FLAG FINANCIAL CORP
Form 10-K
March 31, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

COMMISSION FILE NO. 0-24532

FLAG FINANCIAL CORPORATION
(Exact name of Registrant as specified in its charter)

GEORGIA	58-2094179
State or other jurisdiction of. incorporation or organization).	(I.R.S. Employer Identification No.)

3475 PIEDMONT ROAD, N. E., SUITE 550, ATLANTA, GA 30305
(Address of principal executive offices)

(404) 760-7700
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK, $1.00 PAR VALUE

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2): Yes X No _

The aggregate market value of the Registrant's outstanding Common Stock held by

non-affiliates of the Registrant on June 30, 2002 based on 7,310,760 shares was approximately $78,078,917.

As of March 21, 2003 there were 8,410,290 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on April 15, 2003, are incorporated by reference in Part III hereof.

FLAG FINANCIAL CORPORATION
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

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SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. These forward-looking statements may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by the forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate," and similar expressions are intended to identify the forward-looking statements. The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

(1) The effects of future economic conditions;

(2) Governmental monetary and fiscal policies, as well as legislative and regulatory changes;

(3) The risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;

(4) The effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in the Company's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, and computer and the Internet; and

(5) The failure of assumptions underlying the establishment of reserves for possible loan losses and estimations of values of collateral and various financial assets and liabilities.

All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements.

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PART I

ITEM 1. BUSINESS

THE COMPANY

Flag Financial Corporation ("Flag" or the "Company") is a bank holding company headquartered in Atlanta, Georgia and is registered under the Bank Holding Company Act of 1956, as amended. The Company is the sole shareholder of Flag Bank (the "Bank") and was incorporated under the laws of the State of Georgia on February 9, 1993.

As a bank holding company, the Company facilitates the Bank's abilities to serve its customers' requirements for financial services. The holding company structure provides greater financial and operating flexibility than is available to the Bank. For example, the Company may assist the Bank in maintaining its required capital ratios by borrowing money and contributing the proceeds of the debt to the Bank as primary capital. Additionally, the Articles of Incorporation and Bylaws of the Company contain terms that provide a degree of anti-takeover protection to the Company that is currently unavailable to the Bank and its shareholders under regulations of the Federal Deposit Insurance Corporation (the "FDIC"), but is permissible for the Company under Georgia law.

Flag is also a service provider of mortgage, investment and insurance services though Flag Mortgage, Flag Investment Services and Flag Insurance Services. All of these services are provided by a division of Flag Bank.

Flag's website address is www.Flag.net. You may obtain free electronic copies of our annual reports and Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports at the investor relations section of our website. These reports are available on our website as soon as reasonably practicable after we electronically file them with the SEC.

THE BANK

Flag Bank is a state bank organized under the laws of the State of Georgia with banking offices in the following cities and counties: Atlanta (Fulton County, Dekalb County and Cobb County), Unadilla (Dooly County), Vienna (Dooly County), Montezuma (Macon County), Buena Vista (Marion County), LaGrange (Troup County), Hogansville (Troup County), Thomaston (Upson County), Stockbridge (Henry County) and Suwanee (Forsyth County), Georgia. Flag Bank was originally chartered in 1931 as the Citizens Bank and became a wholly-owned subsidiary of the Company through a series of acquisitions commencing in 1998.

Flag Mortgage operates as a division of Flag Bank and operates mortgage loan production offices in Atlanta (Fulton County), LaGrange (Troup County), Columbus (Muscogee County) and Newnan (Coweta County), Georgia.

BUSINESS OF THE BANK. The Bank's business consists primarily of attracting deposits from the general public and, with these and other funds, making residential mortgage loans, consumer loans, commercial loans, commercial real estate loans, residential construction loans and securities investments. In addition to deposits, sources of funds for the Banks' loans and other investments include amortization and prepayment of loans, loan origination and commitment fees, sales of loans or participations in loans, fees received for servicing loans sold to others and advances from the Federal Home Loan Bank of Atlanta ("FHLBA"). The Bank's principal sources of income are interest and fees collected on loans, including fees received for originating and selling loans and for servicing loans sold to others, and, to a lesser extent, interest and dividends collected on other investments and service charges on deposit accounts. The Bank's principal expenses are interest paid on deposits, interest paid on FHLBA advances, employee compensation and office expenses and other overhead expenses.

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While the Bank attempts to avoid concentrations of loans to a single industry or based on a single type of collateral, the various types of loans the Bank makes have certain risks associated with them. Consumer and commercial loans present risks which, among other things, include fraud, bankruptcy, economic downturn, deteriorated or non-existing collateral, changes in interest rates and customer financial problems. Real estate construction loans present

risks related to, among other things, whether the builder is able to sell the property, whether the buyer is able to obtain permanent financing and the nature of changing economic conditions. Real estate mortgage loans present risks involving, among other things, economic and demographic changes, deterioration of collateral and customer financial problems.

The Company's primary asset is its stock in the Bank. Accordingly, its financial performance is determined primarily by the results of operations of the Bank. For information regarding the consolidated financial condition and results of operations of the Company as of December 31, 2002 and 2001 and for the three years in the period ended December 31, 2002, see "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Consolidated Financial Statements of the Company, and the related notes presented in Part II hereof. All average balances presented in this report were derived based on daily averages.

EMPLOYEES

As of December 31, 2002, the Company (including the Bank) had 230 full-time and 20 part-time employees. The employees are not represented by any collective bargaining unit, and the Company considers its relationship with its employees to be good.

COMPETITION

The banking business in Georgia is highly competitive. The Bank competes not only with other banks and thrifts that are located in the same counties as the Bank and in surrounding counties, but also with other financial service organizations including credit unions, finance companies, and certain governmental agencies. To the extent that the Bank must maintain non-interest earning reserves against deposits, it may be at a competitive disadvantage when compared with other financial service organizations that are not required to maintain reserves against substantially equivalent sources of funds. Also, other financial institutions with which the Bank competes may have substantially greater resources and lending capabilities due to the size of the organization.

SUPERVISION AND REGULATION

Both the Company and the Bank are subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of their operations. These laws are generally intended to protect depositors and not shareholders. The following discussion describes the material elements of the regulatory framework that applies to us.

THE COMPANY

Since the Company owns all of the capital stock of the Bank, it is a bank holding company under the federal Bank Holding Company Act of 1956. As a result, the Company is primarily subject to the supervision, examination, and reporting requirements of the Bank Holding Company Act and the regulations of the Federal Reserve.

ACQUISITIONS OF BANKS. The Bank Holding Company Act requires every bank holding company to obtain the Federal Reserve's prior approval before:

- acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank's voting shares;

- acquiring all or substantially all of the assets of any bank; or

- merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would result in or tend to create a monopoly or, substantially lessen competition or otherwise function as a restraint of trade, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve's consideration of financial resources generally focuses on capital adequacy, which is discussed below.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, the Company or any other bank holding company located in Georgia may purchase a bank located outside of Georgia. Conversely, an adequately capitalized and adequately managed bank holding company located outside of Georgia may purchase a bank located inside Georgia. In each case, however, restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, Georgia law prohibits a bank holding company from acquiring control of a financial institution until the target financial institution has been incorporated for three years. Because the Bank has been incorporated for more than three years, this limitation does not apply to the Bank or to the Company.

CHANGE IN BANK CONTROL. Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring "control" of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is refutably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

- the bank holding company has registered securities under Section 12 of the Securities Act of 1934; or

- no other person owns a greater percentage of that class of voting securities immediately after the transaction.

