

Internal Audit Charter

Fauquier Bankshares, Inc.

Introduction:

Internal Auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of Fauquier Bankshares, Inc. ("the Company). It assists the Company, and its wholly owned subsidiary, The Fauquier Bank ("the Bank") in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's governance, risk management, and internal control.

The Company currently outsources its Internal Audit Functions and has appointed an Audit/Compliance Manager (referred to as Chief Audit Executive or CAE in the *Supplemental Policy Statement on the Internal Audit Function and its Outsourcing*, dated January 23, 2013) to oversee those functions and to work directly with the outside firm(s) engaged to perform internal audits for the bank.

This charter provides the framework for the conduct of the Internal Audit function for the Company and has been approved by the Audit Committee.

Role:

The internal audit function falls under the supervision of and the responsibility of the Audit Committee as outlined in the Audit Committee Charter.

Professional Standards:

The audit firm engaged to provide internal audit services for the Company and the Bank shall govern themselves by adherence to the Institute of Internal Auditors' mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing (Standards). This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

Authority:

The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorized full, free, and unrestricted access to any and all of the Company and the Bank's records, physical properties, and personnel pertinent to carrying out any engagement. All employees are requested to assist the internal audit activity in fulfilling its roles and responsibilities. The internal audit activity will also have free and unrestricted access to the Board.

Organization:

The Audit/Compliance Manager will report functionally to the Audit Committee and administratively (i.e. day to day operations) to the Chief Administrative Officer.

Every bank understands the critical business importance of a viable and proactive compliance program. Effective compliance management, applied to business strategy and supporting activities, is fundamental to the resiliency of the financial institution. Community banks, more so than in larger financial entities, must carefully allocate limited resources across the institution in order to optimize efficiencies and maximize positive results. While compliance risks in certain areas of banking are similar regardless the size of the financial institution, other risks are commensurate with the asset size and complexity of operations. Regulators allow for this factor, as presented in the *Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing, dated January 23, 2013*. The first sentence of the second paragraph states: "This statement applies to supervised institutions with greater than \$10 billion in total consolidated assets, including state member banks...." Ergo, while community banks can learn from regulations directly applied to larger institutions, consideration should be given when implementing said regulations in the community banking environment.

TFB seeks to focus the appropriate resources to those banking functions where they will be the most impactful and more greatly contribute to the Bank's strategic objectives. It is the consideration of the Bank that, while the Chief Executive Officer (CEO) carries the ultimate responsibility for all facets of TFB activities, it is in the Bank's best interest to ensure the CEO is enabled to direct his efforts to the strategic leadership of the Bank and to assign individual responsibilities to resources better positioned to ensure the execution and success of that assignment. In the instance of corporate compliance the CEO has assigned the operational responsibility to the Chief Administrative Officer (CAO). This in no way means the CEO is divested from the compliance function, as institutional controls to ensure Audit/Compliance Manager independence attest. With the Audit/Compliance Manager reporting administratively to the CAO, the Bank provides a mechanism whereby dedicated corporate resources are consistently and effectively provided to the corporate compliance program in general and the Audit/Compliance Manager in particular. This model inures to the general benefit of TFB, providing critical support without functional direction.

The preceding notwithstanding, the Audit/Compliance Manager reports functionally to the Audit Committee and interacts operationally with the Director who chairs the Audit Committee. The Audit Committee with the input of the Audit/Compliance Manager provides the necessary independence of review. As part of the Board, the CEO is available to observe the workings of the TFB corporate compliance program and to direct as he deems necessary. The Bank understands the importance of objectivity by the Audit/Compliance Manager. The Audit Committee, as part of its review function, conducts periodic evaluations to determine and confirm the objectivity of the Audit/Compliance Manager. The Committee further seeks to confirm that the Audit/Compliance Manager is not unduly influenced by the administrative reporting line arrangement. These evaluations will be conducted no less frequently than

annually. Documentation of the evaluations, along with the results of same, will be recorded as part of the Audit Committee meeting minutes, including any corrective actions should they be deemed necessary.

The Audit/Compliance Manager will serve as liaison and work directly with the internal audit firm engaged to perform internal audits for the Fauquier Bank. The internal audit firm will perform audits and other service as outlined in their engagement letter.

