

# QUANTUMSPHERE, INC.

## AUDIT COMMITTEE CHARTER

The following will serve as the Charter for the Audit Committee of the Board of Directors of QuantumSphere, Inc. (“QSI” or the “Company”).

**I. Purpose.** The Audit Committee (the “Committee”) assists the Board of Directors (the “Board”) of QSI in overseeing the accounting and financial reporting processes of the Company and audits of the financial statements of the Company, including (a) the integrity of the Company’s financial statements, (b) the Company’s compliance with legal and regulatory requirements, (c) the independent public accountants’ qualifications and independence, (d) the performance of the Company’s internal audit function and independent public accountants, and (e) such other duties as may be directed by the Board. In addition, the Committee will, upon the Company becoming publicly traded, prepare an Audit Committee Report as required by the Securities and Exchange Commission (“SEC”) to be included in the Company’s annual proxy statement.

While the Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Committee to plan or conduct audits or to determine that the Company’s financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles (“GAAP”) and applicable rules and regulations. These are the responsibilities of management and the independent public accountants.

**II. Membership.** The Committee will be comprised of three directors of QSI’s Board. All members of the Committee will be directors who meet the independence requirements of the SEC (including Rule 10A-3 promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) and other applicable law. In addition, one member of the Committee will meet the knowledge requirements of the SEC and qualify as a “Financial Expert”. The members of the Committee will be appointed by and serve at the discretion of the Board. The Chairperson of the Committee will be appointed by the Board.

**III. Specific Responsibilities and Duties.** The Board delegates to the Committee the express authority to do the following:

**A. Independent Public Accountants**

**1. Selection; Fees.** Be directly responsible for the appointment, compensation, retention and oversight of the work of the independent public accountants (including resolution of disagreements between management and the independent public accountant regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services, and, where appropriate, terminate and replace such firm. Such independent public accountants shall report directly to and be ultimately accountable to the Committee.

**2. Scope of Audit.** Review, evaluate and approve the annual engagement proposal of the independent public accountants (including the proposed scope and approach of the annual audit).

**3. Pre-Approval of Audit and Non-Audit Services.** Pre-approve all auditing services and all non-auditing services to be performed by the independent public accountants. Such pre-approval can be given as part of the Committee's approval of the scope of the engagement of the independent public accountants or on an individual basis. The pre-approval of non-auditing services can be delegated by the Committee to one or more of its members, but the decision must be presented to the full Committee at the next scheduled meeting. The independent public accountants shall not be retained to perform the prohibited non-audit functions listed on Exhibit A.

**4. Statement from Independent Public Accountants.** Obtain and review from the independent public accountants at least annually a formal written statement regarding: (i) the independent public accountants' internal quality-control procedures; (ii) any material issues raised by the most recent internal quality-control review, or peer review, of the independent public accountants, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, with respect to one or more independent audits carried out by the independent public accountants, and any steps taken to deal with any such issues; and (iii) in order to assess the independent public accountants' independence) all relationships between the independent public accountants and the Company.

**5. Hiring Policies.** Set clear hiring policies for employees and former employees of the independent public accountants.

**6. Review Problems.** Review with the independent public accountants any audit problems or difficulties the independent public accountants may have encountered and management's responses, including: (i) any restrictions on the scope of activities or access to requested information; (ii) any recommendations made by the independent public accountants as a result of the audit; (iii) any significant disagreements with management; (iv) any accounting adjustments that were noted or proposed by the independent public accountants but were "passed" (as immaterial or otherwise); (v) any communications between the audit team and the independent public accountants' national office respecting auditing or accounting issues presented by the engagement; (vi) any "management" or "internal control" letter issued, or proposed to be issued, by the independent public accountants to the Company; and (vii) the responsibilities, budget and staffing of the Company's internal audit function.

**7. Review of the Independent Public Accountants.** At least annually, evaluate the independent public accountants' qualifications, performance and independence, including a review and evaluation of the lead partner of the independent public accountants. Ensure that the lead or coordinating audit partner having primary responsibility for the audit or review and the concurring or reviewing audit partner of the independent public accountants are rotated at least every five years and that other audit partners (as defined by the SEC) are rotated at least every seven years in accordance with

rules promulgated by the SEC. Consider whether there should also be a regular rotation of the independent accountants. Present conclusions with respect to the independent public accountants to the full Board.

## **B. Financial Reporting**

**1. Annual and Quarterly Financials.** Review and discuss with management and the independent public accountants the Company's annual and quarterly financial statements (including the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the independent public accountants' reviews of the quarterly financial statements), prior to the public release of such information.

