

# **HAWTHORN BANCSHARES, INC.**

## **AUDIT COMMITTEE CHARTER**

### **I. Audit Committee Purpose/Scope**

The Audit Committee is appointed by the Board of Directors (the "Board") of Hawthorn Bancshares, Inc. (the "Company") to provide assistance to the Board in fulfilling its oversight responsibilities to the shareholders with respect to (i) accounting and financial reporting processes, (ii) financial statement audits, and (iii) monitoring significant risk exposures. The Audit Committee's primary duties and responsibilities are to:

- Monitor the integrity of the Company's financial reporting process, including the disclosure controls and procedures established by management, and of the Company's systems of internal controls regarding finance, accounting, and legal compliance;
- Oversee the accounting and financial reporting processes of the Company and the audits of the Company's financial statements;
- Monitor the independence and performance of the Company's independent auditors and internal auditing department;
- Oversee the Company's compliance with legal and regulatory requirements;
- Oversee senior management to ensure the Company takes prompt and appropriate action on all audit, internal compliance review, and examination findings, particularly in areas where the Company's exposure to compliance risks and potential for consumer harm is increased; and
- Provide an avenue for, and encourage, open dialogue and communication among the independent auditors, the internal audit function, management and the Board so as to foster adherence to, and continuous improvement of, the Company's policies, procedures and practices regarding auditing, accounting and financial reporting matters.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to anyone in the Company. The independent auditors report directly to the Audit Committee. The Audit Committee has the ability to retain, at the Company's expense and without seeking the approval of the Board or the Company, independent legal, accounting, or other consultants or experts it deems necessary or appropriate in the performance of its duties.

### **II. Audit Committee Composition**

A. **Independence.** The Audit Committee shall be comprised of three or more independent directors as determined by the Board. Except as set forth below, each member of the Audit Committee must:

- qualify as independent under the requirements of Rule 10A-3 under the Securities Exchange Act of 1934;

- qualify as a director who is "independent" as defined in Nasdaq Rule 5605, who is not an "affiliated person" of the Company or any of its subsidiaries, and who does not receive any advisory, consulting or compensatory fee, except for service as a member of the Board or the Audit Committee or other committees of the Board and service as a member of the board or any board committee of any subsidiary or affiliate;
- satisfy the requirements for membership on an audit committee set forth in Nasdaq Rule 5605; and
- be free of any relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment as a member of the Audit Committee.

Notwithstanding the foregoing, the Board may appoint one member to the Audit Committee who is not independent as defined under Nasdaq Rule 5605 to the extent permitted by the rules of the Securities and Exchange Commission ("SEC") and Nasdaq if the Board has determined that membership on the Audit Committee by such individual is required by the best interest of the Company and its shareholders. A member of the Audit Committee appointed pursuant to this provision may not serve for in excess of two consecutive years and may not be the Chairman of the Audit Committee.

**B. Qualifications.** All members of the Audit Committee must also be able to read and understand fundamental financial statements, including the Company's balance sheets, income statements and cash flow statements. At least one member of the Audit Committee must at all times be financially sophisticated, in that he or she has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including but not limited to being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities. A member of the Audit Committee who qualifies as an "Audit Committee Financial Expert" under Item 407(d)(5) of SEC Regulation S-K is presumed to qualify as financially sophisticated. If required by SEC or Nasdaq rules, at least one member of the Audit Committee shall be an "Audit Committee Financial Expert." No member of the Audit Committee can have participated in the preparation of the financial statements of the Company or its subsidiaries at any time during the preceding three years.

**C. Appointment; Removal; Resignation.** Each member of the Audit Committee shall be appointed by the Board and generally shall serve until the next annual organizational meeting of the Board at which his or her successor is duly appointed and qualified. The members shall serve until their failure to qualify, resignation, or retirement, their removal by the Board or until their successors shall be duly appointed and qualified. A member of the Audit Committee is deemed to have resigned from the Audit Committee at such time as the member is removed from the Board pursuant to the Bylaws of the Company or such member has resigned or otherwise terminated his or her membership on the Board. A member of the Audit Committee is also deemed to have resigned from the Audit Committee at such time as a majority of the independent members of the Board has determined that such member of the Audit Committee is no longer an independent director of the Board or no longer meets the independence requirements of this Charter.