Our common stock is registered under the Securities Exchange Act of 1934. The regulations provide a procedure for challenging any rebuttable presumption of control.

PERMITTED ACTIVITIES. A bank holding company is generally permitted under the Bank Holding Company Act to engage in or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in the following activities:

- banking or managing or controlling banks; and

- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking.

Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

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- factoring accounts receivable;
- making, acquiring, brokering or servicing loans and usual related activities;
- leasing personal or real property;
- operating a non-bank depository institution, such as a savings association;
- trust company functions;
- financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- performing selected insurance underwriting activities.

Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness, or stability of it or any of its bank subsidiaries.

In addition to the permissible bank holding company activities listed above, a bank holding company may qualify and elect to become a financial holding company, permitting the bank holding company to engage in additional activities that are financial in nature or incidental or complementary to financial activity. The Bank Holding Company Act expressly lists the following activities as financial in nature:

- lending, trust and other banking activities;
- insuring, guaranteeing, or indemnifying against loss or harm, or providing and issuing annuities, and acting as principal, agent, or broker for these purposes, in any state;
- providing financial, investment, or advisory services;
- issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;
- underwriting, dealing in or making a market in securities;

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- other activities that the Federal Reserve may determine to be so

closely related to banking or managing or controlling banks as to be a proper incident to managing or controlling banks;

- foreign activities permitted outside of the United States if the Federal Reserve has determined them to be usual in connection with banking operations abroad;

- merchant banking through securities or insurance affiliates; and

- insurance company portfolio investments.

To qualify to become a financial holding company, the Bank and any other depository institution subsidiary of the Company must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least satisfactory. Additionally, the Company must file an election with the Federal Reserve to become a financial holding company and must provide the Federal Reserve with 30 days' written notice prior to engaging in a permitted financial activity. While the Company meets the qualification standards applicable to financial holding companies, the Company has not elected to become a financial holding company at this time.

SUPPORT OF SUBSIDIARY INSTITUTIONS. Under Federal Reserve policy, the Company is expected to act as a source of financial strength for the Bank and to commit resources to support the Bank. This support may be required at times when, without this Federal Reserve policy, the Company might not be inclined to provide it. In addition, any capital loans made by the Company to the Bank will be repaid only after its deposits and various other obligations are repaid in full. In the unlikely event of the Company's bankruptcy, any commitment by it to a federal bank regulatory agency to maintain the capital of the Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

THE BANK

Because the Bank is a commercial bank chartered under the laws of the State of Georgia, it is primarily subject to the supervision, examination and reporting requirements of the FDIC and the Georgia Department of Banking and Finance. The FDIC and Georgia Department of Banking and Finance regularly examine the Bank's operations and have the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. Both regulatory agencies have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Additionally, the Bank's deposits are insured by the FDIC to the maximum extent provided by law. The Bank is also subject to numerous state and federal statutes and regulations that affect its business, activities and operations.

BRANCHING. Under current Georgia law, the Bank may open branch offices throughout Georgia with the prior approval of the Georgia Department of Banking and Finance. In addition, with prior regulatory approval, the Bank may acquire branches of existing banks located in Georgia. The Bank and any other national or state-chartered bank generally may branch across state lines by merging with banks in other states if allowed by the applicable states' laws. Georgia law, with limited exceptions, currently permits branching across state lines through interstate mergers.

Under the Federal Deposit Insurance Act, states may "opt-in" and allow out-of-state banks to branch into their state by establishing a new start-up branch in the state. Currently, Georgia has not opted-in to this provision. Therefore, interstate merger is the only method through which a bank located outside of Georgia may branch into Georgia. This provides a limited barrier of entry into the Georgia banking market, which protects us from an important segment of potential competition. However, because Georgia has elected not to opt-in, our ability to establish a new start-up branch in another state may be

limited. Many states that have elected to opt-in have done so on a reciprocal basis, meaning that an out-of-state bank may establish a new start-up branch only if their home state has also elected to opt-in. Consequently, until Georgia changes its election, the only way we will be able to branch into states that have elected to opt-in on a reciprocal basis will be through interstate merger.

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PROMPT CORRECTIVE ACTION. The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) in which all institutions are placed.

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital levels for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets at the time it became undercapitalized or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital.

FDIC INSURANCE ASSESSMENTS. The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assigns an institution to one of three capital categories: (1) well capitalized; (2) adequately capitalized; and (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described above, with the "undercapitalized" category including institutions that are undercapitalized, significantly undercapitalized, and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution's primary federal regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. Assessments range from 0 to 27 cents per $100 of deposits, depending on the institution's capital group and supervisory subgroup. In addition, the FDIC imposes assessments to help pay off the $780 million in annual interest payments on the $8 billion Financing Corporation bonds issued in the late 1980s as part of the government rescue of the thrift industry. This assessment rate is adjusted quarterly and is set at 1.68 cents per $100 of deposits for the first quarter of 2003.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

COMMUNITY REINVESTMENT ACT. The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve or the FDIC shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on the Bank and the Company. Additionally, we must publicly disclose the terms of various Community Reinvestment Act-related agreements.

OTHER REGULATIONS. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. For example, under the Soldiers' and Sailors' Civil Relief Act of 1940, a lender is generally prohibited from charging an annual interest rate in excess of 6% on any obligation for which the borrower is a person on active duty with the United States military.

The Bank's loan operations are also subject to federal laws applicable to credit transactions, such as the:

- Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

- Soldiers' and Sailors' Civil Relief Act of 1940, governing the repayment terms of, and property rights underlying, secured obligations of persons in military service; and

- Rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

In addition to the federal and state laws noted above, the Georgia Fair Lending Act ("GFLA") became effective on October 1, 2002. GFLA imposes new restrictions and procedural requirements on most mortgage loans made in Georgia, including home equity loans and lines of credit. While many of the GFLA requirements will apply regardless of the interest rate or charges on the loan, "high cost home loans," as defined by GFLA, are subject to the most requirements.

Due to the high compliance burdens associated with high cost home loans in Georgia, the Company has determined that it will not make such loans in Georgia in 2003.

However, because the Company generally has not made a significant number of "high cost home loans" in prior years, ceasing to make high cost loans should not have a significant impact on the Company's lending volume. With respect to our other lending, we have implemented procedures to comply with GFLA.

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The deposit operations of the Bank are subject to:

- The Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and

- The Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

CAPITAL ADEQUACY

The Company and the Bank are required to comply with the capital adequacy standards established by the Federal Reserve, in the case of the Company, and the FDIC and Georgia Department of Banking and Finance, in the case of the Bank. The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for bank holding companies. The Bank is also subject to risk-based and leverage capital requirements adopted by the FDIC, which are substantially similar to those adopted by the Federal Reserve for bank holding companies.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets. Tier 2 Capital generally consists of subordinated debt, other preferred stock and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is limited to 100% of Tier 1 Capital. At December 31, 2002 our ratio of total capital to risk-weighted assets was 11.3% and our ratio of Tier 1 Capital to risk-weighted assets was 10.1%.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 Capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified

criteria, including having the highest regulatory rating and implementing the Federal Reserve's risk-based capital measure for market risk. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2002, our leverage ratio was 7.6%. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without reliance on intangible assets. The Federal Reserve considers the leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

The Bank and the Company are also both subject to leverage capital guidelines issued by the Georgia Department of Banking and Finance, which provide for minimum ratios of Tier 1 capital to total assets. These guidelines are substantially similar to those adopted by the Federal Reserve in the case of the Company and those adopted by the FDIC in the case of the Bank.

Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and certain other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements. See "-Prompt Corrective Action."

PAYMENT OF DIVIDENDS

The Company is a legal entity separate and distinct from the Bank. The principal sources of the Company's cash flow, including cash flow to pay dividends to its shareholders, are dividends that the Bank pays to its sole shareholder, the Company. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company as well as to the Company's payment of dividends to its shareholders.

The payment of dividends by the Company and the Bank may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. If, in the opinion of the federal banking regulator, the Bank were engaged in or about to engage in an unsafe or unsound practice, the federal banking regulator could require, after notice and a hearing, that the Bank stop or refrain from engaging in the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. See "-Prompt Corrective Action" above.

The Georgia Department of Banking and Finance also regulates the Bank's dividend payments and must approve dividend payments that would exceed 50% of the Bank's net income for the prior year. Our payment of dividends may also be affected or limited by other factors, such as the requirement to maintain adequate capital above regulatory guidelines.

At December 31, 2002, the Bank was unable to pay dividends to the Company without prior regulatory approval.

RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES

The Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- a bank's loans or extensions of credit to affiliates;
- a bank's investment in affiliates;
- assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and
- a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

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The Company and the Bank are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

PRIVACY

Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer or when the financial institution is jointly sponsoring a product or service with a nonaffiliated third party. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers.

ANTI-TERRORISM LEGISLATION

In the wake of the tragic events of September 11th, on October 26, 2001, the President signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally

require financial institutions to take reasonable steps-

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions must establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and
- an independent audit function to test the programs.

Pursuant to the mandate of the USA PATRIOT Act, the Secretary of the Treasury issued regulations effective April 24, 2002 applicable to financial institutions. Because all federally insured depository institutions are required to have anti-money laundering programs, the regulations provide that a financial institution which is subject to regulation by a "federal functional" is in compliance with the regulations if it complies with the rules of its primary federal regulator governing the establishment and maintenance of anti-money laundering programs.

Under the authority of the USA PATRIOT Act, the Secretary of the Treasury adopted rules on September 26, 2002 increasing the cooperation and information sharing between financial institutions, regulators and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Under the new rules, a financial institution is required to:

- expeditiously search its records to determine whether it maintains or has maintained accounts, or engaged in transactions with individuals or entities, listed in a request submitted by the Financial Crimes Enforcement Network ("FinCEN");
- notify FinCEN if an account or transaction is identified;
- designate a contact person to receive information requests;
- limit use of information provided by FinCEN to: (1) reporting to FinCEN, (2) determining whether to establish or maintain an account or engage in a transaction and (3) assisting the financial institution in

complying with the Bank Secrecy Act; and

- maintain adequate procedures to protect the security and confidentiality of FinCEN requests.

Under the new rules, a financial institution may also share information regarding individuals, entities, organizations and countries for purposes of identifying and, where appropriate, reporting activities that it suspects may involve possible terrorist activity or money laundering. Such information-sharing is protected under a safe harbor if the financial institution:

- notifies FinCEN of its intention to share information, even when sharing with an affiliated financial institution;

- takes reasonable steps to verify that, prior to sharing, the financial institution or association of financial institutions with which it intends to share information has submitted a notice to FinCEN;

- limits the use of shared information to identifying and reporting on money laundering or terrorist activities, determining whether to establish or maintain an account or engage in a transaction, or assisting it in complying with the Bank Security Act; and

- maintains adequate procedures to protect the security and confidentiality of the information.

Any financial institution complying with these rules will not be deemed to have violated the privacy requirements discussed above.

The Secretary of the Treasury also adopted a new rule on September 26, 2002 intended to prevent money laundering and terrorist financing through correspondent accounts maintained by U.S. financial institutions on behalf of foreign banks. Under the new rule, financial institutions:

- are prohibited from providing correspondent accounts to foreign shell banks;

- are required to obtain a certification from foreign banks for which they maintain a correspondent account stating the foreign bank is not a shell bank and that it will not permit a foreign shell bank to have access to the U.S. account;

- must maintain records identifying the owner of the foreign bank for which they may maintain a correspondent account and its agent in the Unites States designated to accept services of legal process;

- must terminate correspondent accounts of foreign banks that fail to comply with or fail to contest a lawful request of the Secretary of the Treasury or the Attorney General of the United States, after being notified by the Secretary or Attorney General.

The new rule applies to correspondent accounts established after October 28, 2002.

PROPOSED LEGISLATION AND REGULATORY ACTION

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive

relationships of the nation's financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

EFFECT OF GOVERNMENTAL MONETARY POLICES

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Bank's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

ITEM 2. PROPERTIES

The executive offices of the Company are located at 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia 30305. The Company leases this property. The Company and the Bank conduct business from facilities primarily owned by the Bank, all of which are in good condition and are adequate for the Bank's current and foreseeable needs. The Company and Flag Bank provide services or perform operational functions at 24 locations, of which 16 locations are owned and 8 are leased. See "Item 1 - Business" for a list of the locations in which the Company and the Bank have offices.

ITEM 3. LEGAL PROCEEDINGS

The Company and the Bank are periodically involved as plaintiff or defendant in various other legal actions in the ordinary course of their business. We do not believe that such litigation presents a material risk to the Company's business, financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted by the Company to a vote of its shareholders during the fourth quarter of 2002.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS

As of December 31, 2002, the Company had 811 shareholders of record. The following table sets forth the high and low sales prices for the Flag common stock, as reported by the Nasdaq Stock Market, and the cash dividends paid per share of common stock for the periods indicated.

Quarter	High	Low	Dividend

2003			
First (through March 26, 2003)	$13.39	$11.00	$ 0.06
2002			
Fourth	$11.60	$11.15	$ 0.06
Third	11.70	10.39	0.06
Second	11.25	9.94	0.06
First	10.25	9.10	0.06
2001			
Fourth	$ 8.60	$ 7.64	$ 0.06
Third	7.87	7.16	0.06
Second	7.00	6.01	0.06
First	7.38	6.38	0.06

Subject to board approval, the Company pays quarterly dividends on the first business day of January, April, July and October. See "Item 1 - Business - Supervision and Regulation - Payment of Dividends" for information regarding regulatory restrictions on the Company's ability to pay dividends.

During the first and second quarters of 2002, the Company issued a total of 1,272,000 shares of common stock and 1,272,000 warrants to purchase common stock to directors and members of senior management in a private placement under Rule 506 of the Securities Act of 1933, as amended. The purchase prices of the common stock and the exercise prices of the warrants are set forth below:

NO. OF SHARES AND WARRANTS	PURCHASE AND EXERCISE PRICE
1,068,000	$ 9.10
6,000	9.51
78,000	9.53
30,000	9.69
24,000	9.75
6,000	9.90
6,000	9.94
6,000	10.00
48,000	10.10

The increased prices represent adjustments necessary to match the price of the securities with the market price of the common stock at the time of the sale. The purchase price of the warrants was $1.00 per warrant in each case. The total number of securities authorized for issuance was 1.3 million shares and 1.3 million warrants.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is derived from and should be read in conjunction with our consolidated financial statements, which are included elsewhere in this report.

