

**PALMETTO BANCSHARES, INC.**  
**AUDIT COMMITTEE OF THE BOARD OF DIRECTORS**

**CHARTER**  
**AS OF OCTOBER 20, 2009**

**I. PURPOSE**

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight of the accounting and financial reporting processes of Palmetto Bancshares, Inc (“the Company”), including the preparation of the Company’s financial statements in accordance with generally accepted accounting principles, rules of the Securities and Exchange Commission (“the SEC”), and banking regulatory rules. The Audit Committee’s primary roles are to:

- Monitor 1) the integrity of the Company’s financial statements and the financial reporting process, including the Company’s internal control over financial reporting, 2) the Company’s compliance with legal and regulatory requirements including the Company’s disclosure controls and procedures, 3) the independent registered public accounting firm’s qualifications, independence and performance and 4) the performance of the Company’s internal audit function; and
- Appoint, compensate, approve, and oversee the work of any independent registered public accounting firm employed by the Company for the purpose of auditing or reviewing the Company’s financial statements and internal control over financial reporting and related work, with each such independent registered public accounting firm reporting to the Audit Committee.

**II. COMPOSITION AND MEETINGS**

Audit Committee members shall meet the independence requirements of the New York Stock Exchange<sup>1</sup> and the requirements for independence set out in Rule 10A-3(b)(1). The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be independent nonexecutive directors, free from any relationship that would be expected to interfere with the exercise of his or her independent judgment. All members of the committee shall have a basic understanding of finance and accounting and the regulatory requirements of the Company’s industry and be able to read and understand fundamental

---

1. Since Palmetto Bancshares stock is not traded on any exchange, the Company elected to comply with the New York Stock Exchange’s definition of independence (Section 303A.02) as allowed by the Securities and Exchange Commission guidelines when preparing this Charter. Subsequent to this election, the Sarbanes-Oxley Act was passed and Rule 10A-3(b)(1) was adopted thereunder, dealing with audit committee independence for exchange-listed companies. Therefore, Palmetto Bancshares, Inc. will also take this regulation into account when in relates to Audit Committee member requirements. Under Rule 10A-3(b)(1) , in order for a member of the audit committee of Palmetto Bancshares, Inc. to be independent, he or she generally may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee:

- Accept any consulting, advisory, or other compensatory fee from Palmetto Bancshares, Inc.; or
- Be an affiliated person of Palmetto Bancshares, Inc. or any subsidiary thereof.

financial statements. Additionally, the Company shall disclose whether or not, and if not, the reasons therefore, the Audit Committee includes at least one member who is a financial expert, as such term is defined by the Commission under the Sarbanes-Oxley Act of 2002.

Audit Committee members shall be appointed by the Board of Directors. If an Audit Committee Chair is not designated or present, the members of the committee may designate a Chair by majority vote of the committee membership.

The Audit Committee shall meet at least quarterly, or more frequently as circumstances dictate. The Audit Committee Chair may prepare and/or approve an agenda in advance of each meeting. The committee should meet periodically in separate executive sessions with management, the internal auditor, the independent registered public accounting firm, and alone as a committee to discuss any matters that the committee or each of these groups believe should be discussed. The committee may request any officer or employee of the Company or the Company's outside counsel, the independent registered public accounting firm, or any such other persons whose attendance is appropriate to the matters under consideration to attend any meeting of the committee.

### **III. RESPONSIBILITIES AND DUTIES**

The Audit Committee, to the extent that it deems necessary or appropriate, shall:

#### **Pre-Approval of Auditor Services**

1. The Audit Committee shall approve in advance all auditing services, internal control-related services, and permitted non-audit services (including the fees and terms thereof) to be performed for the Company by its independent registered public accounting firm, in accordance with requirements of and subject to the de minimis exception for non-audit services contained in the Sarbanes-Oxley Act of 2002 and rules adopted thereunder. Approval authorization may be delegated to one or more designated members of the Audit Committee who are independent directors of the Board of Directors, and such member or members shall report any pre-approval decisions to Audit Committee at its next scheduled meeting.

#### **Review Procedures**

2. Periodically review and reassess the adequacy of this charter, and submit any proposed changes to the charter to the Board of Directors for approval. The Company shall publish this charter at least every three years if so required by SEC regulations.
3. Review the Company's annual audited financial statements, and quarterly unaudited financial statements, including disclosures made in Management's Discussion and Analysis of Financial Condition and Results of Operations, prior to filing or distribution. The review should include discussion with management and the independent registered public accounting firm of the critical accounting policies and areas of significant judgment regarding the application of accounting principles and estimates.

4. In consultation with management, the independent registered public accounting firm, and the internal auditors, consider the integrity of the Company's financial reporting processes and internal control over financial reporting. Review significant findings reported by the independent registered public accounting firm and the internal audit department together with management's responses, including the status of previous recommendations. Review management's annual report on the Company's internal control over financial reporting and any related findings or deficiencies and the independent registered public accounting firm's attestation of the effectiveness of internal control over financial reporting prior to filing of the Company's Form 10-K.

