifically for this purpose. It is the view of the resident advisors that is imperative that the new staff of the accounting unit be trained to operate this application package and acquire an understanding of its output that identifies accounting and reporting deficiencies of an individual bank. A local accounting consultant will initiate the skill transfer process and work

closely with selected staff of the new unit until they are fully trained. Following this know-how transfer, the new accounting unit should be in a position to enter into a dialogue with senior management of individual banks with regards to accounting deficiencies and, when necessary, use its enforcement powers to insist on full implementation of IAS. The project advisors have discussed with senior NBG management personnel and agreed upon this strategy. It is estimated that it will take two months for the accounting staff to acquire the skills necessary to analyze finances and report on accounting deficiencies.

- Deficiencies in the Chart of Accounts and Accounts Description Manual launched at the beginning of year 2001 are appearing as the accounting reform process evolves. Presently, instances of these deficiencies have been recorded by accounting consultants engaged on commercial bank technical assistance activities. A final report on this subject is envisaged by May 31, 2002. It is recommended in order to maintain momentum on IAS implementation that the NBG initiates the next revision process with intention to publish revised charts of accounts, an account's descriptions manual, and operating guides by end of year 2002. In the long run, it is envisaged that each commercial bank will further develop the chart of accounts in a manner consistent with its business activities needs and its management information requirements. It is recommended that at a point in time after January 1, 2003, when NBG considers that banks are generally competent in IAS practices, commercial banks should be given the freedom to continue to monitor and adapt the chart as it sees fit.

Accounting Technical Assistance-Commercial Banks

- On-Site assistance to the NBG inspections of two pilot banks is in progress. The commercial bank team is providing assistance with the Accounting, Record Keeping and Internal Controls areas of the inspection, including limited financial and earnings analysis.
- The project objective to help develop management-reporting system of the pilot banks was not completed. The management of the banks need some time in understanding the reliability and usefulness of the accounting information based on IAS. Only one pilot bank has a structured management information report. The project reviewed and provided comments, but concluded that the effort and the resources would be better spent on the assistance of basic IAS implementation at the transaction level to improve the reliability of the accounting information.

8. Concerns/Impediments to Progress

On-site and Off-site Supervision

- The progress of the program, both in the on-site and off-site areas, was hampered for many months by the lack of leadership and understanding of international regulatory standards and policies from the former Director of the Supervision

Department. The former Director was in charge of the Department from approximately March 2000 through December 2001. The former Director did not understand international concepts and methods of banking supervision and there were almost no attempts on her part to utilize help on technical issues in which she had no technical expertise or experience. The Chief of Party discussed these problems and issues on numerous occasions with the NBG's President and Vice President. They both acknowledged that the problem existed and indicated that a solution would be forthcoming. The solution to the problem was finally enacted with the appointment of new Director in December 2001.

The appointment of a new Director has resolved a major obstacle; however, there are still other staffing issues that need to be addressed. The staffing issues include the need to completely staff the Accounting Methodology Department and to replace the Deputy Director of the Policy Division, who is responsible for processing the laws and regulations developed by the resident advisors. On numerous occasions these laws and regulations have been stalled for no logical reason by the policy division. Both the Policy Division and the Accounting Methodology Departments are not properly staffed, and therefore, they are not functioning as productive units within the Banking Supervision Department.

Legal

- Long-term solutions are being sought on ways to make the NBG Legal Department to be more responsive and constructive to the Project's banking reform measures. Although the members of the Department have cordial relations with Project Advisors and staff, their actions have sometimes impeded results.

USAID is aware of the problems that rendered prohibitive efforts at training the Legal Department staff and minimized true collaborative contacts, in particular in legislative and regulatory matters, despite constant and courteous inviting stances by Project Advisors. The above grossly impeded attempts to bring direct, formal training to the NBG Legal Department.

Accounting Methodology – NBG

- The four persons appointed to the new accounting methodology unit do not possess any formal qualifications in IAS accounting although they have been involved in the commercial bank accounting reform program in recent years. Only one person is pursuing the ACCA program that leads to full membership of the internationally recognized accountancy body. This dearth of accounting expertise will render difficult the goal of creating a unit that will become the authority on commercial bank accounting and reporting issues. The support of an experienced international accounting consultant is recommended until at least all the appropriate accounting guidelines have been developed and the staff possess adequate proficiency in analyzing financial reports for the purposes of detecting non-IAS compliance.

The low participation of the NBG employees in IAS accounting studies is mirrored by the low participation rate of banking sector employees. Of the existing pool of ACCA students, only 7% are employed in the banking sector.

- Recently, NBG merged the accounting unit, designed to focus solely on commercial bank accounting matters, with an existing policy unit in the bank supervision department. The newly merged division does not maintain the clear distinction between the specialized accounting activities and other commercial bank policy activities. The long-term development of IAS accounting expertise is best served by an organizational structure, incorporating a specialized accounting unit.
- Commercial banks have weak internal control systems. From an accounting perspective this leads to doubts about the completeness and reliability of financial reports data. Accordingly, once accounting guidelines on IAS practice have been developed, it is imperative that the accounting unit focuses on non-IAS compliance and enforcement issues. Enforcement efforts will probably involve the accounting staff in detailing the corrective action, covering internal control and accounting practice issues and monitoring implementation. Currently, the capacity of the accounting unit to formulate corrective action plans is limited.

Memorandum of Understanding

**MEMORANDUM OF UNDERSTANDING
BETWEEN
THE GOVERNMENT OF THE UNITED STATES OF AMERICA
AND
THE NATIONAL BANK OF GEORGIA**

ARTICLE 1. PURPOSE

The Government of the United States of America, acting through the U.S. Agency for International Development ("USAID"), and the National Bank of Georgia ("NBG"), hereinafter referred to as the Parties, wish to cooperate in a mutual effort to reform the banking system in Georgia in the area of banking supervision and enforcement issues. USAID wishes to furnish and the NBG wishes to receive in-kind assistance for this purpose. Accordingly, the Parties have concluded the present Memorandum of Understanding, hereinafter referred to as the "MOU", to set forth their understandings with respect to their undertakings in support of the stated purpose. This MOU is not intended to effect an obligation of funds by USAID.

ARTICLE 2. UNDERTAKINGS OF THE PARTIES

2.1 The U.S. Government, through USAID, wishes to furnish to the NBG in-kind assistance in the form of technical assistance and training to assist the NBG carry out its responsibility for ensuring and administering the safety, soundness and stability of the banking system in Georgia, through development of a Banking Supervisory Program and improvements in accounting procedures, over a period of approximately one year from the date of this MOU or such later date as the Parties may agree upon in writing. The nature of the assistance provided by USAID and coordination between the Parties is more fully described in Annex I to this MOU.

2.2 In the event USAID furnishes assistance described above, the NBG shall:

(a) provide a sufficient working relationship by senior officials of NBG to accomplish each of the specific areas described herein and in Annex I. This includes, at a minimum, monthly meetings between the President of the NBG, USAID Staff, and the Chief of Party of the contractor selected pursuant to Standard Provision 3.2;

(b) provide relevant participants for training courses offered in conjunction with the assistance described herein and to ensure the full attendance of the participants at the training courses;

(c) provide relevant information on the commercial banks that is necessary for the USAID advisors to fulfill their responsibilities under this MOU;

(d) provide adequate and sufficient office space and certain equipment to USAID-funded advisors in the NBG;

(e) ensure that sufficient information is made available to permit consultants and advisors to accomplish the assistance described in this MOU;

(f) adopt measures necessary to implement the goals and objectives of this MOU, including providing the resident advisors with the appropriate counterparts that have the experience and

training to help accomplish these goals in a realistic and timely manner.

ARTICLE 3. STANDARD PROVISIONS

3.1 **Relation to Framework Bilateral Agreement:** In-kind assistance furnished by USAID pursuant to this MOU is considered United States assistance within the scope of the Agreement between the Government of the United States of America and the Government of the Republic of Georgia Regarding Cooperation to Facilitate Humanitarian and Technical Economic Assistance, signed July 31, 1992, and is subject to the terms and conditions of that agreement, including provisions relating to exemptions from taxes and customs duties exemptions.

3.2 **Third Party Instruments and Availability of Funds:** In order to provide the in-kind assistance described above and in Annex 1, USAID may enter into such contracts and other instruments with public and private parties as USAID deems appropriate. All undertakings of the U.S. Government pursuant to this MOU are subject to the availability of funds and to further agreement between USAID and such public and private parties, regarding the provision of in-kind assistance. This MOU is not intended to effect an obligation of funds by USAID.

3.3 **Compliance with U.S. Law and Regulations:** USAID shall obligate, commit and expend funds and carry out operations pursuant to this MOU only in accordance with the applicable laws and regulations of the United States.

3.4 **Title to and Use of Property:** Unless otherwise directed by USAID, title to all property furnished by USAID shall be in the NBG. Any property furnished by USAID and titled to the NBG shall be used effectively for the assistance purpose described above and, upon completion of the assistance, shall be used so as to further the objectives of the assistance. If property furnished by USAID and titled to the NBG is used for purposes other than those agreed upon by the Parties, under circumstances which could reasonably have been prevented by appropriate action of the NBG, the NBG shall, upon USAID's request and election, return such property or refund the amount disbursed for such property in U.S. dollars.

3.5 **Integrity of Information Systems.** No USAID-funded computer, software or other information technology product provided within the scope of this MOU shall be connected or otherwise integrated with other computers, software or information technologies without prior written approval of USAID based on assurances that such other products are Year 2000 compliant.