In the event that the internal audit firm experiences a temporary or permanent disruption in service and is unable to fulfill its obligation to the bank as outlined in their engagement letter, the Audit Committee will as necessary send out a Request for Proposal Letter and contract with a replacement firm within 30 days.

The Audit Committee will:

- Approve the internal audit charter.
- Annually approve the risk based Audit Universe Schedule and the supporting risk assessments.
- Approve audit related engagement letters.
- Receive communications from the Audit/Compliance Manager regarding the activities and performance of the internal auditors relative to the internal audit plan and other matters.
- Make appropriate inquiries of management and the Audit/Compliance Manager to determine whether there is inappropriate scope or resource limitations.
- Review and approve reports issued by all outsourced internal audit providers as well as those issued by the Audit/Compliance Manager.
- Review and monitor results of all audit findings including management's response and proposed corrective action plan.
- Conduct periodic evaluations (no less frequently than annually) to determine and confirm the objectivity of the Audit Compliance Manager.

The Audit/Compliance Manager will communicate and interact directly with the Audit Committee or Board as appropriate.

Independence and Objectivity:

The Audit/Compliance Manager is independent from the normal operations of the Company and the Bank, and is subject to measurement of the audit function's effectiveness and efficiency by the Board of Directors.

All internal audit activities shall remain free of influence by the various operational and managerial constituencies of the Company and Bank. These activities include, but are not limited to, matters of audit selection, scope, procedures, frequency, timing, or report content to permit the maintenance of independence.

Responsibility:

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organization's governance, risk management, and

internal controls as well as the quality of performance in carrying out assigned responsibilities to achieve the organization's strategic objectives.

This includes:

- Evaluating risk exposure relating to achievement of the organization's strategic objectives.
- Evaluating the reliability and integrity of information and the means used to identify, measure, classify, and report such information.
- Evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on the organization.
- Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Evaluating operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
- Monitoring and evaluating governance processes.
- Monitoring and evaluating the effectiveness of the organization's risk management processes.
- Performing consulting and advisory services related to governance, risk management and control as appropriate for the organization.
- Reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.
- Reporting significant risk exposures and control issues, including fraud risk, governance issues, and other matters needed or requested by the Board.
- Evaluating specific operations at the request of the Board or management, as appropriate.
- Making recommendations to management from time to time regarding internal controls and safeguards, the bank's accounting system, regulatory and legal compliance and changes to the bank's policy and procedures.

The Audit/Compliance Manager is responsible for:

- Developing a flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management and for submitting the Audit Universe Schedule and supporting risk assessments and any subsequent changes to the Audit Committee for review and approval.
- Scheduling and coordinating audits and ensuring audits are performed in conjunction with the Audit Universe Schedule and in accordance with the Audit Plan approved by the Audit Committee.
- Implementing as appropriate, any special tasks or projects requested by management and the Audit Committee.
- Ensuring the internal audit engagement letters are approved annually by the Audit Committee.
- Distributing audit reports received from the internal audit firms and maintaining the corresponding tracking sheet containing management responses to audit findings.
- Following up on audit findings and recommendations.

- Reviewing internal audit work-papers.

Reporting and Monitoring:

The internal audit firm will prepare and issue written reports for each internal audit visit. Copies of reports will be distributed as appropriate and findings from all audits will be communicated to the Audit Committee.

The internal audit reports will include management's response and corrective action taken with regard to audit findings and recommendations. Tracking sheets containing management responses along with an expected completion date will also be communicated to the Audit Committee.

Items that are Complete Pending Retesting will remain (as a separate tab) on the Outstanding Items Tracking Sheet until retesting is complete or documentation is provided to show that the item is complete. Best Practice findings or Observations will not be included on the Pending Retesting sheet.

The internal audit firm or the Audit/Compliance Manager will report to senior management and the Audit Committee or Board as needed on risk exposures and control issues, including fraud risk, governance issues, and other matters needed or requested by senior management and the Audit Committee.


Quality Assurance Program:

The outsourced internal audit activity will maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The program will include an evaluation of the internal audit activity's conformance with the Definition of Internal Audit and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

The Chief Audit Executive from the internal audit firm engaged to perform the bank's internal audits will communicate to the Audit Committee on the outsourced internal audit function's quality assurance and improvement program, including results of internal assessments and external assessments conducted at least every five years.

Internal Audit Charter

Reviewed and adopted by the Board of Directors *January 4, 2017*


Corporate Secretary