**2. Accounting Principles.** Review with management and the independent public accountants (i) material accounting principles applied in financial reporting, including any material changes in the selection or application of accounting principles followed in prior years; (ii) any items required to be communicated by the independent public accountants in accordance with AICPA Statement of Auditing Standards ("SAS") 61; and (iii) analyses prepared by management and/or the independent public accountant 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.

**3. Press Releases.** Discuss and review generally with management earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies. Review the type and presentation of information to be included in earnings press releases, including any use of "pro forma," or "adjusted" non-GAAP, information.

**4. Regulatory Developments.** Review with management and the independent public accountants the effect of regulatory and accounting initiatives, as well as off-balance sheet structures (if applicable) on the Company's financial statements.

## **C. Internal Audit and Risk Management.**

**1. Internal Audit and Controls.** Review the budget, qualifications, activities, effectiveness and organizational structure of the internal audit function and the performance, appointment and replacement of the lead internal auditor, and review summaries of material internal audit reports and management's responses. Review major issues as to the adequacy of the Company's internal controls and any special audit steps adopted in light of control deficiencies.

**2. Risk Management.** Periodically discuss policies with respect to risk assessment and risk management, and the Company's plans to monitor, control and minimize such risks and exposures, with the independent public accountants, internal auditors and management.

#### **D. Financial Reporting Processes.**

**1. Reports.** Obtain and review reports from the independent public accountants regarding: (a) all critical accounting policies and practices to be used by the Company; (b) all alternative treatments of financial information within GAAP that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent public accountants; and (c) all other material written communications between the independent public accountants and management, including any management letter or schedule of unadjusted differences.

#### **E. Legal and Regulatory Compliance**

**1. SEC Report.** Prepare the annual report included in the Company's proxy statement as required by the proxy rules issued or enforced by the SEC.

**2. Complaints.** Establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

#### **F. Other.**

**1. Recommendations; Reports.** Regularly report to the Board on the Committee's activities and make appropriate recommendations. Review with the full board 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, the performance and independence of the Company's independent public accountants, or the performance of the internal audit function.

**2. Evaluation.** Annually evaluate the performance of the Committee.

**3. Review and Publication of Charter.** Review and reassess the adequacy of this Charter at least annually and recommend any proposed changes to the Board, as appropriate, and publish the Charter as required by applicable law.

#### **IV. Meetings.**

**A. Executive Sessions.** The Committee shall meet periodically with the independent public accountants, internal auditors and management in separate executive sessions.

**B. Other Meetings.** Other meetings will be with such frequency, and at such times, as its Chairperson, or a majority of the Committee, determines. A special meeting of the Committee may be called by the Chairperson and will be called promptly upon the request of any two Committee members.

**V. Subcommittees.** The Committee has the power to appoint and delegate matters to subcommittees, but no subcommittee will have any final decision-making authority on behalf of the Board or the Committee.

**VI. Reliance; Experts; Cooperation; Expenses.**

**A.** Retention of Independent Counsel and Advisors. The Committee has the power, in its sole discretion, to retain at the Company's expense such independent counsel, advisors and experts as it deems necessary or appropriate to carry out its duties.

**B.** Reliance Permitted. The Committee will act in reliance on management, the Company's independent public accountants, internal auditors, and advisors and experts, as it deems necessary or appropriate to enable it to carry out its duties.

**C.** Investigations. The Committee has the power, in its discretion, to conduct any investigation it deems necessary or appropriate to enable it to carry out its duties.

**D.** Required Participation of Employees. The Committee shall have unrestricted access to the Company's employees, independent public accountants, internal auditors, internal and outside counsel, and may require any employee of the Company or representative of the Company's outside counsel or independent public accountants to attend a meeting of the Committee or to meet with any members of the Committee or representative of the Committee's counsel, advisors or experts.

**E.** Expenses. The Company shall provide the Committee with appropriate funding, as determined by the Audit Committee, in its capacity as a committee of the Board, for:

**1.** Compensation of the independent public accountants engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company;

**2.** Compensation to any advisors employed by the Audit Committee under Section VI.A hereof; and

**3.** Ordinary administrative expenses of the Audit Committee that is necessary or appropriate in carrying out its duties.

Approved by the Board of Directors on August 10, 2006.

## **EXHIBIT A**

### **Prohibited Non-Audit Services**

1. Bookkeeping or other services related to the accounting records or financial statements of the Company;
2. Financial information systems design and implementation;
3. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
4. Actuarial services;
5. Internal audit outsourcing services;
6. Management functions or human resources;
7. Broker or dealer, investment advisor, or investment banking services;
8. Legal services and expert services unrelated to the audit; and
9. Any other services that the Public Company Accounting Oversight Board to be formed pursuant to the Sarbanes-Oxley Act of 2002 determines, by regulation, is impermissible.