(In thousands except per share data)	2002	2001	2000	1999	1998
FOR THE YEAR					
Net interest income	$ 24,302	23,980	24,961	26,490	25,952
Provision for loan losses	4,549	2,488	3,597	4,656	3,475
Non-interest income	7,395	10,668	11,962	10,072	9,952
Non-interest expense	31,005	25,701	27,633	30,615	28,882
Income taxes	(2,028)	1,753	1,409	78	708
Extraordinary item	165	696	--	--	--
Net earnings (loss)	(1,994)	4,010	4,284	1,213	2,839
PER COMMON SHARE					
Basic earnings (loss) per share	$ (0.24)	.51	.52	.15	.35
Diluted earnings (loss) per share	(0.24)	.51	.52	.15	.34
Cash dividends declared	.24	.24	.24	.24	.20
Book value	7.24	7.33	6.83	6.43	6.92
AT YEAR END					
Loans, net	$374,784	368,967	384,661	419,079	424,660
Earning assets	569,755	520,290	507,929	521,452	568,133
Assets	636,131	570,202	559,037	587,870	635,192
Deposits	509,731	440,582	461,438	483,987	521,671
Stockholders' equity	60,749	54,023	55,498	53,197	56,869
Common shares outstanding	8,394	7,370	8,123	8,273	8,223
AVERAGE BALANCES					
Loans	$366,571	378,867	405,101	449,689	435,422
Earning assets	511,737	508,752	510,898	556,577	576,245
Assets	560,984	560,816	566,355	617,764	624,487
Deposits	442,645	449,985	455,338	496,998	505,337
Stockholders' equity	58,865	56,294	53,853	55,365	55,337
Weighted average shares outstanding	8,201	7,808	8,210	8,258	8,218
KEY PERFORMANCE RATIOS					
Return on average assets	(0.36%)	.72%	.77%	.20%	.45%
Return on average stockholders' equity	(3.39%)	7.12%	7.95%	2.19%	5.13%
Net interest margin, tax equivalent basis	4.86%	4.83%	4.99%	4.90%	4.56%
Dividend payout ratio	N/A	46.27%	45.98%	153.50%	49.49%
Average equity to average assets	10.49%	10.04%	9.51%	8.96%	8.86%

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Flag Financial Corporation ("Flag") is a bank holding company that owns 100 percent of the common stock of Flag Bank (the "Bank"). The Bank is a full-service, retail oriented bank primarily engaged in retail banking, small business, residential and commercial real estate lending, and mortgage banking.

The following discussion focuses on significant changes in the financial condition and results of operations of Flag during the three years ended December 31, 2002. This discussion and the financial information contained herein are presented to assist the reader in understanding and evaluating the

financial condition, results of operations, and future prospects of Flag and should be read as a supplement to and in conjunction with the Consolidated Financial Statements and Related Notes.

RECENT ACQUISITIONS

Effective November 8, 2002, the Bank acquired six branches located in metropolitan Atlanta from Encore Bank. Included in the purchase were real estate, personal property and other assets used in the operation of the branches, and $96 million in deposits. The Bank did not purchase or assume any loans in the transaction.

Effective November 12, 2002, Flag acquired a specialized real estate lending business from Atlanta-based Bankers' Capital Group, LLC (BCG), including approximately $23 million in loans subject to various participation interests. Principals of BCG include Flag Chairman and Chief Executive Officer, Joseph W. Evans, board member William H. Anderson and executives and board members J. Thomas Wiley, Jr. and Stephen W. Doughty. None of these individuals participated in Flag's evaluation or approval of the transaction in view of their positions as principals of BCG.

See Note 2 in the Notes to Consolidated Financial Statements for additional information regarding the Encore and BCG transactions.

Effective December 31, 2001, Flag sold selected loans, deposits and property of its bank branches in Milan and McRae, Georgia.

Effective September 30, 2000, Flag sold the loans, deposits and property of its bank branches in Cobbtown, Metter and Statesboro, Georgia.

Effective September 30, 2000, Flag sold the loans, deposits and property of its bank branches in Blackshear, Homerville and Waycross, Georgia.

On December 29, 2000, Flag acquired certain loans, deposits and property of bank branches in Montezuma, Oglethorpe, Cusseta and Buena Vista, Georgia.

RESULTS OF OPERATIONS

Flag recorded a net loss in 2002 of $1,994,000 or $0.24 per share, compared to net income of $4,010,000 or $0.51 per share in 2001 and net income of $4,284,000 or $0.52 per share in 2000.

Flag's net loss in 2002 resulted primarily from the $6,044,000 after tax charge taken in the first quarter to effect its management restructuring, loss on the early repayment of Federal Home Loan Bank (FHLB) advances, and a larger than normal addition to the provision for loan losses. Flag recorded after tax extraordinary items related to the early repayment of FHLB advances totaling $165,000 and $696,000 in 2002 and 2001, respectively.

NET INTEREST INCOME

Net interest income (the difference or spread between interest income on earning assets and interest expense on borrowed funds) is the largest component of Flag's operating income. Flag manages net interest income in a manner that realizes the largest spread while accepting certain levels of credit, liquidity and interest rate risks. Managing these risks requires systems and processes to identify and evaluate these risks at various levels in the organization. Net interest income was $24.3 million in 2002, compared to $24.0 million and $25.0

million in 2001 and 2000, respectively. Flag's margin has been pressured downward over the past few years by a decreasing interest rate environment. Flag's refinancing of FHLB advances in 2001 and 2002, coupled with aggressive repricing efforts on the deposit base, helped Flag reduce interest rate expense by approximately 38% during 2002, and more than offset decreases in interest income. Net interest margin increased to 4.86% in 2002 compared to 4.83% and 4.99% in 2001 and 2000, respectively.

Total interest income in 2002 was $36.7 million, compared to $44.5 million and $46.4 million in 2001 and 2000, respectively. Yields on average earning assets in 2002 decreased to 7.28% from 8.87% in 2001 and 9.18% in 2000. The falling interest rate environment, evidenced by a prime rate of 4.25% at the end of 2002 versus 8.50% at the beginning of 2000, has been the largest contributor to lower yields on earning assets.

Total interest expense in 2002 was $12.4 million, compared to $20.6 million and $21.4 million in 2001 and 2000, respectively. Aggressive repricing of deposit accounts, accompanied by early repayment and refinancing of FHLB debt, has allowed Flag to significantly reduce interest expense over the time frame discussed. Flag's total deposits cost 2.81%, 4.06%, and 4.17% in 2002, 2001 and 2000, respectively, while FHLB and other borrowings cost 2.16%, 5.70% and 6.34% over the same time periods. (see TABLES 1 & 2).

