

Charter of the Audit Committee

GENERAL OBJECTIVES

This charter will provide the audit committee with formal written directions that will specify the scope of its responsibilities and the means by which it carries out those responsibilities; the external auditor's accountability to the board and audit committee; and the audit committee's responsibility to ensure the independence of the outside auditor.

AUTHORITY

The Board of Directors of Highlands State Bank (the "Bank") will establish a subcommittee called the audit committee. The Audit Committee will be composed of no less than three directors who are independent of management of the bank and are free of any relationship that, in the opinion of the Board, would interfere with their exercise of judgment as a committee member. Such directors will serve for a period of at least one year.

All members of the audit committee shall have a basic understanding of finance and accounting and be able to read and understand fundamental financial statements.

The audit committee shall meet at least three times annually, or more frequently as circumstances dictate. The committee shall meet privately in executive session at least annually with the internal auditors, and the independent auditors and without management being present.

SCOPE OF RESPONSIBILITIES

The audit committee is responsible for the financial oversight of the Bank which includes:

Internal audit - The audit committee has responsibility for the following:

- Establishing an internal auditing function
- Engaging qualified person(s) or firms to serve as internal auditors
- Providing sufficient resources for an adequate audit scope in terms of risk, frequency and coverage of the Bank's and subsidiaries systems
- Ensuring that proper internal control procedures are in place and operating effectively; the major areas of control include:
 - Safeguarding assets and records
 - Ensuring the proper and accurate reporting of transactions
 - Ensuring compliance with a number of criteria, including generally

accepted accounting principles (GAAP) and banking laws and regulations

- Ensuring compliance with all Bank and subsidiaries policies and procedures that reflect the Bank's goals and methods of implementing these goals
- Ensuring that operational and managerial directives are followed
- Ensuring that operational, regulatory, and managerial corrective actions are followed
- Meet with the internal auditors to review their reports and ensure corrective actions have been taken

External audit -The audit committee has responsibility for the following:

- The audit committee will ensure the independence of the external auditor by determining that; the Bank does not and will not extend unsecured credit to the external auditor's firm or to individuals employed by the firm, fees will be determined on a contract basis; the external auditors will at no time make management decisions or perform management duties and; the Bank and the external audit firm will not share any directors. The audit committee will also obtain a formal written statement from the external auditors consistent with standards set by the Independence Standards Board. Additionally, discuss with the auditors any relationships or non-audit services that may affect their objectivity or independence.
- The audit committee will engage the independent outside auditor to audit the financial statements.
- The audit committee will monitor the progress of the external auditor, resolving any conflicts that may arise during the audit.
- The audit committee will be required to meet with the external auditors at the end of the engagement to review the external audit findings, determine corrective action, and ensure that corrective action is implemented.
- Ensuring that the external auditors understand and acknowledge their accountability to the board and audit committee as representatives of shareholders, and these shareholders' representatives ultimate authority and responsibility to select, evaluate, and where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement).
- The audit committee will be available to the external auditor to resolve any conflicts regarding limitations in scope or other problems that arise during the external audit.
- The audit committee will review the opinion expressed in the independent auditor's report and take any appropriate actions necessary.
- If a management letter, or any document prepared by the external auditor that contains significant suggestions or recommendations regarding the Bank's financial statements and reporting, is received from the external auditor, the audit committee will take any appropriate follow-up actions

deemed necessary.

- The audit committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and will have direct access to the independent auditors as well as the books, records, facilities and personnel of the Bank. The audit committee has the ability to retain, at the Bank's expense, special legal, accounting or other consultants or experts it deems necessary in the performance of its duties.

Review procedures – The audit committee shall review with management and the independent auditors the financial statements to be included in the Bank's annual report prior to the issuance thereof, including their judgment about the quality (and not merely the acceptability) of accounting principles, the reasonableness of significant judgments and the clarity of the disclosures in the financial statements. The audit committee will discuss certain matters required to be communicated to audit committees in accordance with Statement on Auditing Standard No. 61.

ANNUAL REVIEW OF CHARTER

The audit committee is responsible for reviewing and assessing the adequacy of this charter on an annual basis. On an annual basis, the audit committee shall submit the audit committee charter to the Board of Directors for re-approval. Annual proxy statements shall include a statement indicating that the audit committee is governed by a charter and the charter shall be published as an appendix to the proxy statement at least every three years in accordance with SEC regulations.

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 Bank's financial statements are complete and accurate and are in accordance with generally accepted accounting principles. These duties are the responsibility of management and the Bank's independent auditors.

Date approved: August 16, 2011