**D. Cure Periods for Audit Committee.** If the Audit Committee fails to satisfy the Audit

Committee composition requirements of this Charter because a member of the Audit Committee ceases to be independent for reasons outside the member's reasonable control or due to a vacancy on the Audit Committee, the Audit Committee may utilize such cure periods as may be permitted by the rules of the SEC and Nasdaq within which to regain compliance with such requirements.

### **III. Audit Committee Meetings**

A. **Chairman**. The Board shall elect one member of the Audit Committee to serve as the Chairman. The Chairman shall be responsible for the overall leadership of the Audit Committee, including presiding over the meetings, reporting to the Board and acting as a liaison with the Chief Executive Officer and the lead independent audit partner. If the Chairman is not present at a meeting of the Audit Committee, the members of the Audit Committee then present may designate one among them to act as the Chairman at such meeting.

B. **Meetings**. The Audit Committee shall meet at least quarterly, prior to the filing of each quarterly report on Form 10-Q or annual report on Form 10-K, as applicable, or more frequently as circumstances dictate or the Chairman deems appropriate, or as required by law or applicable rules and regulations. The Chairman shall prepare and/or approve an agenda in advance of each meeting. The Audit Committee may meet in person or telephonically. The Audit Committee shall establish its own rules of procedure which shall be consistent with the Bylaws of the Company and this Charter. The Chairman or a majority of the members of the Audit Committee may call a special meeting of the Audit Committee.

C. **Quorum**. A majority of the members of the Audit Committee shall constitute a quorum. Except as otherwise provided in this Charter, the vote of a majority of the members present at any meeting at which a quorum exists shall constitute the act of the Audit Committee.

D. **Executive Sessions**. To fulfill its responsibility to foster open communication, the Committee shall meet in separate executive session at least annually with management, the manager/director of the internal auditing department, the independent auditors and as a committee to discuss any matters that the Audit Committee or any of these groups believes should be discussed privately. In addition, the Audit Committee, or at least its Chairman, should communicate with management and the independent auditors at least quarterly to review the Company's financial statements and significant findings based upon the independent auditors' review procedures.

E. **Reporting**. The Audit Committee shall report to the Board and shall keep correct and complete minutes of its proceedings. Following each of its meetings, the Audit Committee shall deliver a report on the meeting to the Board, including a description of all actions taken by the Audit Committee at the meeting. The report will also include any significant issues arising with respect to (1) the quality or integrity of the Company's financial statements, (2) the Company's compliance with legal or regulatory requirements, or (3) the performance and independence of the Company's independent auditors.

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

To fulfill its purpose, the Audit Committee shall perform the following responsibilities and duties.

1. Discuss, review, and approve the results of the Internal Audit Review of the Audit Committee Charter and reassess the adequacy of this Charter at least annually. Submit the Charter and any proposed amendments, after approval by the Audit Committee, to the Board for ratification, and have the Charter published at least every three years, or otherwise made available on the Company's internet website, in accordance with SEC regulations.
2. Review and discuss with management and the independent auditor the Company's annual audited financial statements prior to the earlier of the release of earnings or the filing of its Annual Report on Form 10-K. Discuss significant issues regarding accounting principles, practices and judgments, including the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations", any significant changes to the Company's accounting principles and any items required to be communicated by the independent auditor in accordance with Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 16 (codified as Auditing Standard No. 1301), *Communications with Audit Committees* (as may be modified or amended), including the independent auditor's judgments about the quality, not just the acceptability, of the Company's accounting principles as applied in its financial reporting.
3. Review and discuss with management and the independent auditor, the Company's quarterly financial results and/or the Company's quarterly financial statements prior to the earlier of the release of earnings or the filing of the Quarterly Report on Form 10-Q. Discuss the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations". The Audit Committee Chairman may represent the entire Audit Committee for purposes of this review.
4. In consultation with management and the independent auditor, consider the integrity of the Company's financial reporting processes and controls, including (a) internal control over financial reporting and other internal controls and (b) disclosure controls and procedures. Discuss significant financial risk exposures and the steps management has taken to monitor, control and report such exposures. Review the significant reports to management prepared by the independent auditor, together with management's responses, including the status of previous recommendations, and follow up to these reports.
5. Discuss with management and the independent auditor the adequacy and effectiveness of (a) the Company's internal control over financial reporting, including any significant deficiencies in the design or operation of those controls which could adversely affect the Company's ability to record, process, summarize and report financial data and any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls, and (b) other internal controls.
6. Report regularly to the Board with respect to 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, and the performance and independence of the Company's independent auditor.

