

**NATIONAL BANKSHARES, INC.  
CHARTER OF THE AUDIT COMMITTEE  
OF THE  
BOARD OF DIRECTORS**

**I. Audit Committee Purpose**

The Audit Committee of the Board of Directors of National Bankshares, Inc. (NBI) is appointed by the Board to assist the Board of Directors in discharging its oversight responsibilities by monitoring the integrity of the financial reporting process of the Corporation and its systems of internal controls concerning finance, accounting and legal compliance. The Audit Committee is also responsible for monitoring the independence and performance of the Corporation's independent accountants and of the internal audit function at both holding company and subsidiary levels.

The primary function of the Committee is to serve as an independent and objective party to assist the Board in fulfilling its oversight responsibilities by overseeing and monitoring:

1. The quality and objectivity of financial reports and other financial information provided by NBI to the public and to any governmental body.
2. NBI's system of internal controls for finance, accounting and regulatory compliance.
3. NBI's compliance with legal and regulatory requirements.
4. The independence and performance of NBI's independent accountants.

**II. Audit Committee Membership and Meetings**

The Audit Committee shall consist of three or more Independent Directors (as defined by the Marketplace Rules of the Nasdaq Stock Exchange). Specifically, the Audit Committee members should be independent of the management of the Corporation and free from any relationship that, in the opinion of the Board of Directors, would interfere with their exercise of independent judgment as a Committee member. All Committee members must be able to read and understand fundamental financial statements, including the Corporation's balance sheet, income statement and cash flow statement. At least one Committee member must have past employment experience in finance or accounting, requisite professional certification in accounting or other comparable experience or background, including a current or past position as a chief executive or financial officer or other senior officer with financial oversight responsibilities.

Audit Committee members shall be appointed by the Board of Directors upon recommendation of the Chairman of the Board. If the Chairman of the Audit Committee is not designated or is not present at a meeting, the members of the Committee may designate a Chairman by majority vote of the members.

The Audit Committee shall meet periodically as deemed necessary or appropriate to carry out its responsibilities, but shall meet at least four times annually. After its meetings, the

Committee shall submit a report of its deliberations and actions to the Board of Directors. At least annually the Committee should meet in executive session with the independent accountants to discuss, among other things, the Corporation's accounting practices, internal controls and financial reporting and any significant difficulties encountered by the independent accountants, any important discoveries they have made or any material concerns they may have. If quarterly limited reviews conducted by the independent auditors result in findings that would be reported in a year-end letter under *Statement on Auditing Standards No. 61*, the Audit Committee or its Chairman should communicate with the independent auditors and with management about those findings.

### **III. Audit Committee Responsibilities and Duties**

In carrying out its duties, the Audit Committee shall undertake the following:

#### **A. General Responsibilities**

1. Maintain open communications with the independent accountants, executive management and the Board.
2. Review the financial results presented in all reports filed with the Securities and Exchange Commission.
3. Review all reports issued by regulators and consider the results of regulatory examinations to determine if they could have a material effect on NBI's financial statements, policies and operations.
4. Annually review and assess the adequacy of the Audit Committee Charter.
5. Take other actions required of the Committee by law or regulation or as requested by the Board.

In discharging its duties, the Committee shall have the authority to retain independent legal, accounting or other advisors. NBI shall provide appropriate funding, as determined by the Committee, for payment of compensation to the independent accountants for the purpose of issuing an audit report and to any independent legal or other advisors employed by the Committee.

#### **B. Responsibilities Regarding the Engagement of the Independent Accountants**

1. The Committee shall have the sole authority to appoint or replace the independent accountants. The Committee shall be directly responsible for the compensation of the independent auditors and for the oversight of their work. The independent accountants report directly to the Committee.
2. The Committee shall ensure the independence of the independent accountants by:
  - a. Requiring an annual written report from the independent accountants outlining all relationships between the independent accountants and NBI and addressing the matters set forth in Independence Standards Board Standard No. 1, and engaging in a dialogue with the independent accountants about any relationships or services that may impact their objectivity with regard to NBI.
  - b. Pre-approving all auditing services and permitted non-audit services to be performed by the independent accountants for NBI.
  - c. Ensuring the rotation of the lead audit partner as required by the rules and regulations of the Securities and Exchange Commission and overseeing compliance with guidelines relating to NBI's hiring of employees or former

employees of the independent accountant who participated in the Corporation's audit.

C. Responsibilities for Reviewing the Annual Audit, the Internal Audit Function, and the Financial Statements

1. The Audit Committee should meet with the independent public accountants upon the completion of any audit of the consolidated financial statements of the Corporation to review and discuss: (a) any report or opinion made in connection with the audit, (b) the adequacy and effectiveness of the Corporation's internal controls, (c) significant accounting policies, (d) significant audit adjustments, (e) management judgments and accounting estimates, (f) disagreements with management, (g) consultation with other accountants by management, and (h) any significant relationships between the Corporation and the independent auditors that could impair the auditors' independence.
2. The Audit Committee should review the internal audit function of the Corporation, including the scope and general extent of internal audits and credit reviews, the independence of the Corporate Auditor, the adequacy of the budget and staff and the extent to which recommendations made by the internal auditors or independent public accountants have been accepted and implemented by the Corporation.
3. The Audit Committee should review the consolidated statements of the Corporation and the annual reports required to be submitted to federal regulatory authorities to assess the accuracy and adequacy of the information presented.
4. The Audit Committee should review disclosures made to it by the CEO and CFO of NBI during their certification process for the Form 10-K and Form 10-Q about any significant deficiency in the design or operation of internal controls over financial reporting, any material weakness in internal controls, or any fraud involving management or employees who have a significant role in the Corporation's internal control over financial reporting.

D. Compliance Oversight and Reporting Responsibilities

1. As a part of its responsibilities, the Audit Committee should review with management, internal auditors and independent accountants the Corporation's compliance with applicable laws and regulations, as well as its internal policies concerning conflicts of interest and standards of conduct for Directors and employees.
2. The Audit Committee shall establish procedures for the confidential and anonymous submission by employees of NBI of concerns regarding questionable accounting or auditing matters.
3. As required by the Securities and Exchange Commission, the Committee shall prepare an annual report to shareholders to be included in the Corporation's annual proxy statement.