GOVERNANCE: AUDIT COMMITTEE REPORT

Committee Membership and Qualifications

The Committee continued in 2015 to comprise four non-executive directors of whom two are independent NEDs, Nikoloz Enukidze and Stefano Marsaglia. Nikoloz has in the past been Chairman of Bank of Georgia and Stefano is chairman of investment banking at Mediobanca. The other two committee members, Eric Rajendra and myself, were originally nominated to the Supervisory Board by two of the Bank's shareholder IFIs, IFC and EBRD respectively. The Board, after assessing our links with the respective shareholders, the fact that we have been acting "independent" in letter and spirit on all matters concerning the bank, and how the Board would expect to assess our independence under the key benchmarks of the UK Corporate Governance Code, has deemed us to be independent.

All current members of the Committee (the committee membership and respective biographies are set out on the Bank's Investor Relations website) possess a detailed understanding of the financial sector, with backgrounds primarily in banking, and most have served on (or chaired) other banks' audit and also risk committees. The Committee therefore has sufficient recent and relevant expertise to operate effectively and calls upon other expert internal and external resources when required.

The Audit Committee is acutely aware of the even higher standards expected of the Bank's disclosure, record-keeping and controls associated with its intended Premium Listing and will continue to work to ensure these are fully met and maintained.

Committee Role and Meetings

The Audit Committee, which holds delegated authority from the Supervisory Board and powers explicitly attributed to it by Law, has multiple areas of responsibility and focus. Its first priority is to ensure the integrity (accuracy and full disclosure) of the Bank's financial reporting, looking hardest at areas of reporting risk, supervising the proper interpretation of accounting rules. Second, the Committee oversees the Bank's systems of internal control in relation to financial reporting, fraud and compliance with prevailing laws and regulations, also evaluating management's competence in this task. The Committee relies heavily on Internal Audit to provide an objective and professionally sceptical view of how the Bank is handling a number of key reporting and record-keeping tasks. The Committee also makes recommendations on the appointment and remuneration of external auditors and seeks to maximise the value of the external audit relationship.

In relation to Risk, the Bank has a separate Risk Committee (which Nikoloz Enukidze chairs and of which I am a member) and, while there are areas of overlap (e.g. in relation to operational risk), the two committees each have defined responsibilities and cooperate extensively to minimise duplication and ensure nothing is overlooked. Under forthcoming accounting rule changes, in particular IFRS9, the work of the Audit and Risk committees of banks in general will share many of the same complex issues of judgement and policy.

The Bank continues to grow with the Georgian economy and is accumulating market share in certain key areas. Nevertheless, the Audit Committee is conscious of the 'macro' headwinds facing the global and regional economy which does not leave Georgia unscathed. Therefore, the Audit Committee remains more vigilant than ever in seeking, with the help of external and internal auditors as well as management, to ensure in critical areas, such as the calculation of loan impairments, the accuracy at particular points in time of our financial releases and internal records. The more challenging economic context also potentially raises the operational risks within the Bank and again these are being closely monitored. One initiative planned for 2016 is the implementation of a 'whistleblowing' or anonymous hotline for staff or external entities to alert the Bank to any potentially unsatisfactory practices.

The Committee met formally in person in each quarter of 2015 (March, June, September, December), in accordance with the Bank's quarterly financial reporting cycle and the cycle of Supervisory Board meetings. There were regular interim telephone meetings, mostly around planned releases of financial data, and also ad hoc communications between members and with Internal Audit, external auditors and management.

The table below describes the committee composition and formal meeting attendance for 2015:

Audit Committee Composition

Name	Position	Year of Appointment	Scheduled Meetings Eligible To Attend	Scheduled Meetings Attended	Additional Meetings Eligible to Attend	Additional Meetings Attended
Nicholas Dominic Haag	Chairman	2013	4	4	9	9
Eric J. Rajendra	Member	2012	4	4	9	9
Nikoloz Enukidze	Member	2014	4	4	9	9
Stefano Marsaglia	Member	2014	4	2	9	8

The Bank's CEO, CFO and other management board members (in particular the CRO) were on occasion invited to participate in Audit Committee meetings together routinely with the Head of Internal Audit. Minuted meetings generally took place on the day prior to Supervisory Board meetings and the Audit Committee made a formal report as a separate agenda item in the latter, this also being minuted.