3.6 **Records, Audit and Inspection:** The NBG shall maintain or cause to be maintained, as appropriate, records relating to the assistance adequate to show use and receipt of assistance furnished pursuant to this MOU. Records shall be maintained for a period of three years after assistance has been furnished. The NBG shall afford authorized representatives of USAID, or their designees, the opportunity at all reasonable times to inspect the site of the assistance and records relating to the assistance.

3.7 **Exchange Rate:** If funds are introduced into Georgia by USAID or any public or private

agency for purposes of carrying out obligations of USAID hereunder, the NBG will make such arrangements as may be necessary so that such funds shall be convertible into currency of Georgia at the highest rate which, at the time the conversion is made, is not unlawful in the country.

3.8 **Publicity:** NBG will give appropriate publicity to the assistance as a program to which the U.S. Government has contributed.

3.9 **Information and Implementation Letters:** USAID and the NBG shall provide each other with such information as may be needed to facilitate provision of the assistance and to evaluate the effectiveness of this assistance. In addition, USAID may from time to time issue implementation letters to provide additional information on matters discussed in this MOU. The Parties may also use jointly agreed letters to confirm their mutual understandings with respect to implementation of this MOU, including changes in elements of Annex 1. Implementation letters shall not be used to amend the text of the MOU.

3.10 **Authorized Representatives:** The Parties shall be represented by those holding or acting in the offices held by the signatories to this MOU. Each Party may, by written notice, to the other, identify additional representatives authorized to represent that Party for all purposes other than executing formal amendments to this MOU. Each Party shall notify the other, in writing, of changes in its authorized representatives.

3.11 **Amendment and Modification:** This MOU may be amended or modified by written agreement of the Parties. Elements of Annex 1 may be changed by written agreement of the Parties without formal amendment of this MOU.

3.12 **Suspension and Termination:**

(A) **Suspension.** In the event:

- (i) the NBG fails to comply with any provision of this MOU;
- (ii) USAID determines that an extraordinary situation has occurred which makes it improbable either that the purpose of the MOU will be attained or that the NBG will be able to comply with provisions of the MOU; or
- (iii) USAID determines that continuation of assistance would result in a violation of U.S. law or regulations,

USAID may, at its option, take steps to suspend, in whole or in part, provision of assistance under this MOU and provide written notice of its actions to the NBG. In the event of partial suspension, such notice shall specify affected activities. If, after sixty (60) days from the date of such notice, USAID determines that the cause or causes for suspension have not been corrected, USAID may terminate assistance and provide written notice of its action to the NBG.

(B) Termination. Either Party may terminate this MOU, in whole or in part, by giving the other Party thirty (30) days written notice. In the event of partial termination, such notice shall specify affected activities. Termination of this MOU will terminate any responsibilities of Parties to provide financial or other resources for this activity, except for payments which they are committed to make pursuant to noncancellable commitments entered into with third parties prior to the termination of this MOU. Obligations of the NBG set forth in Section 3.4 above relating to use of property furnished under this MOU shall remain in force after termination. In addition, upon such termination, USAID may, at USAID's expense, direct that title to goods furnished hereunder be transferred to USAID if the goods are from a source outside Georgia, are in a deliverable state and have not been offloaded in ports of entry of Georgia.

3.13 Assignment: The NBG agrees, upon request, to execute an assignment to USAID of any cause of action which may accrue to the NBG in connection with or arising out of the contractual performance or breach of performance by a party to a direct U.S. dollar contract with USAID financed by USAID in connection with this MOU.

3.14 Nonwaiver of Remedies: No delay in exercising any right or remedy accruing to a Party in connection with this MOU will be construed as a waiver of such right or remedy.

3.15 Language. This MOU is prepared in both English and Georgian. In the event of ambiguity or conflict between the two versions, the English language version will control.

3.16 Effective Date: This MOU shall be effective on the date of signing by both Parties.

In witness whereof, the Parties, each acting through their duly authorized representatives, have caused this MOU to be signed in their names and delivered as of this 16th day of December, 1999.



P.E. Balakrishnan, Acting Mission Director
U.S. Agency for International
Development



Irakli Managadze, President
National Bank of Georgia

First Year Work Plan

Booz-Allen Workplan

I. Nature of Assistance

The Parties agree that the following activities constitute a program designed to achieve the purpose of this MOU, and will coordinate as described in section III below to complete these activities to the extent they are supported by USAID in-kind assistance. Provision of in-kind assistance is subject to the terms and conditions of this MOU.

1. Subject to the terms of this MOU, and as further detailed below, this program is intended to assist the NBG carry out its responsibility for ensuring and administering the safety, soundness and stability of the banking system in Georgia. Generally, this includes the development of a Banking Supervisory Program designed to protect the interest of the depositors, creditors and investors in the banking system. In the framework for the implementation of the program, USAID and the NBG will develop a proper legal basis to monitor and conduct the inspections of the bank's activities, including the definition of the Commercial Banks Board of Supervisors' responsibilities to supervise the bank's activity in a proper manner. The system, if implemented, should allow the NBG to adequately react to the current changes taking place in the banking system, and to assess the safety and soundness of the banking system. In addition to the banking supervision and enforcement areas, USAID desires to provide assistance in the accounting area to ensure that the books and records of the commercial banks are maintained according to International Accounting Standards and other aspects of financial reporting.

2. Goals

2.1 On-Site Supervision. The goal is to provide the NBG with a comprehensive on-site inspection program that will allow the NBG's supervisors and/or inspectors to evaluate the risk(s) at commercial banks using a common, standardized methodology of evaluating financial and operating risks. This assessment will result in a composite rating being assigned to each commercial bank using the CAMEL System. In addition, during the year 2000 the NBG and the resident advisors will consider using the CAMELS system to perform on-site inspections, if it is deemed appropriate for the banking system in Georgia.

The joint effort between the NBG and USAID is expected to include the following areas:

- The inspection of commercial banks utilizing the CAMEL(S) system as the standard for performing on-site inspections;
- The development and/or refinement of a legal framework that will support the work of the supervisory department to adopt and implement timely and appropriate actions to eliminate the commercial banks' violations of laws and regulations and other unsafe and unsound practices; and
- An inspector accreditation (training) program to sustain and institutionalize the overall supervision function will be developed and provided to the supervisory staff.

2.2 Off-Site Supervision. The goal is to ensure that the NBG has an adequate information network, utilizing data and information submitted by the commercial banks. The staff of the banking supervision department will use this information to monitor the financial condition with the purpose of identifying risk at the commercial banks between the on-site inspections of the banks.

The joint effort between the NBG and USAID is expected to include the following areas:

- A review of the commercial banks ability to submit timely and accurate financial information (on a regular basis) to the NBG's Bank Supervision Department will be analyzed and recommendations for improvement will be made where appropriate;
- The further development and refinement of the off-site surveillance system, which will assist in the identification of potential problems at commercial banks between the regularly scheduled inspections, will be performed; and
- An integrated approach to linking the on-site and off-site program will be developed, as it is critical to ensure that all pertinent supervisory information concerning a commercial banks activity is shared between these two areas.

2.3 Problem Bank Resolution. The goal is to improve the current methodology of the NBG for affecting the resolution of problem banks, including procedures for bank restructuring, utilizing internationally accepted enforcement practices.

The joint effort between the NBG and USAID is expected to include the following areas.

- Continued assistance for the Bank Supervision Department to help implement measures aimed at rehabilitation rather than liquidation of troubled banks;
- Development and approval of a policy so that problems can be met with adequate corrective action; and
- Development and approval of a NBG policy to coordinate the responsibility for the liquidation of problem and/or insolvent banks when they are declared insolvent or revocation of the bank's license.

2.4 Legal Reform (Methodology). The goal is to review the existing banking legislation and to assist in the development and implementation of new laws and regulations where deemed necessary. The development of normative acts and policy statements will be based upon proven international standards.

The joint effort between the NBG and USAID is expected to include the following areas:

- A joint review of the current banking legislation and normative acts of NBG to determine their adequacy in supervising the commercial banks will be performed.

Recommendations and assistance with drafting new normative acts will be provided as needed and requested by the NBG;

-A review of the current documents used by the NBG methodology division for the correction of problems noted at the commercial banks will be performed and suggestions/recommendations will be made where appropriate; and

-A review of the current NBG banking legislation and normative acts will be made to determine their adequacy in dealing with issues of corporate governance involving the oversight of the commercial banks' activities.

2.5 Bank Accounting Reforms. The goal is to assist the commercial banks achieve full implementation and compliance with International Accounting Standards and to ensure that the NBG's accounting regulations and instructions for use by the commercial banks are in compliance with internationally accepted practices and standards.

The joint effort between the NBG and USAID is expected to include the following areas.

-The continued development of a supervisory accounting function within the Banking Supervision Department of the NBG;

-A review of all NBG instructions and regulations and the current chart of accounts to ensure compliance with International Accounting Standards; and

-The development and implementation of an effective internal audit function for the commercial banks.

II. Chronology

The parties commit themselves to meeting the following benchmarks with respect to the activities described in section I above to the extent such activities are supported by USAID in-kind assistance. Each element of this chronology is cumulative. Coordination between the Parties with respect to this chronology is set forth in section III below.

1. **On-Site Supervision.** The parties shall achieve the following benchmarks with regard to On-Site Supervision:

1.1 A review of the duties and objectives of the On-Site Inspection Division will be performed to determine if the present structure and staffing is adequate given the present workload requirements. Timeframe for implementation: December 1999 – February 2000.

1.2 A recently completed inspection report will be translated to English and reviewed by the resident advisor to allow a better understanding of the inspection process and the type of analysis performed by the on-site staff. Timeframe for implementation: December 1999.