7. Review the independent auditor's report required by Section 204 of Sarbanes-Oxley Act of 2002, describing (a) all critical accounting policies and practices to be used, (b) all alternative treatments of financial information within GAAP that have been discussed with management, (c) ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor, and (d) other material written communications between the auditor and management, such as any management letter or schedule of unadjusted differences.

8. Review annually with management and the independent auditor (a) the report contained in the Company's annual report on Form 10-K regarding management's assessment of the effectiveness of the Company's internal control over financial reporting, and (b) the attestation and report of the independent auditor regarding management's assessment of internal control over financial reporting.

9. Review earnings press releases in advance of the release thereof (paying particular attention to any use of pro forma information and non-GAAP information). Discuss financial information and earnings guidance provided to analysts and rating agencies which may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made).

10. Discuss policies regarding risk assessment and risk management. While it is the job of Company management to assess and manage the Company's exposure to risk, the Audit Committee will discuss guidelines and policies that govern the process ensuring risks and potential for consumer harm is minimized. This discussion may include the Company's financial risk exposures and the steps management has taken to monitor and control exposures.

11. While the fundamental responsibility for the Company's financial statements and disclosures rests with management and the independent auditor, the Audit Committee will review: (a) major issues regarding accounting principles and financial statement presentations, including any significant changes in the Company's selection or application of accounting principles, (b) significant deficiencies or material weaknesses in and major issues as to the adequacy of the Company's internal control over financial reporting disclosed to the Audit Committee and any remedial measures to be taken to cure those deficiencies or weaknesses, (c) analyses prepared by management or the independent auditor 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 the treatment preferred by the independent auditor, and (d) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the Company.

12. Conduct an annual performance self-evaluation of the Audit Committee. The Audit Committee shall report its conclusions regarding this evaluation to the Board. The Audit Committee's report to the Board should generally include an assessment of its compliance with this Charter as well as an identification of areas in which the Audit Committee could improve its performance and this Charter could be improved.

13. Review and discuss with the Manager of Internal Audit and approve as applicable: (a) presentation of the staffing requirements, organizational structure, qualification requirements, and resource requirements to perform its duties; (b) internal audit activity plans; (c) the results of the quality assurance and improvement program; (d) review of the effectiveness of the internal audit activity, including conformance with the International Standards for the Professional Practice of Internal Auditing; and (e) management's response and status of action on important internal audit recommendations.

14. Review annually the appointment, performance and replacement of the person responsible for the Company's internal audit along with related base and incentive compensation.

15. Meet at least quarterly with the Manager of Internal Audit to discuss any matters the Audit Committee or the Manager of Internal Audit believes should be discussed privately.

16. Authorize the Internal Audit Department access to records, personnel, and physical properties relevant to the performance of the engagements.

## **V. Independent Auditors.**

1. The independent auditor is ultimately accountable to and shall report directly to the Audit Committee, as the representative of the Company's shareholders. The Audit Committee has the sole authority and direct responsibility to and shall select, hire, evaluate and, where appropriate, replace the independent auditor or may nominate the independent auditor to be proposed for shareholder approval. The Audit Committee shall annually review the independence, qualifications and performance of the independent auditor, including the review and evaluation of the lead partner of the independent auditor, and shall oversee the work of the independent auditor for the purpose of preparing or issuing an audit report on the Company's financial statements or related work or performing other audit, review or attest services for the Company. In making its evaluation, the Audit Committee shall take into account the opinions of management.

2. The Audit Committee has the authority to, and shall, approve (a) the fees and other compensation to be paid to the independent auditor, (b) the funding for the independent auditors (including fees for the purpose of preparing or issuing an audit report or performing other audit, approved non-audit, review and attestation services for the Company), (c) the funding of the compensation of independent legal, accounting, or other consultants or experts retained by the Audit Committee and (d) the funding of payment for ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.