The Audit Committee Policy of the Bank is set out on the Bank's Investor Relations website.

This Policy document was last reviewed, amended and agreed by the Committee in February 2014 and approved by the Board in March 2015.

Assessment of Effectiveness

The Audit Committee Effectiveness Review is conducted every year by the Board and the individual Committee members in order to assess the Audit Committee's performance, as per international best practice standards.

The review conducted for the year 2015 was completed in March 2016 and concluded that the Committee operates effectively and carries out all its responsibilities as laid out in its Charter.

Planning and Release of Financial Statements

Since 2014 (and IPO) the Audit Committee assumed the role of comprehensively pre-vetting all audited and auditor-reviewed financial releases. Accordingly, the Audit Committee reviewed during the year the releases of half-year and full-year financial statements, making recommendations to the Supervisory Board to approve these. The Committee also had pre-release sight of the third quarter results and held discussions with management about each of these releases, typically with a multi-stage drafting, review and approval process. The Audit Committee has reviewed all data and narrative comment and concluded that the full year financial statements are complete, clear, balanced and consistent with the Committee's understanding of the facts. Likewise, we considered and are satisfied with transparency on the Bank's liquidity and capital adequacy statements.

The Audit Committee held multiple audit planning meetings with PWC in 2015, commencing formal audit planning in June. The Audit Committee had the opportunity, without management present, to highlight areas it wished the external audit to focus on, flagging relevant issues and trends. The Committee has evolved towards a policy of regular quarterly face to face status discussions with PWC as part of its formal Audit Committee meeting agendas, proactively and mutually addressing any material audit or control issues. PWC has started to attend not only Audit Committee but also parts of Supervisory Board, as well as Management Board, meetings. In addition, as Chairman of the Audit Committee, I have regular, candid and free-form private sessions with PWC also between Committee and Board meetings. In recent meetings with PWC, in addition to discussion around valuation of fixed assets, impairment of intangible assets and other topics, we have focused on the Bank's new methodology for calculating loan impairments and provisioning and on the interpretation of, preparedness for and implications of IFRS 9 on banks in general. The Bank has embarked on a tender to select an adviser to assist it on preparing for implementation of IFRS 9 and to ensure that we are in a position as soon as possible to guide investors and other key constituencies on these important changes and what they may mean for the Bank.

Other Areas of Audit Committee Focus

We have assessed the reasonableness and appropriateness of critical accounting policies. The main area of accounting judgment involved the valuation of loans issued and related impairment charges and loan loss provisions.

The Bank revised the accounting treatment of its portfolio of investment securities. These changes are described in detail in the financial statements. The investments that the Bank intends and has the ability to hold to maturity are now classified as Bonds Carried at Amortised Cost in the Consolidated Statement of Financial Position, some GEL372M of such securities being recorded at year end, the vast majority being Ministry of Finance Treasury Bills. In accordance with IAS 39, these investments were moved from the Available for Sale category to Loans and Receivables category. The Audit Committee discussed this change, also with PWC, and is satisfied that it meets best practice disclosure and gives extra clarity on the composition and purpose of the portfolio.

