

# 1<sup>st</sup> FRANKLIN FINANCIAL CORPORATION CHARTER OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

## **Purpose**

The purpose of the Audit Committee (the "Committee") of 1<sup>st</sup> Franklin Financial Corporation (the "Company") is to oversee the Company's (1) financial reports and other financial information provided to any governmental body, its investors and its shareholders; (2) systems of internal controls regarding finance, accounting, legal compliance and ethics; and (3) auditing, accounting and financial reporting processes. Consistent with this function, the Audit Committee should encourage continuous improvement of, and should foster adherence to, the Company's policies, procedures and practices at all levels.

## **Composition of the Committee**

**Number.** The Committee shall consist of no fewer than three members.

### **Qualifications.**

- 1) Each Committee member shall meet the independence criteria of Section 301 of the Sarbanes-Oxley Act of 2002 and the rules and listing requirements promulgated there under by the Securities and Exchange Commission (the "SEC"), including Rule 10A-3 of the Securities Exchange Act of 1934 (the "Exchange Act").
- 2) No Committee member shall have participated in the preparation of the financial statements of the Company or any current subsidiary of the Company at any time during the past three years.
- 3) Each Committee member shall be able to read and understand fundamental financial statements, including a balance sheet, an income statement and a cash flow statement. Additionally, at least one member of the Committee shall have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in such member's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities. The Board of Directors shall determine, in its business judgment, whether at least one member has such financial sophistication and whether there is at least one member that satisfies the financial expert criteria of Section 407 of the Sarbanes-Oxley Act of 2002 and any rules promulgated there under by the SEC. The designation or identification of a person as having such financial sophistication or as a financial expert shall not (A) impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the Committee and Board of Directors in the absence of such designation or identification or (B) affect the duties, obligations or liability of any other member of the Committee or Board of Directors.
- 4) Each Committee member shall receive as compensation from the Company only those forms of compensation as are not prohibited by Section 301 of the Sarbanes-Oxley Act of 2002 and the rules promulgated there under by the SEC. Permitted compensation includes director's fees (which includes all forms of compensation paid

to directors of the Company for service as a director or member of a committee of the Board of Directors.)

- 5) No individual who otherwise meets the independence criteria set forth herein may be the Chairman, or other voting member, of the Committee at any time and for so long as such individual holds or shares (or is an affiliate of any individual or entity that holds or shares) voting and/or dispositive power with respect to twenty percent (20%) or more of the Company's stock.

**Appointment.** The Board of Directors will appoint the members of the Committee. The Board of Directors will, or will delegate to the members of the Committee the responsibility to, appoint a Chairman of the Committee. Committee members shall serve at the pleasure of the Board of Directors and for such term or terms as the Board of Directors may determine.

### **Duties and Responsibilities of the Committee**

The Committee shall be responsible for overseeing the accounting and financial reporting processes of the Company and the audits of the financial statements of the Company on behalf of the Board of Directors. Management is responsible for the preparation, presentation, and integrity of the Company's financial statements and for the appropriateness of the accounting and reporting policies that are used by the Company. The independent auditors are responsible for auditing the Company's financial statements and for reviewing the Company's interim financial statements.

The Committee shall be directly responsible for the appointment, compensation, retention and oversight of the work of the Company's independent auditors (including resolution of differences between management and the auditors regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company, and such auditor shall report directly to the Committee.

In performing its responsibilities, the Committee shall:

- 1) Retain the Independent Auditors: The Committee has the sole authority to (A) retain and terminate the Company's independent auditors, (B) approve all audit engagement fees, terms and services and (C) approve any non-audit engagements with the Company's independent auditors.
- 2) Review and Discuss the Independence of, and Evaluate, the Auditors: In connection with the retention of the Company's independent auditors, the Committee shall, at least annually, review and discuss the information provided by management and the auditors relating to the independence of the audit firm, including, among other things, information related to the non-audit services provided and expected to be provided by the auditors. The Committee is responsible for (A) ensuring that the independent auditors submit at least annually to the Committee a formal written statement delineating all relationships between the auditors and the Company consistent with applicable independence standards, including Independence Standards Board Standard 1, (B) actively engaging in a dialogue with the auditors with respect to any disclosed relationship or services that may impact the objectivity and independence of the auditors and (C) taking, or recommending that the Board of Directors take, appropriate action to oversee the independence of the auditor. In connection with the Committee's evaluation of the auditors' independence, the Committee shall also review and evaluate the lead partner of the independent