1.3 At least three inspections will be performed each quarter utilizing the CAMEL system under the National Bank's approved inspection plan. The inspection reports will

be translated into English and a formal review process by the RA will be performed at the conclusion of each inspection. The review sessions will include written comments and suggestions along with training sessions to discuss the recently completed inspections. Component ratings along with a final composite rating will be assigned at the conclusion of each inspection. Timeframe for implementation: Beginning January 2000 and continuing throughout 2000.

1.4 The current on-site inspection procedures will be reviewed to determine their effectiveness and to ensure that all pertinent areas of a commercial bank's activities are being inspected. The present procedures will be modified, if warranted, to ensure that the Core Principles for Effective Banking Supervision, as detailed by the Basle Committee on Banking Supervision, are in place. Timeframe for implementation: December 1999 and January 2000.

1.5 The inspection manual currently in use by the on-site inspection staff will be reviewed and updated to ensure that all component of the CAMEL System are adequately addressed. The manual is intended to serve as a "how to" document for the on-site inspections and the other remaining supervisory processes. Timeframe for implementation: January-March 2000.

1.6 An Accreditation Program for the banking supervision staff will be developed and implemented to ensure that the staff has the basic skills necessary to carry out the regulatory objectives and procedures of the NBG. The accreditation program will consist of 5 core courses and will be agreed upon by the resident advisors and the NBG. Timeframe for implementation: April 2000 and one course each quarter thereafter.

2. Off-Site Supervision. The parties shall achieve the following benchmarks with regard to Off-Site Supervision:

2.1 A review of the duties and objectives of the Off-Site Department will be performed to determine if the present structure is adequate given the workload. Timeframe for implementation: December 1999.

2.2 A review of the timeliness and accuracy of the monthly/quarterly regulatory reports as submitted by the commercial banks will be conducted. This differs slightly from the accounting function in that the off-site analysis is concerned with receiving the reports in an accurate and timely manner. Timeframe for implementation: January - March 2000.

2.3 A review of the Data Base Project that is currently being developed will be conducted to determine its purpose and usefulness to the bank supervision department. A determination for continuing on past Phase I will be determined after the presentation by the contractor at a meeting in Armenia. Timeframe for implementation: January-February 2000.

2.4 Develop a monthly/quarterly reporting system that can be used by the on-site and off-site departments to monitor trends, identify potential problems at an early stage, and help develop a more tailored scope for on-site inspections. The use of Peer Group analysis will also be introduced. The analysis, in the form of written reports on individual

banks, will be provided to the Senior Management of the BSD. Timeframe for implementation: April – June 2000.

2.5 Design and implement an off-site surveillance system, which augments information available from the commercial banks with a focus on identifying potential problems in the banking system on a macro and/or consolidated basis. Timeframe for implementation: July – September 2000.

2.6 An off-site manual that covers the timeframes for internal reporting of financial analysis and monitoring, as well as establishing supervisory deadlines will be developed and/or refined. The manual is intended to ensure that all pertinent financial information and ratios are prepared on a regular basis and fully understood by the off-site and on-site staffs. Timeframe for implementation: August – October 2000.

2.7 A one-week seminar on how to integrate the analysis and reporting performed by the off-site monitoring group and how this benefits the entire regulatory process. Timeframe for implementation: May and October 2000.

3. Legal Reform (Methodology). The parties shall achieve the following benchmarks with regard to legal reforms:

3.1 A review of the Law on the National Bank of Georgia and the Law on Banks and Banking Activity will be made to determine their effectiveness in dealing with the issues of corporate governance and enforcement actions. The legal review may be expanded, as deemed necessary by both parties, to other laws and regulations such as related party or insider transactions, collateral laws, insolvency issues and definitions, and proper asset classification and provisioning requirements for problem assets. Timeframe for implementation: January – March 2000.

3.2 Assistance in the development of a corporate governance policy and related procedures, which places the responsibility and the emphasis for the control of the commercial banks' activities by the Commercial Bank's Board of Supervisors, will be provided. These procedures will review the type and quality of information submitted to the Commercial Bank's Council on a periodic basis. Timeframe for implementation: February – March 2000.

3.3 Specific reviews will be made to identify current problems in existing banking legislation and/or normative acts that deal with enforcement issues will be undertaken. Recommendations will be given on the development of international practices to be used by the NBG to rehabilitate problem banks. Timeframe for implementation: March – April 2000.

3.4 Development of a program for implementing enforcement actions against problem banks will be implemented. This program will include the development of formal enforcement policies and procedures. These recommendations will include the establishment of an oversight committee within the banking supervision department to ensure consistency in applying sanctions, penalties, and other remedial programs. Timeframe for implementation: July – September 2000.

4. Problem Bank Resolution. The parties shall achieve the following benchmarks with regard to resolution of problem banks:

4.1 Assist the NBG's staff in writing and developing the procedures for enforcement actions and/or restructuring techniques for commercial banks that have been identified as problem banks. Timeframe for implementation: June – August 2000.

4.2 The NBG and the Resident Advisors will review the existing criteria for a bank to be formally designated as a problem bank. The analysis will be performed on those banks that are not in compliance with the minimum capital adequacy requirements, those that have poor operating results, and/or those receiving a composite inspection rating of 4 or 5 based on the CAMEL system. Timeframe for implementation: July – September 2000.

4.3 Procedures for the drafting and implementation of enforcement actions or remedial measures will be developed. On-the-job (informal) and formal training will be provided as to what enforcement actions should be utilized given a bank's current financial situation. Timeframe for implementation: August – October 2000.

5. Bank Accounting. The parties shall achieve the following benchmarks with regard to accounting issues:

5.1 An internal audit program for commercial banks will be developed and implemented. Upon completion of this program, a training seminar will take place to ensure the effectiveness of the audit function. Timeframe for implementation: April – June 2000.

5.2 An accounting seminar on the purpose and use of an external audit will be developed for the bank supervision staff, the commercial bank accountants, and other appropriate commercial bank personnel. The training will consist of the purpose of an audit, the proper scope for an audit, the difference between an audit and an inspection, the various types of opinions, and how to determine if an auditor's recommendations have been implemented. Timeframe for implementation: March 2000.

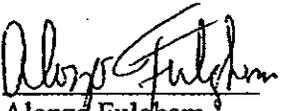
6. Selected Topics for Short Term Assistance and/or Specialized Training. The parties shall achieve the following benchmarks with regard to the selected topics.

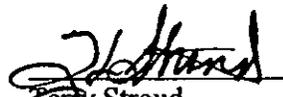
6.1 Deposit Insurance – Advice and training on the development and utilization of a deposit insurance program. At a minimum, a written proposal(s) will be formulated to include issues such as initial membership, funding issues, level of insurance coverage and limitations, and other pertinent issues as they are identified. Timeframe for implementation: September – October 2000.

The chronology may be adjusted pursuant to the procedure for modifying this Annex. Unless specifically stated otherwise in modification document, an adjustment to one element shall not postpone fixed deadlines established in following elements.

III. Coordination

The Parties will act to support activities undertaken pursuant to this MOU, recognizing, however, that provision of USAID in-kind assistance is subject to the terms and conditions of the MOU. Each Party acknowledges that regular communication regarding the status of any activity primarily the responsibility of that Party is essential to the accomplishment of the purpose of this MOU. In particular, the Parties agree that they will keep each other informed with respect to meeting the chronology in Section II and will promptly inform each other when it becomes likely that a deadline will not be met, so as to permit timely adjustments where appropriate.


Alonzo Fulgham
Director
Economic Restructuring Office
USAID/Caucasus


Terry Stroud
Booz-Allen & Hamilton

Second Year Work Plan

Booz – Allen Work Plan

Technical Assistance to the National Bank of Georgia

On Reforming the Banking System in Georgia

Article 1. General Purpose and Nature of Assistance

The relevant parties agree that the following activities constitute a program designed to achieve the goals and objectives as detailed more fully below in this document. This program for reforms is intended to assist the National Bank of Georgia ("NBG") carry out its responsibility for ensuring the safety, soundness and stability of the commercial banking system in Georgia. In the process of implementing all necessary reforms, the NBG will receive technical assistance to develop a proper accounting and legal framework to monitor and conduct the inspections of the commercial banks.

The provisions for this in-kind assistance is subject to the terms and conditions of the Memorandum of Understanding ("MOU") that was executed and signed on December 19, 1999 between the NBG and the United States Agency for International Development ("USAID").

Article 2. Goals and Objectives

This work plan outlines the framework for mutual cooperation between the NBG and USAID to achieve the stated purpose outlined in Section 1 above.

2.1 On-Site Supervision. The goal is to provide the NBG with a standardized and comprehensive on-site inspection program that will allow the NBG's supervisors and/or inspectors to evaluate the risk(s) at commercial banks using a common, standardized methodology of evaluating financial and operating risks. This assessment will result in a composite rating being assigned to each commercial bank using the CAMEL System.

The joint efforts between the NBG and USAID are detailed in the agreed benchmarks set out in Article 3 of this work plan but include the following areas.

- The continued development and implementation of an inspection program for the commercial banks utilizing the CAMEL system as the standard for performing on-site inspections;
- The continued implementation for using the inspection report as a management tool which effectively communicates a commercial bank's strengths and weaknesses to the subject bank's supervisory board;

- The continued development and refinement of a legal framework that will support the work of the supervisory department in adopting and implementing the timely and appropriate actions needed to eliminate the commercial banks' violations of laws and regulations and other unsafe and unsound practices;
- The continued implementation of an inspector accreditation (training) program to sustain and institutionalize the overall supervision function will be developed and provided to the supervisory staff;
- The development of a working group consisting of the IMF, IFC, EBRD, World Bank, USAID, and other donors involved in the commercial banking system to enhance the communication process involving the various reforms being implemented between the various donors and relevant participants.