TABLE 1 - CONSOLIDATED AVERAGE BALANCES, INTEREST, AND RATES - TAXABLE EQUIVALENT BAS
(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31,						
	2002			2001			
	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	WEIGHTED AVERAGE RATE	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	WEIGHTED AVERAGE RATE	AVERA BALAN
ASSETS							
Interest-earning assets:							
Loans	$366,571	29,702	8.10%	378,867	36,798	9.71%	405,1
Taxable investment securities	120,364	6,513	5.41%	107,777	6,825	6.33%	84,8
Tax-free investment securities	10,294	768	7.46%	10,155	887	8.74%	11,1
Interest-bearing deposits in other banks.	1,748	74	4.23%	2,962	159	5.37%	2,7
Federal funds sold.	12,760	186	1.46%	8,991	435	4.84%	7,0
Total interest-earning assets	511,737	37,243	7.28%	508,752	45,104	8.87%	510,8
Other assets.	49,247			52,064			55,4
Total assets.	$560,984			560,816			566,3
LIABILITIES AND STOCKHOLDERS' EQUITY							
Interest-bearing liabilities:							
Interest-bearing demand							

deposits	$131,967	2,151	1.63%	109,375	2,494	2.28%	90,5
Savings deposits.	25,322	214	0.85%	25,283	371	1.47%	27,1
Other time deposits	244,113	8,900	3.65%	267,703	15,381	5.75%	284,3
Federal funds purchased . .	3,406	54	1.59%	3,210	158	4.92%	7,9
FHLB advances and other borrowings	48,715	1,053	2.16%	37,768	2,151	5.70%	30,3
Total interest-bearing liabilities . .	453,523	12,372	2.73%	443,339	20,555	4.64%	440,2
Non-interest bearing demand deposits.	41,243			47,624			53,3
Other liabilities	7,353			13,559			18,8
Stockholders' equity.	58,865			56,294			53,8
Total liabilities and stockholders' equity. .	$560,984			560,816			566,3
Tax-equivalent adjustment		570			569		
Net interest income		24,301			23,980		
Interest rate spread.			4.55%			4.23%	
Net interest margin			4.86%			4.83%	
Interest-earning assets/ interest-bearing liabilities			113%			115%	

CONSOLIDATED AVERAGE BALANCES, INTEREST, AND RATES

TABLE 1 presents for the three years ended December 31, 2002, average balances of interest-earning assets and interest-bearing liabilities, and the weighted average interest rates earned and paid on those balances. In addition, interest rate spreads, net interest margins and the ratio of interest-earning assets versus interest-bearing liabilities for those years are presented. Average interest-earning assets were $511.7 million in 2002 versus $508.8 million in 2001 and $510.9 million in 2000. Average interest-bearing liabilities were $453.5 million in 2002 versus $443.3 million and $440.3 million in 2001 and 2000, respectively.

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Flag's ratio average earning assets to average total assets was 91.2% in 2002, 90.7% in 2001 and 90.2% in 2000

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TABLE 2 shows the change in net interest income from 2001 to 2000 and from 2000 to 1999 due to changes in volumes and rates.

TABLE 2 - RATE/VOLUME VARIANCE ANALYSIS - TAXABLE EQUIVALENT BASIS
(DOLLARS IN THOUSANDS)

	YEARS ENDED DECEMBER 31,					
	2002 COMPARED TO 2001			2001 COMPARED TO 2000		
		RATE/	NET		RATE/	NET

	VOLUME	YIELD	CHANGE	VOLUME	YIELD	CHANGE
INTEREST INCOME:						
LOANS	$(1,005)	(6,091)	(7,096)	(2,564)	(651)	(3,215)
TAXABLE INVESTMENT SECURITIES . . .	681	(993)	(312)	1,453	(99)	1,354
TAX-FREE INVESTMENT SECURITIES .	10	(129)	(119)	(89)	115	26
INTEREST-BEARING DEPOSITS IN OTHER BANKS	(20)	(65)	(85)	13	(17)	(4)
FEDERAL FUNDS SOLD.	55	(304)	(249)	93	(67)	26
TOTAL INTEREST INCOME.	(279)	(7,582)	(7,861)	(1,094)	(719)	(1,813)
INTEREST EXPENSE:						
INTEREST BEARING DEMAND DEPOSITS. .	515	(858)	(343)	464	(198)	266
SAVINGS DEPOSITS.	1	(158)	(157)	(36)	(128)	(164)
OTHER TIME DEPOSITS	(1,355)	(5,126)	(6,481)	(948)	92	(856)
FEDERAL FUNDS PURCHASED	10	(114)	(104)	(303)	(45)	(348)
FHLB ADVANCES AND OTHER BORROWINGS.	623	(1,721)	(1,098)	471	(245)	226
TOTAL INTEREST EXPENSE	(206)	(7,977)	(8,183)	(352)	(524)	(876)
NET INTEREST INCOME	$ (73)	395	322	(742)	(195)	(937)

NON-INTEREST INCOME

Total non-interest income decreased to $7.4 million in 2002 from $10.7 million in 2001 and $12.0 million in 2000. The decrease in other income in 2002 resulted largely from the absence of a gain on the sale of branches. Flag recorded gains on the sale of branches in 2001 of $3.3 million and $5.1 million in 2000.

Service charges on deposit accounts decreased during 2002 to $3.5 million from $3.9 million in 2001and $3.5 million in 2000. The decrease in 2002 from 2001 is due largely to the sale of two branch offices in December 2001 with approximately $31 million in deposits. The increase in 2001 over 2000 levels relates in part to increased demand deposits and lower earnings credits.

Mortgage banking activities includes origination fees, service release premiums and the gain on the sale of mortgage loans originated solely for the purpose of being sold. The lower interest rate environment, coupled with more effective originators, helped Flag improve the income from its mortgage banking activities in 2002 by 21% as compared to 2001. Total income from mortgage banking activities increased to $2.9 million in 2002 from 2001 and 2000 levels of $2.4 million and $1.7 million, respectively.

Effective December 31, 2001, Flag sold selected loans, deposits and property of its branches in Milan and McRae, Georgia and recognized a gain on sale of approximately $3.3 million.

During 2000, Flag sold the loans, deposits and property of its bank branches in Cobbtown, Metter and Statesboro, Georgia and recognized a gain on sale of approximately $2.0 million. Flag also sold the loans, deposits and property of its bank branches in Blackshear, Homerville and Waycross, Georgia and recognized a gain on sale of approximately $3.1 million.

NON-INTEREST EXPENSES

Salary and employee benefits increased during 2002 to $18.6 million from $13.9 million in 2001 and $14.4 million in 2000. The increase in 2002 relates largely to the management restructuring undertaken in the first quarter of 2002, in which Flag took a special charge related to buyouts of employment contracts and severance of approximately $3.1 million. The decrease in 2001 compared to 2000 relates to the lower number of staff due to the sale of branch offices during 2000.

Occupancy expenses continued a trend, decreasing to $3.6 million in 2002 from $3.8 million in 2001 and $4.3 million in 2000. This positive trend for Flag is the result of an effort to consolidate branch offices to improve individual branch performance as well as that of the consolidated company. This effort has resulted in 16 offices being closed or sold since the beginning of 2000.

Professional fees increased to $1.8 million from $1.2 million in 2001 and were flat against 2000 levels of $1.7 million. The higher amounts in 2002 relate to approximately $350,000 of professional fees related to the management restructuring and private placement effected in the first quarter, whereas the higher amounts in 2000 relate to the professional fees incurred in conjunction with branch divestiture in six markets. Other expenses increased slightly over the prior year to $3.8 million from $3.7 million. Other expenses were $5.0 million in 2000 and relate in part to increased operating and conversion expense associated with the disposition of branches in six markets.

INVESTMENT SECURITIES

The composition of the investment securities portfolio reflects management's strategy of maintaining an appropriate combination of liquidity, interest rate risk and yield. Flag seeks to maintain an investment portfolio with minimal credit risk, investing mostly in obligations of the US Treasury or other state and federal governmental agencies.

Investment securities increased to $138.9 million at December 31, 2002 from $131.5 million at December 31, 2001. At December 31, 2002, all investment securities outstanding were classified as available-for-sale. The increase in investments resulted from the investment of a portion of the proceeds received from the acquisition of branch offices from Encore Bank in November 2002. At December 31, 2002, gross unrealized gains in the total portfolio amounted to $3.2 million and gross unrealized losses amounted to $58,000.

TABLE 3 reflects the carrying amount of the investment securities portfolio for the past three years.