auditors and take such steps as may be required by law with respect to the identification and regular rotation of the audit partners serving on the Company's audit engagement team. In connection with the overall evaluation of the independent auditors the Committee shall obtain and review a report by the independent auditors describing such auditor's internal quality control procedures and any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm, as well as any steps taken to deal with any such issues.

- 3) Set Hiring Policies: The Committee is to set hiring policies for employees or former employees of the independent auditors.
- 4) Review and Discuss the Audit Plan: The Committee is to review and discuss with the independent auditors the plans for, and the scope of, the annual audit and other examinations, including the adequacy of staffing and compensation.
- 5) Review and Discuss Conduct of the Audit: The Committee is to review and discuss with the independent auditors the matters required to be discussed by relevant regulatory and auditing standards relating to the conduct of the audit, as well as any audit problems or difficulties and management's response, including (A) any restriction on audit scope or on access to requested information, (B) any differences with management and (C) significant issues discussed with the independent auditors' national office. The Committee is to decide all unresolved differences between management and the independent auditors regarding financial reporting.
- 6) Review and Discuss Financial Statements and Disclosures: The Committee is to review and discuss with appropriate officers of the Company and the independent auditors the annual audited and quarterly financial statements of the Company, including (A) the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and (B) the disclosures regarding internal controls and other required matters.
- 7) Review and Discuss Earnings Press Releases: The Committee is to review and discuss earnings and other financial press releases (including any use of "pro forma" or "adjusted" non-GAAP information), as well as financial information and earnings guidance provided to analysts and rating agencies, if applicable (which review may occur after issuance and may be done generally as a review of the types of information to be disclosed and the form of presentation to be made).
- 8) Review and Discuss Internal Audit Plans: The Committee is to review and discuss with the senior internal auditing executive and appropriate members of the staff of the internal auditing, department the plans for the scope of their ongoing audit activities, including adequacy of staffing and compensation.
- 9) Review and Discuss Internal Audit Reports: The Committee is to review and discuss with the senior internal auditing executive and appropriate members of the staff of the internal auditing department the annual report of the audit activities, examinations and results thereof of the internal auditing department.

- 10) Review and Discuss the Systems of Internal Accounting Controls: The Committee is to review and discuss with the independent auditors, the senior internal auditing executive and, if and to the extent deemed appropriate by the Chairman of the Committee, members of their respective staffs the adequacy of the Company's internal accounting controls, the Company's financial, auditing and accounting organizations and personnel, and the Company's policies and compliance procedures with respect to business practices which shall include (A) the disclosures regarding internal controls and other required matters and (B) a review with the independent auditors of their opinion on the effectiveness of management's assessment of internal controls over financial reporting.
- 11) Review and Discuss the Recommendations of Independent Auditors: The Committee is to review and discuss with the senior internal auditing executive and the appropriate members of the staff of the internal auditing department recommendations made by the independent auditors and the senior internal auditing executive, as well as such other matters, if any, as such persons or other officers of the Company may desire to bring to the attention of the Committee.
- 12) Review and Discuss the Audit Results: The Committee is to review and discuss with the independent auditors (A) the report of their annual audit, or proposed report of their annual audit, (B) any management letter and (C) the reports of their reviews of the Company's interim financial statements. The foregoing shall include, as appropriate, a review of (A) major issues regarding (i) accounting principles and financial statement presentations, including any significant changes in the Company's selection or application of accounting principles, and (ii) the adequacy of the Company's internal controls; (B) analyses prepared by management and/or the independent auditors setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; and (C) the effect of regulatory and accounting initiatives on the financial statements of the Company.
- 13) Obtain Assurances under Section 10A(b) of the Exchange Act: The Committee is to obtain assurance from the independent auditors that in the course of conducting the audit, there have been no acts detected or that have otherwise come to the attention of the audit firm that require disclosure to the Committee under Section 10A(b) of the Exchange Act.
- 14) Obtain Reports Regarding Conformity With Legal Requirements and the Company's Code of Conduct: The Committee is to periodically obtain reports from management, the Company's senior internal auditing executive and the independent auditor that the Company and its subsidiary entities are in conformity with applicable legal requirements and the Company's Code of Business Conduct and Ethics. The Committee is to review and discuss reports and disclosures of insider and affiliated party transactions. The Committee should advise the Board of Directors with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations and with the Company's Code of Business Conduct and Ethics.
- 15) Approve Related Party Transactions: The Committee is to approve all related party transactions that are required to be disclosed pursuant to Item 404 of Regulation S-K promulgated by the SEC.