2.2 Off-Site Supervision. The goal is to ensure that the NBG has an adequate information network, utilizing data and information submitted by the commercial banks. The staff of the banking supervision department will use this information to monitor the financial condition with the purpose of identifying risk at the commercial banks between the on-site inspections of the banks.

The joint effort between the NBG and USAID are detailed in the agreed benchmarks set out in Article 3 of this work plan but include the following areas:

- A review of the commercial banks ability to submit timely and accurate financial information (on a regular basis) to the NBG's Bank Supervision Department will be analyzed and recommendations for improvement will be made where appropriate.
- The further development and refinement of the off-site surveillance system, which will assist in the identification of potential problems at commercial banks between the regularly scheduled inspections, will be performed.
- An integrated approach to linking the on-site and off-site program will be developed, as it is critical to ensure that all pertinent supervisory information concerning a commercial banks activity is shared between these two areas.

2.3 Problem Bank Resolution. The goal is to improve the current methodology of the NBG for affecting the resolution of problem banks, including procedures utilizing any new expanded enforcement techniques that will be provided under the new laws and regulations that are currently being developed and implemented.

The joint effort between the NBG and USAID are detailed in the agreed benchmarks set out in Article 3 of this work plan and include the following areas.

- Accurately measure the financial risk of each troubled bank and minimize the cost of resolving the problems without increasing the risk to the entire banking system.
- Continued assistance for the Bank Supervision Department to help implement measures and procedures directed at rehabilitation rather than liquidation of troubled banks.
- The refinement of a system of Supervisory Action Plan to be implemented by the supervisory staff of the NBG when a commercial bank becomes a "problem bank" as defined by the NBG.
- Develop a NBG policy to coordinate the transfer of responsibility for the liquidation of problem and/or insolvent banks when they are declared insolvent or upon the revocation of the bank's license.

2.4 Legislative, Regulatory and Judicial Reform. The goal is to continue the analysis of the current commercial banking law and other relevant legislation as well as all current NBG regulations and decrees. The purpose for the analysis is to assess their effectiveness as supervisory and enforcement tools in accordance with international standards and best practices. The analysis of the commercial banking law will be particularly concerned with capital adequacy, credit risk management, corporate governance, and surveillance of persons who control banks, and prompt corrective actions. This analysis will constitute the basis for numerous recommendations, which will call for a substantial reconstruction of the commercial banking law.

The recommendations will include the introduction of authority for the establishment and regulation of various types of non-bank financial institutions (NBFIs), including, in particular, different kinds of micro-credit institutions such as credit unions, mutual societies and NGOs. The analysis of other relevant legislation will result in recommendations intended to lay the foundations for the accurate, impartial and swift enforceability of the commercial banking law and of regulations and decrees of the NBG. The analysis of key prudential regulations and NBG decrees will result in recommendations for needed amendments and the writing of new ones where needed.

The joint tasks of the NBG and USAID are detailed in subsection 3.1.3 of this Work Plan, which provide agreed timeframes for each such task. These tasks include the following.

- Joint analysis and discussions resulting in agreed proposals for changes and additions to all relevant laws. These changes and additions will be embodied in draft legislation forwarded to the Ministry of Justice and other relevant Ministries as well as to the banking community for appropriate review and comment after which they will be brought before

relevant Parliamentary Committees and then to the full Parliament for eventual enactment.

- Joint analysis and discussions resulting in agreed proposals for amended or new regulations and decrees as needed. These proposals will be approved by the Board of the NBG after appropriate review and comment by the Ministry of Justice and the banking community after which they will be put into effect through publication in the Official Gazette.
- Joint analysis and discussions resulting in agreed proposals for the training of judges in the special need for accurate, impartial and swift enforcement of significant litigation involving banks and the NBG. In particular, in cases of judicial review of NBG corrective actions, the judicial doctrine of "due deference" will be introduced. Under this doctrine, any decision or action of the NBG or any other regulator will be presumptively respected unless it appears that it was unauthorized, or was not supported by law, or was arrived at in an arbitrary or capricious manner, or was manifestly politically motivated.

2.5 Bank Accounting Reforms. The goal is the adoption of international accounting, and reporting standards, by all licensed commercial banks. Requirements stipulated in supervisory and regulatory pronouncements of the NBG will be based on approved international accounting standards and practices.

The joint efforts between the NBG and USAID are detailed in the agreed benchmarks set out in Article 3 of this work plan but include the following areas.

- The continued development of an accounting methodology unit supporting the Bank Supervision Department of the NBG.
- The development of accounting policy positions and regulations that support the adoption of newly approved IAS Chart of Accounts and accounting practices consistent with Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS).
- Assistance and advice to the NBG on formulating responses to enquiries on accounting matters from commercial banks and Bank Supervision Department.
- Training to commercial banks accounting staff and bank supervision staff.
- The completion of an internal audit program and promotional support towards its adoption by commercial banks.
- The international consultants joining the project in January 2001 will prepare and submit an addendum to this work plan detailing the technical assistance that will be provided to the commercial banks.

Article 3. Benchmarks

3.1 The Goals and Objectives of this Work Plan will be implemented as detailed in the following timeframes.

3.1.1 On-Site Supervision. The Parties shall achieve the following benchmarks with regard to On-Site Supervision:

- A review of the duties and objectives of the On-Site Inspection Division will be performed to determine if the present management structure and staffing is adequate given the present workload requirements.

Timeframe for Implementation: January 2001

- 10 inspections, in which the Resident Advisor will be involved on site at the commercial banks, will be performed during the year 2001. These 10 banks (in which the resident advisor will participant) will only involve large banks as ranked by assets or those banks that have systemic risk to the banking sector or other unusual operating problems requiring unique assistance. These 10 inspections will require that the reports be translated into English and a formal review process by the Resident Advisor(s) will be performed at the conclusion of each inspection. These review sessions will include written comments and suggestions to be presented in a workshop format to discuss the recently completed inspections.

Timeframe for Implementation: Beginning January 2001 and continuing throughout the year

- The current on-site inspection procedures will be revised to increase their effectiveness and to ensure that all new laws and regulations recently adopted are addressed by inspectors during an inspection. The additional items for review and consideration involve the commercial bank's adherence and compliance with the newly implemented International Accounting Standards, new asset classification procedures, new auditing procedures, and new conflicts of interest policies and procedures.

Timeframe for Implementation: January - March 2001

- The inspection manual currently in use by the on-site inspection staff will be reviewed and updated to ensure that the new laws and regulations are adequately addressed. In addition,

training sessions will be conducted to explain the practical aspects of the new regulations to the supervisory and legal staff of the NBG.

Timeframe for Implementation: April - May 2001

- An Accreditation Program for the banking supervision staff will continue to be implemented. There will be three additional courses presented during the year 2001. These courses are intended to ensure that the staff has the basic skills necessary to carry out the regulatory objectives and procedures of the NBG.

Timeframe for Implementation: February 2001 and one course each quarter thereafter

3.1.2 Off-Site Supervision. The Parties shall achieve the following benchmarks with regard to Off-Site Supervision:

- Introduce new monthly financial/regulatory reports and schedules based on the new Chart of Accounts, which will be submitted by the commercial banks to the NBG. Develop instructions and a mapping schedule for the reports.

Timeframe for Implementation: December 2000

- Review timely submission and accuracy of the new monthly reports submitted by the commercial banks to the NBG and affirm their adherence to the new Chart of Accounts and IAS.

Timeframe for Implementation: January - March 2001

- First Irish Consultants have been working with the NBG's Bank Supervision IT Department to develop a data based information system. In conjunction with this project, the off-site department will develop an off-site analytical report/tool that will be derived from the new financial reports and will contain quarterly financial ratios and peer group data similar to the Uniform Bank Performance Reports ("UBPR"). This report can be used by both off-site and on-site analysts to monitor trends, identify potential problems at an early stage and help develop a more tailored scope for the on-site inspections

Timeframe for Implementation: December 2000 – March 2001

- Provide training for the analysts in the use of the "UBPR", focusing on trend, ratio and peer group analysis.

Timeframe for Implementation: March - April 2001

- Design and implement a system for the Off-site, On-site and Policy Divisions of Department of Banking Supervision whereby all information, (financial and regulatory reports, inspection reports, quarterly CAEL reports, enforcement documents and correspondence) for each commercial bank is centralized and easily accessible to Supervisory staff.

Timeframe for Implementation: March - April 2001

- Design and implement an off-site surveillance system with information from the commercial banks, which focuses on identifying potential problems in the banking system on a macro/consolidated basis.

Timeframe for Implementation: May 2001

3.1.3 Problem Bank Resolution. The Parties shall achieve the following benchmarks with regard to resolving problem banks.

- Review the NBG newly approved "System for Supervisory Actions of the Activity of Commercial Banks" to determine whether it serves the purpose of taking timely, appropriate, and effective corrective action on banks facing potential difficulties. If needed, refine such system in order for Bank Supervision to have the necessary tools to correct problem situations before the trust of the depositors and other creditors decreases and the bank's financial condition deteriorates further.

Timeframe for Implementation: November–December 2000

- Identify each institution that is not reporting compliance with the applicable capital regulation or has a composite rating of 4 or 5.

Timeframe for Implementation: December 2000-February 2001

- Review each of the undercapitalized and 4 or 5-rated institution's financial performance and develop a case priority

system whereby each institution is prioritized according to its level of problems and systemic risk to the banking sector. (Special emphasis will be placed on the larger banks as they pose a greater systemic risk to the banking sector).