TABLE 3 - CARRYING VALUE OF INVESTMENTS
(DOLLARS IN THOUSANDS)

	DECEMBER 31,		
	2002	2001	2000
SECURITIES AVAILABLE-FOR-SALE:			
U.S. TREASURIES AND AGENCIES	$ 23,577	25,859	22,554
CORPORATE DEBT SECURITIES. .	2,201	2,673	2,014
STATE, COUNTY AND MUNICIPAL.	9,972	10,572	10,652
MORTGAGE-BACKED SECURITIES .	86,784	77,418	56,202
TRUST PREFERRED SECURITIES .	15,886	14,448	8,811
EQUITY SECURITIES.	434	556	489
TOTAL.	$138,854	131,526	100,722

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LOANS

Gross loans increased to $381.7 million in 2002 from $376.3 million at December 31, 2001. Gross loans decreased during the first half of 2002 to approximately $339.5 million as Flag chose to exit lower yielding and higher risk relationships. Flag's focus on existing markets, correspondent lending and the line of business purchased from BCG helped outstanding loans grow 12.5% during the second half of 2002.

TABLE 4 shows the changes in the makeup of Flag's loan portfolio from 1998 through 2002.

TABLE 4 - LOAN PORTFOLIO
(DOLLARS IN THOUSANDS)

	DECEMBER 31,						
	2002		2001		2000		1999
	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT
COMMERCIAL/FINANCIAL /AGRICULTURAL	$ 56,052	14.7%	74,569	19.8%	92,757	23.7%	117,728
REAL ESTATE CONSTRUCTION	68,169	17.7%	65,052	17.3%	37,501	9.6%	43,602
REAL ESTATE MORTGAGE. . .	240,182	62.9%	213,748	56.8%	228,508	58.4%	218,920
INSTALLMENT LOANS TO INDIVIDUALS	15,848	4.2%	17,793	4.7%	28,767	7.4%	40,620
LEASE FINANCINGS.	1,421	0.5%	5,153	1.4%	3,711	0.9%	5,226
TOTAL LOANS.	381,672	100%	376,315	100%	391,244	100%	426,096
LESS:							
ALLOWANCE FOR LOAN LOSSES	6,888		7,348		6,583		7,017
TOTAL NET LOANS. . .	$374,784		368,967		384,661		419,079

TABLE 5 represents the expected maturities for commercial, financial, and agricultural loans and real estate construction loans at December 31, 2002. The table also presents the rate structure for these loans that mature after one year.

TABLE 5 - LOAN PORTFOLIO MATURITY
(DOLLARS IN THOUSANDS)

	MATURITY				RATE STRUCTURE FOR L MATURITY OVER ONE Y	
	ONE YEAR OR LESS	OVER ONE YEAR THROUGH FIVE YEARS	OVER FIVE YEARS	TOTAL	FLOATING OR ADJUSTABLE INTEREST RATE	PR
COMMERCIAL, FINANCIAL, AND AGRICULTURAL.	$ 19,097	17,586	19,369	56,052	22,959	
REAL ESTATE - CONSTRUCTION	58,448	9,721	0	68,169	8,615	
	$ 77,545	27,307	19,369	124,221	31,574	

PROVISION AND ALLOWANCE FOR LOAN LOSSES

TABLE 6 presents an analysis of activities in the allowance for loan losses for the past five years. An allowance for possible losses is provided through charges to Flag's earnings in the form of a provision for loan losses. The provision for loan losses was $4.5 million in 2002, $2.5 million in 2001 and $3.6 million in 2000. Flag's increase in the provision for loan losses during 2002 was needed to replenish the allowance for loan losses due to the higher than normal amount of net charge-offs experienced. The provision for loan losses included approximately $1.0 million in 2001 for certain large agricultural credits and approximately $1.8 million in 2000 related to retained loans in the branch divestitures and one agricultural credit in South Georgia.

Management determines the level of the provision for loan losses based on outstanding loan balances, the levels of non-performing assets, and reviews of assets classified as substandard, doubtful, or loss and larger credits, together with an analysis of historical loss experience and current economic conditions.

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As shown in Table 6, the year-end allowance for loan losses decreased to $6.9 million at December 31, 2002, from $7.3 million at December 31, 2001. The decrease in the allowance during 2002 was the result of higher charge-offs of problem loans during 2002 than experienced in 2001. Net charge-offs were $5.0 million in 2002, $1.7 million in 2001, and $3.2 million in 2000. The allowance for loan losses was 1.80% of gross loans at December 31, 2002, versus 1.95% and 1.68% at December 31, 2001 and 2000, respectively.

Management believes that the allowance for loan losses is both adequate and appropriate. However, the future level of the allowance for loan losses is highly dependent upon loan growth, loan loss experience, and other factors, which cannot be anticipated with a high degree of certainty.
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TABLE 6 - ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES
(DOLLARS IN THOUSANDS)

	Years Ended December 31,				
	2002	2001	2000	1999	1
Average loans	$366,571	378,867	405,101	449,689	435

Allowance for loan losses, beginning of the period.	7,348	6,583	7,017	6,194	5
Charge-offs for the period:					
Commercial/financial/agricultural	1,009	400	1,246	722	1
Real estate construction loans.	284	24	-	-	
Real estate mortgage loans.	3,737	980	2,308	1,305	
Installment loans to individuals.	462	453	894	1,007	
Lease financings.	77	206	6	1,056	
Total charge-offs	5,569	2,063	4,454	4,090	3
Recoveries for the period:					
Commercial/financial/agricultural	107	102	86	46	
Real estate construction loans.	2	-	-	-	
Real estate mortgage loans.	316	134	964	60	
Installment loans to individuals.	100	34	93	149	
Lease financings.	35	70	109	2	
Total recoveries	560	340	1,252	257	
Net charge-offs for the period	5,009	1,723	3,202	3,833	2
Provision for loan losses	4,549	2,488	3,597	4,656	3
Allowance related to assets purchased and sold. . .	-	-	(829)	-	
Allowance for loan losses, end of period.	$ 6,888	7,348	6,583	7,017	6
Ratio of allowance for loan losses to total loans outstanding	1.80%	1.95%	1.68%	1.65%	
Ratio of net charge-offs during the period to total average loans outstanding during the period . . .	1.37%	0.45%	0.79%	0.85%	

ASSET QUALITY

At December 31, 2002, non-performing assets totaled $11.1 million compared to $20.5 million at the end of 2001. The decrease in 2002 is attributed to a combination of Flag's comprehensive loan review program, its intense management of problem assets, and the larger than normal amount of net charge-offs for the year. At December 31, 2002, there were no commitments to advance additional funds on any loan classified "non-accrual."

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TABLE 7 summarizes the non-performing assets for each of the last five years.

TABLE 7 - RISK ELEMENTS
(DOLLARS IN THOUSANDS)

	DECEMBER 31,				
	2002	2001	2000	1999	1998
LOANS ON NONACCRUAL	$ 9,243	17,122	7,144	12,118	7,729
LOANS PAST DUE 90 DAYS AND STILL ACCRUING	122	594	4,701	2,775	813
OTHER REAL ESTATE OWNED	1,718	2,831	992	939	2,251

TOTAL NON-PERFORMING ASSETS	$11,083	20,547	12,837	15,832	10,793
TOTAL NON-PERFORMING LOANS AS A PERCENTAGE OF GROSS LOANS	2.90%	5.57%	3.34%	3.78%	2.54%

RISK ELEMENTS

There may be additional loans within Flag's loan portfolio that may become classified as conditions may dictate; however, management was not aware of any such loans that are material in amount at December 31, 2002. At December 31, 2002, management was unaware of any known trends, events, or uncertainties that will have, or that are reasonably likely to have a material effect on the Bank's or Flag's liquidity, capital resources, or operations.