### **Independent Auditors**

5. The Audit Committee, in its capacity as a committee of the Board of Directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any independent registered public accounting firm employed by the Company for the purpose of preparing or issuing an audit report or related work, and each such independent registered public accounting firm shall report to the Audit Committee. The Audit Committee shall review the independence and performance of the auditors and annually recommend the appointment of the independent registered public accounting firm or approve any discharge of auditors when circumstances warrant. The Audit Committee shall review and approve engagement letters of the independent registered public accounting firm and shall seek to ensure the rotation of the audit partners as required by law. The Company shall provide for appropriate funding, as deemed by the Audit Committee for payment of compensation to the independent registered public accounting firm.
6. On an annual basis, the committee should receive written disclosures and the letter from the independent registered public accounting firm required by applicable requirements of the Public Accounting Oversight Board concerning independence, and discuss with the independent registered public accounting firm all significant relationships they have with the Company that could impair the auditors' independence.
7. Review the independent auditors' audit and review plans – discuss scope, staffing, locations, reliance upon management and internal audit, and the general audit approach.
8. Discuss the results of the audit with the independent registered public accounting firm. Discuss certain matters required to be communicated to audit committees in accordance with AICPA SAS 61.<sup>2</sup>

---

2. Statement of Auditing Standards (SAS) No. 61 requires that auditors discuss certain matters with audit committees of all SEC engagements. The communication may be in writing or oral and may take place before or after the financial statements are issued. Items to be communicated include:

- The auditor's responsibility under Generally Accepted Auditing Standards (GAAS);
- Significant accounting policies;
- Management judgments and accounting estimates;
- Significant audit adjustments;
- Other information in documents containing audited financial statements;

9. Consider the independent auditors' judgments about the quality and appropriateness of the Company's accounting principles as applied in its financial reporting.
10. Review and discuss any reports provided to the Audit Committee by the independent registered public accounting firm which detail 1) critical accounting policies and practices to be used in the audit; 2) alternate treatment of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent registered public accounting firm; and 3) other material written communications between the independent registered public accounting firm and management, including, but not limited to, any reports on internal controls and adjusted or unadjusted differences.
11. At least annually, receive and review a report by the independent registered public accounting firm describing the firm's internal quality-control procedures and any material issues raised by the most recent peer review examination by the Public Company Accounting Oversight Board or by any inquiry or investigation by any governmental or professional authorities within the past five years with respect to one or more independent audits carried out by the firm, and any steps taken to address such issues.

### **Internal Audit Department and Legal Compliance**

12. Discuss with the independent auditor, the senior internal audit executive and/or management the budget, plan, changes in plan, activities, resources, organizational structure, qualifications and expertise of the internal audit department, as the Audit Committee determines to be needed. The internal audit department shall have a direct reporting responsibility to the Audit Committee.
13. Review the appointment, performance, and replacement of the senior internal audit executive.
14. Review significant reports prepared by the internal audit department together with management's response and follow-up to these reports.
15. On at least an annual basis, review with the Company's counsel, any legal matters that could have a significant impact on the Company's financial statements, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.

- 
- Disagreements with management – including accounting principles, scope of audit, disclosures;
  - Consultation with other accountants by management;
  - Major issues discussed with management prior to retention; and
  - Difficulties encountered in performing the audit.

## Other Audit Committee Responsibilities

16. Maintain minutes of meetings and periodically report to the Board of Directors on significant results of the foregoing activities.
17. Establish procedures for the receipt, retention, and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters.
18. Establish procedures for the receipt and treatment of confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.
19. Monitor compliance with the Company's Insider Trading Policy and the Code of Ethics for Executive Management and Senior Financial Officers.
20. Perform any other activities consistent with this charter, the Company's by-laws, and governing law, as the Audit Committee or the Board deems necessary or appropriate.

While the Audit Committee has the responsibilities and powers set forth in this charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the independent registered public accounting firm.

## IV. COMMITTEE REPORTING

The Committee shall produce the following reports and provide them to the Board:

1. A written or oral summary of the pertinent actions taken at each Committee meeting, which shall be presented to the Board at the next Board meeting.
2. (Annually) a report to shareholders as required by the SEC to be included in the Company's annual proxy statement.<sup>3</sup>
3. An annual performance evaluation of the Committee, which evaluation shall compare the performance of the Committee with the requirements of this charter. The performance evaluation shall also recommend to the Board any improvements to this charter deemed necessary or desirable by the Committee. The performance evaluation by the Committee shall be conducted in such manner as the Committee deems appropriate, including the use of an external consultant if desirable by the Committee.

---

3. The SEC requires that the Audit Committee issue a report to shareholders stating whether they have:

- Reviewed and discussed the audited financial statements with management;
- Discussed with the independent auditors the matters required to be discussed by SAS 61; and
- Received certain disclosures from the auditors regarding their independence as required by the ISB 1 and then include a statement if based on this review if the audit committee recommended to the board to include the audited financial statements in the annual report filed with the SEC.

## **V. AUTHORITY**

In discharging its duties, the Committee is empowered to investigate any matter within the scope of its responsibilities. The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors as well as anyone in the organization. The Audit Committee has the ability to retain, at the Company's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

The Committee shall have resources and authority appropriate to discharge its duties and responsibilities, including the authority to select, retain, terminate, and approve the fees and other retention terms of special counsel or other experts or consultants, as it deems appropriate without seeking approval of the Board or management.

Where legally permissible, the Committee shall have the authority to delegate such of its responsibilities, as the Committee may deem necessary or appropriate in its sole discretion.