- 16) Establish Procedures for Complaints Regarding Financial Statements or Accounting Policies: The Committee is to establish procedures for (A) the receipt, retention, and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and (B) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.
- 17) Review and Discuss Other Matters: The Committee should review and discuss such other matters that relate to the accounting, auditing and financial reporting practices and procedures of the Company as the Committee may, in its own discretion, deem desirable in connection with the review functions described above.
- 18) Make Board Reports: The Committee shall report its activities regularly to the Board of Directors in such manner and at such times as the Committee and the Board of Directors deem appropriate, but in no event less than once a quarter. Such report should include a review of any issues that arise with respect to the quality or integrity of the Company's financial statements, the Company's compliance with legal or regulatory requirements, the performance and independence of the Company's independent auditors or the performance of the internal audit function.
- 19) Maintain Flexibility: the Committee, in carrying out its responsibilities, policies and procedures should remain flexible, in order to best react to changing conditions and circumstances.

### **Meetings of the Committee**

The Committee shall meet in person or telephonically at least quarterly, or more frequently as it may determine necessary, to comply with its responsibilities as set forth herein. The Chairman of the Committee shall, in consultation with the other members of the Committee, the Company's independent auditors and the appropriate officers of the Company, be responsible for calling meetings of the Committee, establishing agenda therefore and supervising the conduct thereof. The Committee may also take any action permitted hereunder by unanimous written consent.

The Committee may request any officer or employee of the Company or the Company's outside legal counsel or independent auditors to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee. The Committee shall meet, at least annually and more frequently as the Committee shall determine, with the Company's management, the internal auditors and the independent auditors periodically in separate private sessions to discuss any matter that the Committee, management, the independent auditors or such other persons believes should be discussed privately.

### **Resources and Authority of the Committee**

The Committee shall have the resources and authority appropriate to discharge its responsibilities as required by law, including the authority to engage independent counsel and such other advisors as the Committee deems necessary to carry out its duties. The Committee may also, to the extent it deems necessary or appropriate, meet with the Company's investment bankers or financial analysts who follow the Company.

The Company will provide for appropriate funding, as determined by the Committee, for payment of (a) compensation to the Company's independent auditors engaged for the purpose of rendering or issuing an audit report or related work or performing other audit, review or attest services for the Company, (b) compensation to independent counsel or any other advisors employed by the Committee and (c) ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.

### **Audit Committee Report**

The Committee will prepare, with the assistance of management, the independent auditors and outside legal counsel, the Audit Committee Report to be included in the Company's annual report.

### **Annual Review of Charter**

The Committee will conduct and review with the Board of Directors annually an evaluation of the adequacy of this Charter and recommend any changes to the Board of Directors. The Committee may conduct this charter evaluation in such manner as the Committee, in its business judgment, deems appropriate.

### **Annual Performance Evaluation**

The Committee will conduct and review with the Board of Directors annually an evaluation of the Committee's performance with respect to the requirements of this Charter. This evaluation should also set forth the goals and objectives of the Committee for the upcoming year. The Committee may conduct this performance evaluation in such manner as the Committee, in its business judgment, deems appropriate.