

## **DOWNEY FINANCIAL CORP.**

### **CHARTER FOR THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS**

#### **I. Audit Committee Purpose**

The Audit Committee shall be appointed by the Board of Directors, to assist the Board in fulfilling its oversight responsibilities. The Audit Committee's primary duties and responsibilities are to:

- Assist Board oversight of the integrity of the financial statements of Downey Financial Corp. and its subsidiaries (individually "DFC" and with DFC's subsidiaries, collectively called "Downey");
- Assist Board oversight of the independence, qualifications and performance of Downey's independent auditors, the performance of the internal auditing department, and the internal asset review function;
- Assist Board oversight of Downey's compliance with legal and regulatory requirements; and
- Prepare any report required by the rules of the United States Securities and Exchange Commission ("SEC") to be included in DFC's annual proxy statement.

The Audit Committee shall have the sole authority to appoint or replace the independent auditors, subject to any required shareholder ratification. The Audit Committee may retain, at Downey's expense, independent legal, accounting, or other consultants or experts it deems necessary in the performance of its duties. Downey shall provide for appropriate funding, as determined by the Audit Committee, to compensate the independent auditors and any advisors the Audit Committee employs, and to cover ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.

#### **II. Audit Committee Composition and Meetings**

Audit Committee members shall satisfy the requirements for independence and expertise established by the New York Stock Exchange, Inc., in Rule 10A-3 of the Securities Exchange Act of 1934 ("Exchange Act") and other rules and regulations of the SEC. The Audit Committee shall be comprised of at least three directors, each of whom shall be independent non-executive directors, free from any relationship that would interfere with the exercise of his or her independent judgment. Each member of the Audit Committee shall be financially literate, as such qualification is interpreted by DFC's Board in its business judgment. At least one member of the Audit Committee shall have accounting or related financial management expertise.

The Audit Committee shall meet periodically (at least annually) in separate executive sessions with management, the Director of Internal Audit, the Director of Internal Asset Review, the independent auditors, and as a committee to discuss any matters that the Committee or each of those groups believe should be discussed.

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

The Audit Committee shall:

1. Meet to review and discuss with management and the independent auditors Downey's quarterly and annual audited financial statements, including disclosures made in "management's discussion and analysis of financial condition and results of operations" prior to filing or distribution and recommend to the Board whether the audited financial statements should be included in DFC's Form 10-K.
2. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures.
3. Review major issues regarding accounting principles and financial statement presentations, including any significant changes in Downey's selection or application of accounting principles, any major issues as to the adequacy of Downey's internal controls and any special steps adopted in light of any material control deficiencies identified.
4. Discuss with management and the independent auditors the effect(s) of regulatory and accounting initiatives as well as off-balance sheet structures on Downey's financial statements.
5. Discuss DFC's earnings press releases including the type and presentation of information to be included therein (paying particular attention to any use of "pro forma" or "adjusted" non-GAAP information) as well as financial information and earnings guidance provided to analysts and rating agencies, if any.
6. Review and discuss quarterly reports from the independent auditors on: significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including all critical accounting policies and practices to be used; all alternative treatments 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 auditors; and other material written communications between the independent auditors and management, such as any management letter or schedule of unadjusted differences.
7. Review the independence and performance of the independent auditors and annually select the independent auditors or approve any discharge of independent auditors when circumstances warrant.

8. Assume direct responsibility for the compensation and oversee the work of the independent auditors (including resolution of disagreements between management and the independent auditors regarding financial reporting) for purposes of preparing or issuing an audit report or related work. The independent auditors shall report directly to the Audit Committee. Preapprove all auditing services and permitted non-audit services (including the fees and terms thereof) to be performed for Downey by its independent auditors, subject to the de minimus exceptions for non-audit services described in Section 10A(I)(1)(B) of the Exchange Act which are approved by the Audit Committee prior to completion of the audit.
9. Set clear policies for the hiring of employees or former employees of the independent auditors who participated in any capacity in any audit of Downey.
10. Discuss certain matters required to be communicated to audit committees in accordance with AICPA SAS 61.<sup>1</sup>
11. Evaluate the lead partner of the independent auditor team. Ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by law. Consider whether there should be regular rotation of the audit firm itself in order to assure continuing auditor independence. Obtain and review a report from the independent auditors at least annually describing (a) the independent auditors' internal quality control procedures, (b) any material issues raised by the most recent internal quality control review or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five (5) years respecting one or more independent audits carried out by the firm, (c) any steps taken to deal with any such issues, and (d) all relationships between the independent auditors and Downey. Evaluate the qualifications, performance and independence of the independent auditors, taking into account the opinions of management and the internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditors to the Board.
12. Review and discuss with the independent auditors and management guidelines and policies with respect to risk assessment and risk management and financial strength.

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<sup>1</sup> Statement of Auditing Standards (SAS) No. 61 requires auditors to discuss certain matters with audit committees. 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 auditors' responsibility under Generally Accepted Auditing Standards (GAAS);
- Significant accounting policies;
- Management's judgments and accounting estimates;
- Significant audit adjustments;
- Other information in documents containing audited financial statements;
- 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.

13. Discuss with management and the independent auditors any correspondence with regulators or other governmental agencies and any published reports which raise material issues regarding Downey's financial statements or accounting policies.
14. Annually prepare a report to shareholders as required by the SEC to be included in DFC's annual proxy statement.
15. Establish procedures for the Audit Committee to receive, retain and address complaints Downey receives regarding accounting, internal accounting controls, or auditing matters, and any confidential, anonymous submissions by Downey employees regarding questionable accounting or auditing matters.
16. Maintain minutes of meetings and periodically report to the Board.
17. Evaluate the Audit Committee's performance annually.
18. Review with the independent auditors any audit problems or difficulties and management's response. This review should include any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. The committee may also review with the auditor: any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or internal control" letter issued, or proposed to be issued, by the audit firm to Downey.

**DOWNEY FINANCIAL CORP.**

**Audit Committee Meeting Agenda Guidelines**

Scheduled Meetings			
Apr.	Jul.	Oct.	Jan.-Feb.

**I. Audit Committee Purpose**

Conduct special investigations

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**II. Audit Committee Composition and Meetings**

1. Assess independence and financial literacy of audit committee
2. Establish number of meetings
3. Audit Committee Chair to establish meeting agenda
4. Enhance financial literacy – update on current financial events
5. Executive session with auditors, internal audit, mgmt, committee

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

1. Review Charter, publish in proxy if necessary or appropriate
2. Meet to review annual financial statements-discuss with mgmt., auditors
3. Consider internal controls and financial risks
4. Meet to review quarterly results and findings
5. Recommend appointment of auditors
6. Approve audit fees
7. Discuss auditor independence
8. Review auditor plan
9. Discuss year-end results, SAS 61 report
10. Discuss quality of accounting principles
11. Review internal audit plan
12. Review appointment, performance of Director of Internal Audit
13. Review significant internal audit reports
14. Review legal matters with counsel
15. Prepare report to shareholders
16. Perform other activities as appropriate
17. Maintain minutes and report to Board

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			X
X	X	X	X
X	X	X	X
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			X
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			X
			X
X	X	X	X
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X	X	X	X

**X**= Recommended timing

**\***= As needed