DEPOSITS AND BORROWINGS

Total deposits increased approximately $69.1 million during 2002, totaling $509.7 million at December 31, 2002 compared to $440.6 million at December 31, 2001. The increase in Flag's deposit base in 2002 is attributable to the acquisition of the six banking offices with approximately $100 million in deposits in north metropolitan Atlanta in the fourth quarter with approximately $96 million in deposits.

The maturities of time deposits of $100,000 or more issued by the Bank at December 31, 2002, are summarized inTABLE 8.

TABLE 8 - MATURITIES OF TIME DEPOSITS OVER $100,000
(DOLLARS IN THOUSANDS)

THREE MONTHS OR LESS.	$ 34,566
OVER THREE MONTHS THROUGH SIX MONTHS.	23,569
OVER SIX MONTHS THROUGH TWELVE MONTHS	31,137
OVER TWELVE MONTHS.	12,956
	$102,228

At December 31, 2002, the Bank was a shareholder in the Federal Home Loan Bank of Atlanta ("FHLB"). Through this affiliation, advances totaling $58.0 million were outstanding at rates competitive with time deposits of like maturities. Management anticipates continued utilization of this short- and long-term source of funds to minimize interest rate risk and to fund competitive fixed rate loans to customers.

During 2002, Flag repaid $8.4 million in fixed rate advances from the FHLB prior to their original maturity date, incurring a prepayment penalty totaling approximately $266,000. In 2001, Flag repaid approximately $26 million in advances with prepayment penalties totaling approximately $1.1 million. These advances were repaid in both years due to a falling interest rate environment in which Flag could obtain new borrowings at significantly lower rates.

ASSET-LIABILITY MANAGEMENT

A primary objective of Flag's asset and liability management program is to control exposure to interest rate risk (the exposure to changes in net interest income due to changes in market interest rates) so as to enhance its earnings and protect its net worth against potential loss resulting from interest rate fluctuations.

Historically, the average term to maturity or repricing (rate changes) of assets (primarily loans and investment securities) has exceeded the average repricing period of liabilities (primarily deposits and borrowings). TABLE 9 provides information about the amounts of interest-earning assets and interest-bearing liabilities outstanding as of December 31, 2002 that are expected to mature, prepay, or reprice in each of the future time periods shown (i.e., the interest rate sensitivity). As presented in this table, at December 31, 2002, the liabilities subject to rate changes within one year exceeded our assets subject to rate changes within one year. This mismatched condition suggests that an increasing rate environment would be detrimental to Flag's margin. However, interest bearing liabilities are not as sensitive to changing rates as are Flag's assets, so management believes a rising interest rate scenario would not result in a decrease in net interest income. Management assumptions and theories regarding the interest rate risk are the products of systems that project net interest income under various scenarios and considers the sensitivity of individual components of the balance sheet. This approach is believed to produce more accurate results than the approach summarized in the following table.

Management carefully measures and monitors interest rate sensitivity and believes that its operating strategies offer protection against interest rate risk. As required by various regulatory authorities, Flag's Board of Directors has established an interest rate risk policy, which sets specific limits on interest rate risk exposure. Adherence to this policy is reviewed by Flag's executive committee and presented at least annually to the Board of Directors.

Management has maintained positive ratios of average interest-earning assets to average interest-bearing liabilities. As represented in TABLE 1 this ratio, based on average balances for the respective years, was 113% in 2002, 115% in 2001 and 116% in 2000.

TABLE 9 - INTEREST RATE SENSITIVITY ANALYSIS
(DOLLARS IN THOUSANDS)

	DECEMBER 31, 2002 MATURING OR REPRICING IN				
	ONE YEAR OR LESS	OVER 1 YEAR THROUGH 3 YEARS	OVER 3 YEARS THROUGH 5 YEARS	OVER 5YEARS	TOT
INTEREST-EARNING ASSETS:					
ADJUSTABLE RATE MORTGAGES	$ 127,982	4,949	-	-	132,
FIXED RATE MORTGAGES.	26,356	41,977	18,085	20,833	107,
OTHER LOANS	109,109	13,439	12,371	19,177	154,
INVESTMENT SECURITIES	47,089	25,981	11,263	61,316	145,
INTEREST-BEARING DEPOSITS IN OTHER BANKS AND FEDERAL FUNDS SOLD	36,715	-	-	-	36,

TOTAL INTEREST-EARNING ASSETS . . .	347,251	86,346	41,719	101,326	576,
INTEREST-BEARING LIABILITIES:					
FIXED MATURITY DEPOSITS	216,441	43,056	14,290	548	274,
NOW AND MONEY MARKET DEMAND ACCOUNTS	170,857	-	-	-	170,
PASSBOOK ACCOUNTS.	24,500	-	-	-	24,
FHLB ADVANCES.	5,000	-	53,000	-	58,
TOTAL INTEREST-BEARING LIABILITIES . . .	416,798	43,056	67,290	548	527,
INTEREST RATE SENSITIVITY GAP.	(69,547)	43,290	(25,571)	100,778	48,
CUMULATIVE INTEREST RATE SENSITIVITY GAP	$ (69,547)	(26,257)	(51,828)	48,950	
CUMULATIVE INTEREST RATE SENSITIVITY GAP TO TOTAL ASSETS.	(10.9%)	(4.1%)	(8.1%)	7.7%	

TABLE 10 represents the expected maturity of investment securities by maturity date and average yields based on amortized cost at December 31, 2002. It should be noted that the composition and maturity/repricing distribution of the investment portfolio is subject to change depending on rate sensitivity, capital needs, and liquidity needs.

TABLE 10 - EXPECTED MATURITY OF INVESTMENT SECURITIES AVAILABLE-FOR-SALE (DOLLARS IN THOUSANDS)

	WITHIN ONE YEAR		AFTER ONE BUT WITHIN FIVE YEARS		AFTER FIVE BUT WITHIN TEN YEARS	
	AMOUNT	YIELD	AMOUNT	YIELD	AMOUNT	YIELD
U.S. TREASURY AND AGENCIES	$ 500	6.20%	$22,565	5.45%	$ -	-
STATE, COUNTY AND MUNICIPALS	400	4.36%	3,612	3.80%	1,146	4.69
CORPORATE DEBT SECURITIES.	-	-	2,024	6.63%	-	-
EQUITY SECURITIES.	-	-	-	-	-	-
MORTGAGE-BACKED SECURITIES	108	6.46%	29,122	3.92%	30,992	4.67
TRUST PREFERRED SECURITIES	-	-	500	6.50%	-	-
	$ 1,008	5.50%	$57,823	4.63%	$32.138	4.67

LIQUIDITY

The objective of liquidity management is to ensure that sufficient funding is available, at reasonable cost, to meet the ongoing operational cash needs of Flag and to take advantage of income producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of Flag to maintain a sufficient level of liquidity in all expected economic environments. Liquidity is defined as the ability of a bank to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining Flag's ability to meet the daily cash flow requirements of the Bank's customers, both depositors and borrowers.