3. The Audit Committee shall obtain and review a formal written statement of the independent auditor prior to its initial engagement, and thereafter, at least annually, prepared in accordance with applicable requirements of the PCAOB, describing all relationships between the independent auditor or its affiliates on the one hand, and the Company or persons in financial reporting oversight roles at the Company, on the other hand. Prior to such initial engagement, and thereafter, following receipt of each such

report annually, the Audit Committee will discuss with the independent auditor any disclosed relationships or services that may impact the objectivity and independence of the independent auditors, and if so determined by the Audit Committee, will recommend that the Board take appropriate action to oversee the independence of the independent auditor. The Audit Committee will also cause the independent auditor to affirm, in writing, to the Audit Committee that it is independent and in compliance with PCAOB requirements and to document the substance of its discussion with the Audit Committee.

4. The Audit Committee shall confirm that neither the lead audit partner nor the primary reviewing partner of the independent auditor has performed audit services for the Company for each of the five previous fiscal years.

5. The Audit Committee shall consider results of the independent accountant's last peer review, litigation status, and disciplinary actions, if any.

6. At least annually, the Audit Committee shall consult with the independent auditor, out of the presence of management, about the adequacy and effectiveness of the internal control over financial reporting and the fair presentation of the Company's financial statements and their preparation in accordance with GAAP.

7. The Audit Committee shall review the independent auditor engagement letter and audit plan and discuss the scope and general approach of the audit, including staffing, locations and reliance upon management.

8. The Audit Committee shall approve in advance any audit services (which may entail providing comfort letters in connection with securities underwritings) and non-audit services (including the fees and terms thereof) to be performed by the independent auditor to determine whether such relationships and services are compatible with the auditor's independence; provided, however, that the following services cannot be provided even with Audit Committee approval, except to the extent permitted by the SEC rules or unless the PCAOB approves an exemption on a case by case basis: (a) bookkeeping or other services related to the accounting records or financial statements of the Company; (b) financial information systems design and implementation; (c) appraisal or valuation services, fairness opinions or contribution-in-kind reports; (d) actuarial services; (e) internal audit outsourcing services; (f) management functions or human resources; (g) broker-dealer, investment adviser, or investment banking services; (h) legal services and expert services unrelated to the audit; and (i) any other service that the PCAOB determines, by regulation is not permissible.

9. The Audit Committee may pre-approve audit and non-audit services by either (a) designating one or more members of the Audit Committee to pre-approve any audit or non-audit services to be performed by the independent auditor; provided that such member(s) present such pre-approved activity to the full Audit Committee at its next scheduled meeting or (b) establishing pre-approval policies and procedures; provided the policies and procedures are detailed as to the particular service, the Audit Committee is informed of each service and such policies do not delegate the Audit Committee's responsibilities to management.

10. The Audit Committee shall review and discuss certain matters required to be communicated to the Audit Committee in accordance with PCAOB requirements.

11. The Audit Committee shall consider the independent auditor's judgments about the quality and appropriateness of the Company's accounting principles as applied in financial reporting by:

a. discussing with management and the independent auditor the quality of the accounting principles and underlying estimates used in the preparation of the Company's financial statements;

b. discussing with the independent auditor the clarity and fair presentation of the financial disclosure practices used or proposed by the Company; and

c. inquiring as to the independent auditor's view about whether management's choices of accounting principles appear reasonable from the perspective of income, assets and liability recognition, and whether those principles are common practices or are minority practices.

12. The Audit Committee shall periodically discuss with the independent auditor whether all material correcting adjustments identified by the independent auditor in accordance with GAAP and rules of the SEC are reflected in the Company's financial statements.

13. The Audit Committee shall assure that the independent auditor change the audit partners for the audit in accordance with the rules of the SEC and PCAOB and at least annually consider whether, in order to assure continuing auditor independence, the Company should change the independent auditor.

## **VI. Internal Audit**

The mission of the Internal Audit Department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

A. The scope of work of Internal Audit is to determine whether the organization's network of governance, risk management, and control processes, as designed and represented by management, is adequate and functioning.

B. To ensure the mission and scope of Internal Audit is achieved, the responsibilities of the Manager of Internal Audit include but are not limited to the following:

1. Ensure strong communication and reporting lines between the Internal Audit Department and the Audit Committee. To achieve independence, the Manager of Internal Audit should report functionally to the Audit Committee and administratively to the Chief Operations Officer/Chief Risk Officer.