The most significant change in the Bank's accounting estimates over 2015 was the implementation of the Bank's new provisioning policy and definition of non-performing loans. The Audit Committee has worked closely alongside the Risk Committee and members of the Management Board (in particular the Bank's Chief Risk Officer) in designing and implementing the Bank's enhanced loan loss provisioning methodology with detailed advice from a specialist external adviser, Deloitte. The Audit Committee believes that this policy is now more accurate in assessing impairments of the loan portfolio, benefiting from more granular segmentation of the portfolio and comprehensive assessment of risk parameters for different loan segments, (calculated over 3 years of historic data). The Audit Committee notes that loan provisioning has risen from GEL150M to GEL194M over the course of 2015 and this latter sum would have been GEL5.6M higher under the previous provisioning methodology. The Audit Committee is satisfied, based on a review of the new methodology, questions posed to the Finance and Risk teams and conversations with external auditors, that this presents a realistic picture of the credit status of the Bank's loan portfolio. The Bank has also moved to a revised and more market-typical definition of non performing loans as loans 90 days+ past due or loans with underlying well-defined weaknesses regardless of the existence of any past-due amount or of the number of days past due. Audit Committee believes that this definition is more meaningful than the one the Bank previously used. The Audit Committee, benefiting from work streams led by the Risk Committee, continues to monitor on a regular basis major individually-assessed loans on the Bank's watch list and collectively-assessed loans including those that are less than 90 days past due (and not yet classified as impaired) to calibrate any deterioration of credit quality that may feed through into impairments.

The Audit Committee has also paid close attention to the changes in the reporting and operational segmentation of the Bank's different businesses and clients, an evolution partly designed to reflect the Bank's integration of Bank Constanta. Certain borrowers and depositors have been recategorised from the Retail segment to the Micro segment. The Audit Committee is satisfied that this presents a realistic view of the Bank's different businesses and is supported by changes to the Bank's management structures.

In 2015 the Bank carried out a revaluation of its own-use Land, Premises and Construction in Progress and investment property (for disclosure purposes) which resulted in some significant valuation increases. Baker Tilly was involved in this process. The Audit Committee is satisfied that reported increases in valuation were validated by a credible external specialist, this being the first external revaluation of Land, Premises and Construction in Progress since 2012, and used a process based on the real market valuation of equivalent assets adjusted for the specifics of our portfolio versus these benchmarks.

In 2015 Audit Committee undertook for the first time a review of the Bank's internal tax department. We interviewed this unit to satisfy ourselves on the adequacy of their resourcing, governance and quality of personnel. We investigated the key tax issues, scope for process automation and real time tax reporting in this area as well as their ability to forecast tax. We concluded that this unit is fit for purpose, is not overcomplicated by multiple tax jurisdictions and is in compliance with the Bank's tax obligations.

Internal Audit and Control Environment

The Audit Committee meets regularly with the Head of Internal Audit with no management present, and benefits from the department's objective assurance and insights. As chairman of the Committee, I am in at least monthly contact with the Head of Internal Audit. The Committee routinely reviews Internal Audit's annual and rolling 3 year plan, provides feedback on it and authorises any changes to its scope. We provide targets for and formal assessment of Internal Audit and ensure that it is effective, suitably embedded in the organisation and respected by management and of use to them. The head of Internal Audit now routinely attends monthly Management Board meetings. Audit Committee solely determines Internal Audit's budget and compensation. We are satisfied that Internal Audit has sufficient resources to perform its role and Audit Committee has where necessary requested additional funds for Internal Audit to purchase the training and tools necessary for it to function effectively.

We have extended the remit of Internal Audit. Internal Audit now undertakes its own assessment of financial and regulatory reporting to give the Committee (and management) further assurance on the integrity of our reported numbers. We have also asked Internal Audit to assess, in the second half of 2016, the adequacy and effectiveness of the Bank's revised risk management framework to ensure that it is being implemented according to plan. Internal Audit has expanded its role to include the internal audit of branches previously within Constanta Bank (which used to have its own internal audit function). Internal Audit played an important role in 2015 in the investigation of a couple of internal fraud cases. As soon as these frauds came to light, Internal Audit escalated them to the Audit Committee (and to Bank management) in accordance with newly-refined escalation procedures and the consequences were calibrated and contained.