The primary objectives of asset/liability management are to provide for adequate liquidity in order to meet the needs of customers and to maintain an optimal balance between interest-sensitive assets and interest-sensitive

liabilities, so that Flag can also meet the investment requirements of its shareholders as market interest rates change. Daily monitoring of the sources and use of funds is necessary to maintain a position that meets both requirements

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and the maturities and sales of securities. Mortgage loans held for sale totaled $12.6 million at December 31, 2002, and typically turn over every 45 days as the closed loans are sold to investors in the secondary market. Real estate-construction and commercial loans that mature in one year or less amounted to $77.5 million, or 19.7% of the total loan portfolio at December 31, 2002. Other short-term investments such as federal funds sold are additional sources of liquidity.

The liability section of the balance sheet provides liquidity through depositors' interest bearing and non-interest bearing deposit accounts. Federal funds purchased, FHLB advances, other borrowings and securities sold under agreements to repurchase are additional sources of liquidity and represent Flag's incremental borrowing capacity. These sources of liquidity are short-term in nature and are used as necessary to fund asset growth and meet other short-term liquidity needs.

As disclosed in Flag's consolidated statements of cash flows included in the consolidated financial statements, net cash used by operating activities was $6.8 million during 2002. The major uses of cash by operating activities were the changes in mortgage loans held for sale and the changes in other assets and liabilities. Net cash provided by investing activities of $48.5 million consisted primarily of funds acquired in the acquisition of the six north-metro Atlanta branch offices and proceeds from sales and maturities of investment securities, offset by net changes in loans, interest bearing deposits in other banks and purchases of investment securities. Net cash used by financing activities was $23.5 million, and consisted mostly of the net change in deposits and the increase in amounts due to the FHLB.

In the opinion of management, Flag's liquidity position at December 31, 2002 is sufficient to meet its expected cash flow requirements. Reference should be made to the consolidated statements of cash flows appearing in the consolidated financial statements for the three-year analysis of the changes in cash and cash equivalents resulting from operating, investing and financing activities.

CAPITAL RESOURCES AND DIVIDENDS

Stockholders' equity at December 31, 2002 increased 12.5% to $60.7 million from $54.0 million at December 31, 2001. This increase is largely due to the 1,300,000 share private placement approved by Flag's Board of Directors during the first quarter of 2002. During 2002, 1,272,000 shares and 1,272,000 warrants had been sold for $11.7 million to the Company's management or employees.

Flag continued its stock repurchase program during 2002. Flag repurchased 338,960 shares of its common stock in 2002, 755,257 shares of its common stock in 2001 and 145,244 shares of its common stock in 2000.

The Federal Deposit Insurance Corporation Improvement Act ("FDICIA") requires federal banking agencies to take "prompt corrective action" with regard to institutions that do not meet minimum capital requirements. As a result of FDICIA, the federal banking agencies introduced an additional capital measure called the "Tier 1 risk-based capital ratio." The Tier 1 ratio is the ratio of

core capital to risk adjusted total assets. Note 12 to the Consolidated Financial Statements presents a summary of FDICIA's capital tiers compared to Flag's and the Bank's actual capital levels. The Bank exceeded all requirements of a "well-capitalized" institution at December 31, 2002.

TABLE 11 - EQUITY RATIOS

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
RETURN ON AVERAGE ASSETS	(0.36%)	.72%	.77%
RETURN ON AVERAGE EQUITY	(3.39%)	7.12%	7.95%
DIVIDEND PAYOUT RATIO.	N/A	46.27%	45.98%
AVERAGE EQUITY TO AVERAGE ASSETS	10.49%	10.04%	9.51%

Provision for Income Taxes

The benefit for income taxes was $2.0 million in 2002, compared to a provision for income taxes of $1.8 million in 2001 and of $1.4 million in 2000. The effective tax rate in 2002 was higher than the Federal statutory rate of 34% due to interest income on tax exempt securities and general business credits. Also, during 2002 the amount of loss before income taxes was lower than the earnings before income taxes in prior years. The effect of tax exempt interest income and general business credits is greater in years that income (loss) before taxes is lower. The tax rates for 2001 and 2000 are lower than the statutory Federal rate of 34% primarily due to interest income on tax exempt securities and general business credits. See Flag's consolidated financial statements for an analysis of income taxes.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related financial data presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in relative purchasing power over time due to inflation.

Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than does the effect of inflation. The liquidity and maturity structures of Flag's assets and liabilities are critical to the maintenance of acceptable performance levels.

RECENT ACCOUNTING PRONOUNCEMENTS

Accounting standards that have been issued or proposed by the Financial Accounting Standards Board and other standard setting entities that do not require adoption until a future date are not expected to have a material impact on Flag's consolidated financial statements upon adoption.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's net interest income and the fair value of its financial instruments (interest-earning assets and interest-bearing liabilities) are influenced by changes in market interest rates. The Company actively manages its exposure to interest rate fluctuations through policies established by its senior management and Board of Directors. The Company's senior management implements asset/liability management policies, develops and implements strategies to improve balance sheet positioning and net interest income and regularly assesses the interest rate sensitivity of the Bank.

The Company utilizes an interest rate simulation model to monitor and evaluate the impact of changing interest rates on net interest income and the market value of its investment portfolio. The ALCO policy limits the maximum percentage changes in net interest income and investment portfolio equity, assuming a simultaneous, instantaneous change in interest rate. These percentage changes are as follows:

Changes in Interest Rates (In Basis Points)	Percentage Change in Net Interest Income	Percent Change in Market Value of Portfolio Equity
300	20%	20%
200	20%	20%
100	20%	20%

As of December 31, 2002, the Company was in compliance with its ALCO policy.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements are included herein:

Report of Independent Certified Public Accountants
Consolidated Balance Sheets as of December 31, 2002 and 2001
Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000
Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2002, 2001 and 2000
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2002, 2001 and 2000
Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000
Notes to Consolidated Financial Statements

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors
Flag Financial Corporation
Atlanta, Georgia

We have audited the accompanying consolidated balance sheets of Flag Financial

Corporation and subsidiary as of December 31, 2002 and 2001, and the related statements of operations, comprehensive income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of Flag's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Flag Financial Corporation and subsidiary as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

/s/ Porter Keadle Moore, LLP

Atlanta, Georgia
January 24, 2003

FLAG FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2002 AND 2001

ASSETS

	2002
	(In Thous
Cash and due from banks, including reserve requirements of $730 and $9,362	$ 14,006
Interest-bearing deposits in banks	6,000
Federal funds sold	18,304
Cash and cash equivalents	38,310
Interest-bearing deposits	12,412
Investment securities available-for-sale	138,854
Other investments	6,795

Mortgage loans held-for-sale	12,606
Loans, net	374,784
Premises and equipment, net	21,063
Other assets	31,307
	$636,131

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits:	
Demand	$ 40,039
Interest-bearing demand	170,857
Savings	24,500
Time	172,107
Time, over $100,000	102,228
Total deposits	509,731
Federal funds purchased and repurchase agreements	-
Advances from Federal Home Loan Bank	58,000
Other borrowings	-
Other liabilities	7,651
Total liabilities	575,382
Stockholders' equity:	
Preferred stock (10,000,000 shares authorized; none issued and outstanding)	-
Common stock ($1 par value, 20,000,000 shares authorized, 9,638,501 and 8,277,995 shares issued in 2002 and 2001, respectively)	9,639
Additional paid-in capital	23,463
Retained earnings	35,225
Accumulated other comprehensive income	1,999
Less: treasury stock, at cost; 1,246,961 shares in 2002 and 908,001 shares in 2001	(9,577)
Total stockholders' equity	60,749
	$636,131