2. Monitor and assess internal audit effectiveness. The Manager of the Internal Audit must:

- a. develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity;
- b. communicate the results of the quality assurance and improvement program to senior management and the Audit Committee;
- c. effectively manage the internal audit activity to ensure it adds value to the organization; and
- d. ensure external assessments are conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization and communicate results to senior management and the Audit Committee;

3. Review Internal Audit staffing, organizational structure, and qualification requirements ensuring Internal Audit has the necessary resources and competencies to perform its duties. Present findings of review to the Audit Committee for approval annually;

4. Periodically review the Audit Committee Charter and present results of review to senior management and Audit Committee for approval;

5. Communicate the internal audit activity's plans to senior management and the Audit Committee for review and approval;

6. Reports to senior management and the Audit Committee must include significant risk exposures and control issues, including governance issues, and other matters needed or requested by senior management and the Audit Committee; and

7. Establish a follow-up process to monitor and ensure management actions have been effectively implemented or that senior management has accepted the risk for not taking action.

## **VII. Legal Compliance**

At least annually, the Audit Committee shall review with the Company's legal counsel (a) any legal matters that could have a significant impact on the organization's financial statements or reporting, (b) the Company's compliance with applicable laws and regulations and internal controls designed to ensure such compliance, and (c) inquiries received from regulatory or governmental agencies.

## **VIII. Other Audit Committee Responsibilities.**

The Audit Committee shall:

1. Annually prepare a report to shareholders as required by the SEC. The report is to be included in the Company's annual proxy statement. The report is to state whether the Audit Committee has:

a. reviewed and discussed the audited financial statements with management;

b. discussed with the independent auditor the matters required to be discussed by the applicable requirements of the PCAOB and SEC; and

c. received certain disclosures from the independent auditor required by applicable requirements of the PCAOB regarding the independent auditor's communications with the Audit Committee concerning the independent auditor's independence and has discussed with the independent auditor the independent auditor's independence.

2. If, based on the foregoing review and discussions, the Audit Committee recommends to the Board that the audited financial statements be included in the Annual Report filed with the SEC, then a statement to that effect shall be included in the report to shareholders included in the Company's annual proxy statement.

3. Review, exercise oversight over and approve all related-party transactions on an ongoing basis.

4. Adopt and implement a policy (a) to receive, handle and retain complaints regarding (i) accounting and auditing matters, (ii) internal control over financial reporting and other internal accounting controls and (iii) disclosure controls and procedures, and (b) to provide for the confidential, anonymous submissions by employees making complaints regarding questionable accounting or auditing matters or other matters referenced in clause (a).

5. Establish clear policies for hiring current employees or former employees of the independent auditor, including policies to ensure that any such hiring will not cause such independent auditor to no longer be considered independent.

6. Review succession planning within the Company with respect to financial and accounting personnel.

7. Perform any other activities consistent with this Charter, the Company's Articles of Incorporation and Bylaws, governing law, rules and regulations, and Nasdaq listing standards as the Audit Committee or the Board deems necessary or appropriate.

## **IX. RELIANCE ON OTHERS**

Unless a committee member has knowledge that makes reliance unwarranted, each Committee member, in discharging his or her duties to the Company, may rely on information, opinions, reports, or statements, any of which may be written or oral, formal or informal, including financial statements, valuation reports, and other financial data, if prepared or presented by: (a) one or more officers or employees of the Company whom the Committee member believes in his or her

reasonable business judgment and good faith to be reliable and competent in the matters presented; (b) compensation consultants, legal counsel, or other persons as to matters which the Committee member believes in his or her reasonable business judgment and good faith to be within the professional or expert competence of such person; or (c) another committee of the Board of which such Committee member is not a member if the Committee member believes in his or her reasonable business judgment and good faith that such Committee merits confidence.

**X. Internal Audit Profession Framework.**

The internal audit profession is covered by the International Professional Practices Framework of the Institute of Internal Auditors. The internal audit department will meet or exceed these mandatory requirements of the profession.

The Manager of Internal Audit will annually discuss with the Audit Committee the results of the internal audit quality assurance and improvement program by which the Manager of Internal Audit assures effective operation of internal audit activities.