Timeframe for Implementation: January – March 2001

- Develop and recommend a staffing plan for the NBG based upon the identified workload according to the aforementioned priority system

Timeframe for Implementation: February – March 2001

- Implement supervisory and enforcement action where applicable (e.g. targeted inspections, remedial agreements, memoranda of understanding, cease and desist order, temporary administrators, etc.).

Timeframe for Implementation: March – May 2001

- Based on the analysis of the problem banks' financial condition and any submitted re-capitalization plan, make initial determinations as to which institutions can be rehabilitated and which are beyond reasonable help. With regard to the institutions that can be rehabilitated, formulate a precise plan of action that minimizes the cost of resolution without exacerbating the risk to the banking system. These plans can include the following: 1) require a bank to raise new capital in a reasonable timeframe or 2) arrange for the bank to be acquired by a larger, well-capitalized bank, depending on specific circumstances.

Timeframe for Implementation: June – July 2001 for the initially identified problem banks and ongoing thereafter.

- With respect to the institutions that are beyond reasonable help, coordinate with the Resident IMF Advisor the closing of the bank, revoking of its license and its smooth transfer to the Bank Supervision Division of Liquidation. This action must be taken in a timely fashion in order to minimize the cost of resolution.

Timeframe for Implementation: June – July 2001 for the first identified bank and ongoing thereafter.

3.1.4 Legislative, Regulatory and Judicial Reform The parties shall achieve the following benchmarks with regard to the following elements of legislative, regulatory and judicial reforms.

- A review of the need for a Georgian Regulatory Attorney to work with the Banking Supervision Department will be undertaken with appropriate recommendations to the Senior Management of the NBG.

Timeframe for Implementation: January 2001

- The task of analyzing and recommending amendments to the "Law on the Activities of Commercial Banks" will be expanded to include critical proposals to also amend in relevant part "The Civil Code", "The Criminal Code", "The Civil Procedures Law", "The Administrative Procedures Code" and the "Administrative Violations Code". These amendments will be necessary to achieve proper enforceability of banking and securities laws. In addition, all such amendments will be rendered consistent with laws and regulations relating to the bankruptcy, insolvency, and collateral and other secured transactions. The task will entail collaborative contact with the Securities Commission of Georgia to establish a regime of functional regulation of underwriting and broker-dealer activities by banks and their affiliates.

Timeframe for Implementation: January – March 2001

- The task of analyzing and recommending amendments to the "Law on the National Bank of Georgia" shall be expanded to include appropriate supporting analysis of the Constitution of Georgia and other relevant organic laws. The emphasis of this analysis will be on seeking ways to sustain the independence of the NBG. This analysis will include consultations with the Legal Department of the NBG and with selected constitutional specialists including the Chief Judge of the Supreme Court of Georgia.

Timeframe for Implementation: January - March 2001

- The task of drafting the exact amendatory language embodying all agreed legislative recommendations, submitting it jointly through the NBG Supervision Department and NBG Legal Department to the NBG Board for approval. Upon completion of this, these will then be sent to the proper Ministries for review and to the banking community for comment.

Timeframe for Implementation: February - March 2001

- Recommendations will be given on the development and installation of Credit Information Bureau to assist banks in their credit investigations and to bring more credit management disciplines to lending and borrowing sector.

Timeframe for Implementation: April 2001

- Recommendations will be given on the development of corrective actions in accordance with international practices to be developed by the NBG to assist it in establishing policies and procedures under law in deciding whether and how to rehabilitate problem banks.

Timeframe for Implementation: May - June 2001

- Recommendations will be given on regulatory policies with respect to various types of micro-finance institutions and draft regulations will be submitted to the NBG implementing these policies after analysis and discussion by the NBG with a micro-finance specialist consultant brought in on a medium term basis to assist in the formulation of policies and regulations aimed at these entities.

Timeframe for Implementation: August – October 2001

The following are timeframes for completing the drafts on specific comments and recommendations for specific laws:

- Final draft comments on amendments to the “The National Bank Act”.

Timeframe: February 2001

Enactment Timeframe: April 2001

- Final draft comments on the commercial banking law to be entitled “The Law of Georgia on Banks and Financial Institutions”.

Timeframe: February 2001

Enactment Timeframe: September 2001

The following are timeframes for completing the drafts and submitting the relevant comments to the NBG on the noted regulations and decrees:

- Asset Classifications and Loan Loss Reserves

Timeframe: December 2000

- Conflicts of Interest and Related Party Transactions
Timeframe: January 2001
- Internal Audit Requirements
Timeframe: January 2001
- Minimum and Risk Adjusted Capital Requirements
Timeframe: March 2001
- Prompt Corrective Actions
Timeframe: April 2001
- Mergers of Banks and of Persons Who Control Them
Timeframe: May 2001
- Credit Concentration and Large Exposures
Timeframe: June 2001
- Liquidity Requirements
Timeframe: July 2001
- Fixed Asset Limitations
Timeframe: August 2001
- Licensing and Branching
Timeframe: September 2001
- Foreign Exchange Exposures
Timeframe: October 2001
- Securities Activities and Investment Classification
Timeframe: November 2001
- Holdings and Activities of Persons Who Control Banks
Timeframe: December 2001

3.1.5 Bank Accounting: The parties shall achieve the following benchmarks with regard to accounting issues:

- A memorandum detailing proposals relating to direct, and indirect, technical assistance to commercial banks, including proposed handover arrangements relating to EU TACIS Help Desk and the

selection of local accounting personnel, from the beginning of 2001 will be developed, discussed and agreed with relevant personnel and implemented.

Timeframe for Implementation: December 2000 – March 2001

- Position statements on the key accounting issues, relevant to the introduction of the approved IAS Chart will be formulated and understanding will be promoted throughout accounting and bank supervision departments.

Timeframe for Implementation: November 2000 – April 2001

- In order to strengthen NBG enforcement of international accounting standard two accounting regulations, entitled General Accounting Policies for Commercial Banks and Accounting for Repossessed Assets, will be developed. The accounting principles underlying these regulations will be explained to staff from accounting methodology department.

Timeframe for Implementation: November – December 2000

- A mapping guide facilitating the transfer of account balances will be reviewed and recommendations made for improvement, and modification, where necessary.

Timeframe for Implementation: November – December 2000

- In order to ensure a commercial bank gets a consistent and comprehensive response to a written request for information, concerning accounting issues relating to introduction of new IAS chart, accounting and reporting practices, a recommended written reply, or other advice, will be provided when requested.

Timeframe for Implementation: Beginning in November 2000 and continuing throughout the year 2001

- In order to address frequently asked accounting questions by commercial banks, relating to issues concerning accounting conversion, a Guidance Paper on accounting conversion issues will be prepared for issue to commercial banks with approved chart of accounts and descriptions manual.

Timeframe for Implementation: December 2000

- A proposed Internal Audit Manual, supporting a recommended Internal Audit Regulation will be reviewed and edited with a view to ensuring compatibility with the current requirements concerning the development of an internal audit function in commercial banks. Once the Regulation and Internal Audit Manual are approved seminars for commercial banks and bank supervision staff will be held for the purposes of explaining the principles inherent in the regulation and enhancing understanding, and applicability, of the listed procedures.

Timeframe for Implementation: February 2001

- Develop accounting regulations required for the complete adoption of international accounting, and reporting, standards including any deemed necessary to support other NBG regulatory and supervisory decrees, orders or regulations. Ten regulations will be formulated and proposed to accounting methodology department. *These regulations will deal with the accounting treatment of fixed assets, depreciation, loan portfolio, foreign exchange, investments and securities, taxation issues, provisions and contingencies, trading instruments, head office and branch accounting, and end of year accounting adjustments.*

Timeframe for Implementation: April - November 2001

- The new IAS Chart and Accounts Descriptions Manual will be reviewed in the light of implementation phase experiences and a report on findings will be delivered to accounting department.

Timeframe for Implementation: January – February 2002

Article 4 – Selected Topics for Seminars/Presentations

- The Booz-Allen staff will provide a formal presentation on the one-year results of the Banking Supervision Program to USAID and other relevant Officials in Tbilisi.

Timeframe for Implementation: January 2001

- Seminars will be organized for banks supervision staff so as to deal with questions on new IAS Chart and IAS compliant accounting practices. At least three accounting related seminars will be organized. Additionally, a written response will be provided to

bank supervision staff following a written request for guidance or clarification of an accounting related matter.

Timeframe for Implementation: January – February 2001 and October 2001 – February 2002

- In consultation with other accounting consultants working with commercial banks, identify accounting issues impeding IAS introduction, develop and deliver training programs to commercial bank accounting personnel. One training program will be delivered every three months commencing April 2001.

Timeframe for Implementation: April, July, October 2001 and January 2002.

- An accounting seminar on the purpose and use of an external audit will be developed for the bank supervision staff, the commercial bank accountants, and other appropriate commercial bank personnel. The training will consist of the purpose of an audit, the proper scope for an audit, the difference between an audit and an inspection, the various types of opinions, and how to determine if an auditor's recommendations have been implemented.

Timeframe for Implementation: May – June 2001

- Seminar on the Newly Passed Banking Laws and Regulations and on Supervisory and Regulatory Policies will be provided.

Timeframe for Implementation: October 2001

Article 5. Standard Provisions

5.1 It is planned that the assistance contemplated under this Work Plan will occur over the period from approximately November 15, 1999 through February 15, 2002 or such later date as the Parties may agree upon in writing.

5.2 Unless otherwise directed by USAID, title to all property furnished by USAID pursuant to this contract shall be transferred to the NBG. If property furnished by USAID is used for purposes other than those which will further the Goals and Objectives of this Work Plan, the return of such property may be warranted and USAID will be entitled to the return of the property or a refund of the amount disbursed for such property in U.S. Dollars.