Audit Committee has increasingly organised Internal Audit's plan to be risk-weighted (ie investigate the higher risk priorities more frequently and in greater depth) and also more flexible, allowing it to conduct one-off projects where the Supervisory or Management Boards wish it to undertake special investigations arising from situations where the Bank may have heightened vulnerability. Internal Audit plans to invest in specialist software and has down-selected a preferred vendor to speed up some of its more routine tasks, allowing it to concentrate on its most added-value missions.

As usual, we have reviewed the robustness of the Bank's controls, working with external auditors and also with Internal Audit to track closely any identified shortcomings and scrutinising remediation follow-up with vintage analyses being carefully maintained. KPIs in respect of the reduction of deficiencies identified by Internal Audit, however minor, continue to be cascaded down to branch and departmental level and also included in KPIs for members of the Management Board. Audit Committee regularly reviews progress in this vital discipline and alerts the Chief Executive officer, divisional heads and the full Supervisory Board where it occasionally sees intractable problems and insufficient effort at continuous process improvement. The Audit Committee was pleased to note that in 2015 there was an improvement in the rate of remediation of deficiencies identified by Internal Audit. Audit Committee has asked Management and Internal Audit to ensure that the operational standards of previous Constanta Bank branches, whilst improving, are brought up to the high level existing in the rest of the Group. We have also asked Internal Audit to monitor more regularly the control standards in all subsidiaries of the Group, in particular at TBC Kredit in Azerbaijan given the deteriorating economy in this country.

In 2015 the Bank undertook a review of the information security resilience of the Bank, with the help of a specialist external adviser. This has brought to light a number of areas for improvement. Audit Committee is very focused on in particular cyber security and access control within the Bank, these areas being subject to special ongoing review with the head of the Bank's IT division delegated to lead the improvement process. A specialist IT internal auditor was hired and has already extensively reported and will continue to do so. We have also asked our external auditor PWC to probe the Bank's information technology systems general controls and fraud risk assessment procedures to the extent necessary for its annual financial audit process.

Audit Committee has sought to involve all Management Board members in contributing to Internal Audit's 2016 audit plan by identifying all key processes under individuals' supervision and ranking them in a priority-based hierarchy. The intention is to use this as a double check to ensure that Internal Audit and the Audit Committee are properly aware of all processes and risk areas within the Bank and to drive risk-awareness, accountability and involvement for all members of senior management.

External Auditor Independence and Reappointment

The Audit Committee is responsible for the assessment of the performance, objectivity and independence of the external auditor and the delivery of a quality audit. Each year the Audit Committee is required to consider the reappointment of the auditors, the suitability of the lead engagement partner as well as the wider audit team and the remuneration and terms of engagement for the chosen auditor. 2015 has been the eighth year in which PWC has audited the

Bank. We remain satisfied that PWC continues to offer an independent, professional and cost-effective service. We reached this decision on the basis of their openness to challenge, our perception of their proper independence from management, the very low level of prior year financial restatements and PWC's proven ability to meet our tight reporting deadlines. It is the Committee's current intention, subject to suitable contract terms, to recommend that we proceed with PWC for the year 2016 audit, after which we will consider whether it would be appropriate to conduct an external audit tender.

Audit Committee is rigorous in ensuring that all non-audit assignments to PWC are vetted by us in order to ensure the proper independence of judgement of our external auditor. We have hired PWC for work associated with our Premium Listing as this is justified by the synergies with their role as our external auditor. The Audit Committee and management are in agreement that we should look to other providers for future non-audit services where they offer an economically and professionally equivalent alternative. The Audit Committee policy adopted in 2015 formally introduces new rules on the engagement and remuneration of the Bank's external auditor in relation to the performance of non-audit services. Essentially, we will only use PWC for non-audit services where such a contract has been pre-cleared with Audit Committee and where there is either a clear synergy with PWC's audit role or where PWC offers superior competence or materially better commercial terms. As stated, we remain satisfied that PWC demonstrates a sufficient degree of independence and objectivity in its role as the Bank's external auditor.

Mr. Nicholas Haag

Chairman of the Audit Committee