5.3 The Parties shall provide each other with information as may be needed to facilitate provision of the assistance, but at a minimum, the NBG must provide the information necessary for the advisors to fulfill their responsibilities in a competent manner.

5.4 This Work Plan may be amended or modified as agreed to by written agreement of the Parties.

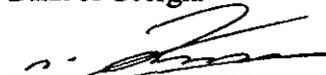
5.5 The Suspension of this Work Plan may be effected by either party, in the event of:

- The failures of either party to comply with any provision of this Work Plan that is not the result of a contradiction the policy of the Government of that party;
- The determination by either party that an extraordinary situation has occurred which makes it improbable that either the purpose of the Work Plan will be attained or that either party will be able to comply with the provisions of this Work Plan; or
- The determination by either party that continuation of the assistance would result in a violation of law or regulation of the Government of that party.

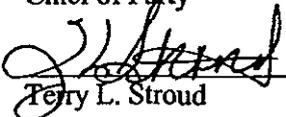
5.6 Either Party may terminate this Work Plan, in whole or in part, by giving the other party written notice of at least 90 days. In the event of partial suspension, such notice shall specify affected activities.

5.7 This Work Plan shall be effective when signed by all Parties.

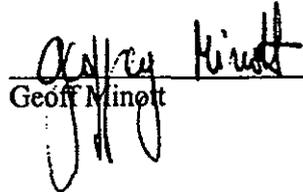
On Behalf of the National Bank of Georgia
The President of the National
Bank of Georgia


Mr. Irakli Managadze

On Behalf of Booz-Allen
Chief of Party


Terry L. Stroud

On Behalf of USAID


Geoff Minott

DATE: 2/14/01

ADDENDUM

To

Booz-Allen Work Plan

Work Plan for IAS Technical Assistance to Commercial Banks

Article 2. Goals and Objectives

An effective accounting, management reporting and internal control systems are essential to the safety and soundness of a commercial bank. National bank supervisors are keenly interested in how commercial bank managers use and report their financial and accounting information. Reliable and consistent financial reporting is essential to the overall effectiveness of a banking supervisory program.

The Georgian banking system is still in the beginning stages of accounting reform process. The National Bank of Georgia (the "NBG") has issued a new Chart Of Accounts (the "new COA"), together with accompanying individual account descriptions, in an IAS compliant format for commercial banks in Georgia. Formal conversion of the accounting system to this new COA for all commercial banks were effective January 1, 2001. However, even after the formal conversion, it will take considerable time until the system functions in an efficient and effective manner, at the transactions level, so that the information produced is useful for bank supervisory analytic purposes. The conversion to the new COA is an important first step in this process, but is largely mechanical and does not ensure that IAS-compliant accounting procedures will be used on a comprehensive consistent manner. Adoption of the new COA, when fully and properly implemented, will provide meaningful financial information to allow the NBG supervisors to monitor the financial condition and earnings of the commercial banks in a consistent and reliable manner.

2.6 **Commercial Bank Accounting Reforms.** The primary goal is to facilitate the full implementation of International Accounting Standards by commercial banks in Georgia. This effort encompasses the following objectives:

- The conversion of accounting practice of the Georgian banking system to a Chart of Accounts (COA) which is consistent with International Accounting Standards (IAS).
- The development and implementation of IAS-compliant accounting policies and procedures including internal control requirements.
- The preparation of IAS-compliant external and internal reporting.
- The preparation of management reporting to enhance banks' risk management capacity.
- The development of an internal audit function to upgrade banks' internal control function.
- The development of Georgians trained in the fundamentals of bank accounting who can constitute the basis for professional level training and mentoring in the banking system after the conclusion of this project.

Article 3. Benchmarks

3.1.6 Commercial Bank Accounting. The following steps and/or actions will be taken to accomplish the goals and objectives of the Commercial Bank Accounting Reforms:

- Identify six commercial banks (the “pilot banks”) to receive on-site direct assistance in the implementation of the new chart of accounts in conformity with International Accounting Standards. The criteria employed will be: one of the largest ranked by assets, a CAMEL rating of 3 or better, meets the ‘going concern’ assumption, under Georgian control, a demonstration of commitment to accounting reform and a formal expression of an interest in receiving such assistance.

Timeframe for Implementation: January 2001

- Receive a written approval for work at these pilot banks from the President of the National Bank of Georgia. Obtain written invitations from the pilot banks confirming their desire for assistance and their willingness to provide office space and other facilities as requested.

Timeframe for Implementation: February 2001

- Coordinate the transition of accounting technical assistance provided by the TACIS project. Consider and interview all TACIS Georgian accounting professional staff members expressing an interest in joining the USAID project. Obtain all documentation and information available on the six pilot banks and IAS accounting issues in general.

Timeframe for Implementation: February - March 2001

- Conduct initial interviews with the pilot bank chief accountants and senior management and perform an initial review of the financial statements of the pilot banks. Review off-site reports and any available on-site inspection reports. In this regard, determine whether the initial conversion has been properly accomplished at the transaction level. Make arrangements with the pilot bank management to spend significant amount of time on-site, as warranted, at each of the pilot banks to determine in more detail the actual progress of the conversion to International Accounting Standards. This procedure would include reviewing the beginning balances at January 1, 2001 confirming cross-over conversion adjustments to the ending balances of December 31, 2000.

Timeframe for Implementation: March - April 2001

- Meet with consultants from the USAID Georgia Enterprise Support project to become familiar with their progress to date and plan future coordination.

Timeframe for Implementation: March 2001

- Obtain copies of audit adjustments proposed by external auditors for the pilot bank's fiscal year 2000 financial statement audits. Determine if the adjustments were posted by the bank and, if not, why. Analyze the nature and scope of the proposed adjustments in light of the cross-over adjustments made by the banks, if any. Audit adjustments are one of the primary tools in diagnosing a bank's progress in conversion to International Accounting Standards.

Timeframe for Implementation: March - May 2001

- During on-site inspections of the pilot banks, provide on-the-job assistance to NBG inspectors in the review of accounting related matters and development of related report comments. At the completion of the inspection field work, follow up with the subject bank as needed to assist the chief accountant with reporting and accounting questions. Specific areas in which assistance will be provided will vary depending on the needs of the each bank. In addition, assistance will be provided, as warranted, to adjust the accounting and reporting deficiencies noted during the inspection.

Timeframe for Implementation: March 2001 and on-going

- Provide on-site direct assistance and training as needed (see additional formal training activities scheduled in the overall project plan) to ensure full implementation and conversion. This procedure may include detail review of individual transaction entries, monthly accrual and valuation adjustments. The actual needs for each individual pilot bank may vary, depending on the level of expertise of those responsible for financial reporting, the size of the banks, types of transactions, and organizational structure.

Timeframe for Implementation: April 2001 and on-going

- As requested and warranted, utilizing our local staff accountants, provide additional written opinions regarding accounting issues to the staff of the commercial banks. Train local staff accountants regarding this process, including: (a) research techniques, (b) structure of written opinions, and (c) maintenance of adequate filing system and documentation for future reference.

Timeframe for Implementation: April 2001 and on-going

- Conduct training seminars for chief accountants of the banks IAS concepts and related standards on below listed areas, frequently asked questions (FAQs), issues considered complex and relevant in implementation of the new chart of accounts, and issues arising from the compliance with the new call reports. Selected IAS concepts and areas are:

1) Accrual Accounting	April 2001
2) Fixed Assets and Depreciation	July 2001
3) Loans and Investments	October 2001
4) External Audit, Audit Adjustments Audited Financial Statements w/ Notes	January 2002

Timeframe for Implementation: Quarterly Scheduled as Above

- Based on the insight gained from working with the six pilot banks and through the issues addressed by the project help desk, develop a list of needed revisions to the chart of accounts and to National Bank instructions to commercial banks. Such revisions should address the need for modifications in accounting practices due to changes in International Accounting Standards and to resolve any discrepancies in current National Bank instructions.

Timeframe for Implementation: June 2001 and on-going

- Working with the National Bank off-site inspection staff and Resident Advisor, follow up on the preparation of monthly financial reports and schedules to NBG by the pilot banks. Assist pilot bank personnel in any areas of difficulty in interpreting preparation instructions.

Timeframe for Implementation: July 2001 and on-going

- Build upon the efforts above on monthly financial reports and schedules to NBG, help develop management reporting system of the pilot banks to enhance banks' risk management capacity. Utilize where possible a management reporting model developed by the USAID sponsored assistance to the national banks of other CIS countries.

Timeframe for Implementation: August 2001 and on-going

- Conduct an assessment of the pilot banks' internal control environment and internal control structure over the financial reporting cycle for adequacy and effectiveness. This procedure would include review of accounting policies and procedures, its compliance with the IAS, and approved by the bank's board of directors. The policies and procedures may differ depending on each bank's size, type of services and products offered. The effectiveness of the internal controls over the financial reporting also depends on the existence of internal audit monitoring and enforcement function over the bank's compliance with the existing internal policies and procedures.

Timeframe for Implementation: September - October 2001

- Working with the National Bank's proposed draft regulation on Internal Audit Requirements for Commercial Banks, perform a review of the pilot banks' current internal audit function for possible compliance with the regulation. Offer assistance considered necessary by the pilot banks in interpretation and implementation of the regulation upon issuance.

Timeframe for Implementation: November 2001 and on-going

- Analyze the tax laws of the Republic of Georgia to the extent necessary to determine appropriate accounting entries. In accordance with IAS, it is necessary for banks to identify the temporary and permanent differences between IAS and tax accounting. In this way, appropriate tax liabilities and deferred taxes can be recorded in the general ledger under IAS. Based on this analysis, prepare materials to be incorporated in the training seminars for commercial bank accountants.

Timeframe for Implementation: December 2001 and on-going

- Assist the pilot banks with the reconciliation of significant general ledger accounts and year-end closing process. Review the prior year audit adjustments to ensure that current financial statements reflect the recommendations of the audit report. Ensure that the chief accountants understand their responsibilities in preparation of the annual financial statements, discuss the independent annual financial statement audit process and how the audit adjustments indicate weaknesses in the banks accounting process.

Timeframe for Implementation: December 2001 - February 2002

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Terms of Reference Matrix

COMPARISON WITH THE TOR

Bank Supervision and Enforcement Program

Tasks	Results Achieved	Comments/Suggestions
30 DAY BENCHMARK		
<p>Within one month of arrival in country, the Contractor shall provide USAID and the NBG with a written Proposed Implementation Plan and Timeline ("Proposed Work plan") for achievement of all Tangible Results and Benchmarks. A key element of this Proposed Work plan shall be the inclusion of measurement tools to determine the effectiveness of the program in meeting ENI and Program strategic Objectives.</p> <p>The Proposed Work plan must also take into consideration possible interactions and synergies between the Market Reform, Democracy and Governance, IRM and other USAID programs, discuss possible joint efforts with the Chief of Parties and recommend mutually reinforcing efforts between the activities.</p> <p>The Proposed Implementation Plan and Timeline will be revised based on findings and conclusions from the assessments to be completed at the 60 DAY BENCHMARK as needed and a Final Implementation Plan and Timeline ("Work plan") shall be submitted to USAID by the 60 DAY BENCHMARK. USAID will determine the acceptability of the Work plan.</p>	<p>A work plan for each year of phase I was prepared and agreed to, with the NBG and the USAID. An additional work plan was developed for the added accounting component. Please note that the work plan reflected the actual current needs and were more different in specifics from the original more general TOR. The differences were due to a variety of reasons as follows: updated needs, prioritization of needs during Phase I, and responsibilities handled by IMF, Treasury etc. The work plans were fully deliberated upon by NBG and USAID before adoption. A signed copy of both work plans is included as an exhibit to this report.</p>	
60 DAY BENCHMARKS		
<p>1. Completion of an acceptable comprehensive assessment of the existing substantive and technical framework for each of the following:</p> <ul style="list-style-type: none"> • on-site supervision (the "On-site Assessment" or "OA") • off-site supervision (the "Off-Site Assessment" or "OFFA") • license revocation and approval procedures (the "Licensing Assessment" or "LA"); • early regulatory intervention, problem bank resolution, and bank liquidation framework ("Resolution and Liquidation Assessment" or "RLA) bank accounting (the "Bank Accounting Framework Assessment" or "BAFA"), and; • Legal framework for the Georgian banking sector, (the "Legal Framework Assessment" or "LFA") with special consideration to proposed or pending amendments to the current Law of the National Bank and Law on Banking Activities. 	<p>A complete and comprehensive assessment was made on the responsibilities and functions of the on-site and off-site divisions and relevant issues for improving the BSD were incorporated in the work plan.</p> <p>The USAID program did not get involved with the licensing procedures involving the approvals of or revocations due to the fact that these functions were the responsibility of the IMF Resident Advisor. This was negotiated and agreed upon with the IMF Advisor and USAID.</p> <p>A comprehensive and complete analysis was performed on the Law of the National Bank and the Law on the Activities of Commercial Banks. This assessment resulted in the complete redrafting of both laws which were eventually approved and enacted by the Georgian Parliament.</p>	

Tasks	Results Achieved	Comments/Suggestions
<p>• Organizational framework and management systems in place for the BSD (the "Organization Development Assessment" or "ODA") with special attention to Strategic Planning, Management Training and Professional Development, US based training with a US bank regulatory agency for at least 10 NBG employees, an Examiner Certification Program, Strategic Coordination of Donor Technical Assistance, Internal and External Communications and Public Outreach, and Harmonization with International Banking Standards, corruption, fraud, money laundering and other forms of illegal activity, on the banking sector in Georgia (the "Anti-Corruption, Fraud and Money Laundering Assessment" or "ACFMLA"),</p> <p>Primary source documents to be translated into English where necessary and attached to the assessment</p>	<p>An accreditation program for the NBG's inspectors was designed and implemented. 4 of the 5 courses were customized and presented to the entire banking supervision staff. Additional details on the status of each of these courses are provided in the narrative of the final report.</p> <p>During the first phase, a conscious decision was made to limit the US based training for the NBG inspectors until the accreditation program had been fully implemented and delivered to the inspection staff. However certain staff of the NBG was selectively chosen for US based training.</p>	<p>The 5th course in the accreditation program will be provided in July 2002.</p>
<p>2. Completion of an acceptable technical assistance-training plan based upon the assessments for all listed categories above, which shall serve as the Final Implementation Plan and Timeline ("Work plan"). The Work plan shall be submitted to USAID and USAID will determine the acceptability of the Work plan</p>	<p>As stated above, an inspector accreditation program was developed and 4 of the 5 courses were developed and implemented during phase I.</p>	
<p>3. Provision of technical assistance and training to the NBG and to the BSD</p>		
<p>4. Identification of any significant weaknesses in the legal framework for bank liquidations and provision of input to the NBG's decision making process on whether a liquidation entity should be created</p>	<p>Significant weaknesses in the legal framework for bank liquidations were identified. They were then corrected by amendments to the commercial banking legislation in October, 2001. The amendments diminished the role of the courts in the appointment of liquidators significantly depoliticizing the liquidation process. The amendments also corrected a major flaw in depositor claim priorities in liquidation, placing all depositors before all creditors except secured creditors, consistent with international standards. The amendments also introduced bridge banks as a tool in aid of liquidations. However, All day-to-day issues involving liquidations were under the scope of work of the IMF Resident Advisor. This was coordinated and approved by the CTO and the local mission staff.</p>	

<p>5. Provision of written preliminary recommendations to USAID on money laundering legislation and anti-monopoly legislation. Commencement and training in implementation of revised asset classification regulation, policies and procedures.</p>	<p>Per the USAID decision directly, full responsibility for the implementation of money laundering activities was given to the Advisors of the US Treasury. A new asset classification regulation was implemented in January 2001 and training was provided to the NBG inspectors.</p>	
<p>6. Work has begun on an assessment and/or survey of possible obstacles to credit access for businesses and individuals (the "Access to Credit Report" or "ACR"). The ACR includes a detailed work-plan for integration of bank supervision technical assistance into other programs designed to increase the breadth and fairness of credit access to credit in Georgia</p>	<p>USAID did not want the work on a Credit Information Bureau to commence during Phase I of this program.</p>	
<p>7. Planning for implementation of two (2) Regional Bank Supervision conferences to be sponsored by the NBG as agreed between USAID and the Contractor in the Work Plan has begun. Consideration is given to coordination with the BIS Transcaucasion Bank Supervision Group and any other currently established ongoing meetings of regional banking supervisors in addition to USAID's Annual ENI Bank Supervision Conference.</p>	<p>Two Regional Banking Supervision Conferences were held in which the NBG's Supervisory Department was the host and moderator.</p>	
<p>180 DAY BENCHMARKS</p>		
<p>Task 1 - INSTITUTIONAL DEVELOPMENT OF THE BSD • On-site Supervision Provision of on-the-job (OTJ) training to NBG examiners on at least five regular on-site examinations with detailed written feedback to the examiners and the examiner-in-charge (the "EIC") on areas of strengths and weaknesses.</p>	<p>At the end of 180 days, the resident advisor was involved in 6 inspections and a written assessment was provided to the staff on the accuracy and quality of the inspector's findings.</p>	
<p>Completion of at least two training classes for on-site supervisors.</p>		
<p>• Off-site Analysis Provision of assistance to the off-site staff in the preparation of at least ten institution profiles and implementation of the simulation model introduced by the IMF with detailed written feedback to the BSD staff on areas of strengths and weaknesses.</p>	<p>The workings of the off-site staff were completely revised and a new reporting system was devised. An assessment on the CAEL write-ups for all 29 banks was performed and written feedback was provided to the management and each of the analysts in the off-site department.</p>	
<p>Task 2- INSTITUTIONAL DEVELOPMENT OF THE PROBLEM BANK RESOLUTION UNIT Assistance provided to the NBG on recommendations for activity restrictions or other actions on all banks with CAMEL ratings of 4 or 5.</p>	<p>Several new enforcement techniques including the issuance of Memorandums of Understandings and Cease and Desist Orders. These were developed and utilized during the 1st phase of this program in an attempt to eliminate or at least minimize the problems of the subject banks.</p>	

<p>Task 3-INSTITUTIONAL DEVELOPMENT OF ACCOUNTING STANDARDS AND REGULATORY REPORTING</p> <p>Assistance provided to the NBG in a pilot analysis of at least three key banks to determine whether compliance with IAS is acceptable and whether conversions to IAS have been completed on the transaction level.</p>	<p>The USAID program only became responsible for the accounting conversion in March 2001. At that time the resident advisors and the NBG selected 7 pilot banks began to assist (on a daily basis) in the conversion to International Accounting Standards ("IAS").</p>	
<p>Task 4-INSTITUTIONAL DEVELOPMENT OF THE LEGAL DEPARTMENT AND LEGAL FRAMEWORK</p>		
<p>Completion of at least one training course for the Legal Department based on finding of the assessment of the LFA.</p>	<p>No formal training of the NBG Legal Department was provided for, under the USAID work plan. However, on-the-job training for the Legal Department was informally accomplished through working closely on legal reforms with the three principal Legal Department lawyers in legislative, regulatory and transactional matters on a regular basis. This collaboration exposed them to methods of legal implementation of international standards of supervision and enforcement. It introduced them to new legal policies and approaches used to implement and support the wider reforms being instituted by the USAID Program throughout the financial sector.</p>	
<p>Completion of a comparative analysis between the current legal framework for the Georgian banking sector (the "Comparative Legal analysis" or "CLA") and: Regional banking sectors with relevant macroeconomic, trade or other potential impacts on Georgia; and</p>	<p>No CLA was provided for in the USAID Program. This exercise would have required extended person-days and resources.</p>	
<p>Other leading banking sector models including the United States, selected European Countries, the European Union Banking Directives and selected advanced transitional countries.</p>	<p>Leading banking sector law models including those of the United States, those of the Basle Committee on Bank Supervision and those of selected transitional economies were availed of.</p>	
<p>Task 5 ORGANIZATION DEVELOPMENT AND TRAINING At least two employees of the NBG have attended US based training.</p>		
<p>Implementation of The Examiner Certification Program has commenced.</p>	<p>The accreditation program commenced in the spring of 2000 with the first course, Introduction to Accounting, being presented at that time.</p>	
<p>Task 9 - REGIONAL BANK SUPERVISION CONFERENCES Dates, sites and proposed agendas for both Regional Bank supervision Conferences are finalized.</p>	<p>See the above noted comment in this area.</p>	

ONE YEAR BENCHMARKS		
<p>Task 1 - INSTITUTIONAL DEVELOPMENT OF THE BSD</p> <ul style="list-style-type: none"> • On-site Supervision <p>Provision of on-the-job (OTJ) training to NBG examiners on at least 9 regular on-site examinations with detailed written feedback to the examiners and the examiner-in-charge (the "EIC") on areas of strengths and weaknesses.</p>	<p>At the end of the first year, the resident advisor had been involved in the inspection of 12 banks. Each of the inspection reports on these 12 banks was translated into English for review and editing. Written feedback was then provided to the senior management of the NBG.</p>	
<p>Completion of at least two training classes for on-site supervisors.</p>	<p>2 of the 5-accreditation classes were provided during the 1st year of this program.</p>	
<ul style="list-style-type: none"> • Off-site Analysis <p>Provision of assistance to the off-site staff in the preparation of at least ten institution profiles and implementation of the simulation model introduced by the IMF with detailed written feedback to the BSD staff on areas of strengths and weaknesses.</p>	<p>The CAEL reports for each individual bank operating in Georgia, are prepared on a quarterly basis. The appropriate Resident Advisor for the quality of its analysis and content then reviewed each of these reports. Formal workshops were then provided to help point out the strengths and weaknesses of the reports.</p>	
<p>Task 2-INSTITUTIONAL DEVELOPMENT OF THE PROBLEM BANK RESOLUTION UNIT</p> <p>Assistance provided to the NBG on recommendations for activity restrictions or other actions on all banks with CAMEL ratings of 4 or 5.</p>		
<p>Task 3- INSTITUTIONAL DEVELOPMENT OF ACCOUNTING STANDARDS AND REGULATORY REPORTING</p> <p>Assistance provided to the NBG in a pilot analysis of at least three key banks to determine whether compliance with IAS is acceptable and whether conversions to IAS have been completed on the transaction level.</p>	<p>7 pilot banks were selected in which the resident advisors were to assist the bank's management in the implementation of IAS.</p>	
<p>Task 4-INSTITUTIONAL DEVELOPMENT OF THE LEGAL DEPARTMENT AND LEGAL FRAMEWORK</p> <p>Completion of at least one training course for the Legal Department based on finding of the assessment of the LFA.</p>	<p>As stated before, no formal training of the NBG Legal Department was provided for in the USAID Program. However, on-the-job training for the Legal Department was informally accomplished through working closely on legal reforms with the three principal Legal Department lawyers in legislative, regulatory and transactional matters on a regular basis. This collaboration exposed them to methods of legal implementation of international standards of supervision and enforcement. It introduced them to new legal policies and approaches used to implement and support the wider reforms being instituted by the USAID Program throughout the financial sector.</p>	

<p>Completion of a comparative analysis between the current legal framework for the Georgian banking sector (the "Comparative Legal Analysis" or "CLA"), and; Regional banking sectors with relevant macroeconomic, trade or other potential impacts on Georgia, and;</p>	<p>As explained before, no CLA was provided for in the USAID Program.</p>	
<p>Other leading banking sector models including the United States selected European countries, the European Union Banking Directives and selected advanced transitional countries.</p>	<p>Leading banking sector law models including those of the United States, those of the Basle Committee on Bank Supervision and those of selected transitional economies were availed of.</p>	
<p>Task 5- ORGANIZATION DEVELOPMENT AND TRAINING At least two employees of the NBG have attended US based training.</p>		
<p>Implementation of The Examiner Certification Program has commenced.</p>		

Tasks	Results Achieved	Comments/Suggestions
EIGHTEEN MONTH BENCHMARKS		
<p>Task I - INSTITUTIONAL DEVELOPMENT OF THE BSD • On-site Supervision Provision of on-the-job (OTJ) training to NBC examiners on at least 13 regular on-site examinations with detailed written feedback to the examiners and the examiner-in-charge (the "EIC") on areas of strengths and weaknesses.</p>	<p>At this point in the program, the resident advisor had been involved in the inspections of 18 banks.</p>	
<p>Completion of at least 4 training class for on-site supervisors. Class includes coverage of any significant changes or updates to the On-site manual.</p>		
<p>• Off-site Analysis Assistance provided for the off-site staff in the preparation of at least 20 institution profiles and implementation of the simulation model introduced by the IMF with detailed written feedback to the BSD staff on areas of strengths and weaknesses.</p>		
<p>Case studies based on the institution profiles are prepared and presented in at least 2 training sessions focused on any areas of weakness in the off-site capacity discovered during the profile assistance.</p>		

Georgia

Bank Supervision and Enforcement Program

Tasks	Results Achieved	Comments/Suggestions
TWENTY FOUR MONTH BENCHMARKS		
<p>Task 1 - INSTITUTIONAL DEVELOPMENT of THE BSD</p> <ul style="list-style-type: none"> • On-site Supervision <p>Provision of on-the-job (OTJ) training to NBC examiners on at least 17 regular on-site examinations with detailed written feedback to the examiners and the examiner-in-charge (the "EIC") on areas of strengths and weaknesses.</p>	<p>At the end of 24 months, the resident advisor had participated in the inspection of 24 banks. The resident advisor on the strengths and weaknesses of the inspectors' work provided written analysis and feedback.</p>	
<p>Completion of at least 5 training classes for on-site supervisors. Class includes coverage of any significant changes or updates to the On-site manual.</p>	<p>See previous comments on the accreditation program.</p>	
<ul style="list-style-type: none"> • Off-site Analysis <p>Assistance to the off-site staff in the preparation of at least 25 (institutions may be repeated) institution profiles and implementation of the simulation model introduced by the IMF.</p>	<p>Each quarter this type of analysis is prepared by the BSD staff and reviewed by the resident advisors.</p>	
<p>Case studies based on the institution profiles are prepared and presented in at least 3 training sessions focused on any areas of weakness in the off-site capacity discovered during the profile assistance.</p>	<p>Numerous workshops and cases studies were prepared on individual banks.</p>	
<p>Task 2- INSTITUTIONAL DEVELOPMENT OF THE PROBLEM BANK RESOLUTION UNIT</p> <p>Assistance provided to the NBC on recommendations for activity restrictions or other actions on all banks with CAMEL ratings of 4 or 5.</p>		
<p>Case studies based on problem bank assistance are prepared and presented in at least three training sessions focused on any areas of weakness in the problem bank capacity discovered during the assistance.</p>		
<p>Task 3- INSTITUTIONAL DEVELOPMENT OF ACCOUNTING STANDARDS AND REGULATORY REPORTING</p> <p>Assistance provided to the NBG in the analysis of at least 9 key banks to determine whether compliance with IAS is acceptable and whether conversions to IAS have been completed on the transaction level.</p>	<p>See the previous comments on the selection of 7 pilot banks that were selected to receive training and assistance in the implementation of IAS.</p>	

<p>Lessons learned and weaknesses in the Georgian Banking system's compliance with IAS are compiled with concrete recommendations on any needed institutional strengthening to deepen the level of compliance with IAS and increase transparency.</p>		
<p>Task 4- INSTITUTIONAL DEVELOPMENT OF THE LEGAL DEPARTMENT AND LEGAL FRAMEWORK Completion of at least 4 training courses for the Legal Department based on findings of the LFA and CLA.</p>	<p>No formal training of the NBG Legal Department was provided for, in the USAID Program. However, on-the-job training for the Legal Department was informally accomplished through working closely on legal reforms with the three principal Legal Department lawyers in legislative, regulatory and transactional matters on a regular basis. This collaboration exposed them to methods of legal implementation of international standards of supervision and enforcement. It introduced them to new legal policies and approaches used to implement and support the wider reforms being instituted by the USAID Program throughout the financial sector.</p>	
<p>The LFA and CLA are updated to incorporate any changes in the legal framework.</p>	<p>No CLA was provided for in the USAID Program. This exercise would have required extended person-days and resources.</p>	
<p>Task 5- ORGANIZATION DEVELOPMENT AND TRAINING All ten (10) employees of the NBG who have attended US based training, have made presentations to colleagues at the NBC on the subject matter areas in which they received training. Train-me-trainer certification shall have been completed for these individuals pursuant to the Examiner Certification Program.</p>		

03/27/02