

NANOPHASE TECHNOLOGIES CORPORATION

AUDIT COMMITTEE CHARTER

(as amended through April 29, 2004)

Purpose

The primary purpose of the Audit Committee (the "Committee") is to represent and assist the Board of Directors (the "Board") in fulfilling its responsibilities for oversight of: the Company's accounting and financial reporting processes; the preparation, presentation and integrity of the financial reports and other financial information provided by the Company to any governmental or regulatory body, the public or other users thereof; the adequacy and efficacy of the Company's systems of internal accounting, auditing and financial controls; the Company's compliance with legal and regulatory requirements; the conduct, independence and qualifications of the Company's outside auditor; and the performance of the annual independent audit of the Company's financial statements.

Authority

The Committee shall have the authority and sufficient funding to discharge its duties and responsibilities, including the authority to engage special legal, accounting or other consultants (without seeking Board approval) to advise the Committee as it determines necessary. In discharging its oversight role, the Committee shall be empowered to conduct or authorize investigations into or studies of matters within the Committee's scope of responsibilities as described herein, and may retain, at the expense of the Company, independent counsel or other consultants necessary to assist the Committee in any such investigations or studies. The Committee shall have sole authority to negotiate and approve the fees and retention terms of such independent counsel or other consultants, and ordinary administrative expenses of the Committee that are deemed necessary or appropriate in carrying out its duties.

Composition of the Committee

The Committee shall consist of at least three members of the Board, with the exact number being determined by the Board. The members of the Committee shall be appointed and replaced from time to time by the Board. The Board shall elect or appoint a chair of the Committee, who will have authority to act on behalf of the Committee between meetings.

Each member of the Committee shall be "independent" as that term is defined in (i) paragraph (m) of Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f), and the rules and regulations of the Securities and Exchange Commission promulgated thereunder, and (ii) the rules of The Nasdaq Stock Market, Inc. ("NASDAQ"), or any other stock exchange or quotation service on which the Company's securities are listed. Further, each member of the Committee shall meet all other requirements for membership on the Committee set forth in the rules of NASDAQ, or any other stock exchange or quotation service on which the Company's securities are listed, and be free from any relationship that, in the opinion of the Board, would interfere with the exercise of his or her independent judgment as a member of the Committee.

All members of the Committee shall, in the judgment of the Board, possess the ability to read and understand the Company's fundamental financial statements, and have a working familiarity with basic finance and accounting practices. In addition, at least one member of the Committee shall be, in the judgment of the Board, an audit committee financial expert in accordance with the rules and regulations of the SEC, and at least one member (who may also serve as the audit committee financial expert) shall have, in the judgment of the Board, past employment experience

in finance or accounting, requisite professional certification in accounting, or other comparable experience or background that results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities, in accordance with NASDAQ's listing requirements. Committee members may enhance their familiarity with finance and accounting by participating in educational programs conducted by the Company or an outside consultant.

The composition of the Committee shall be examined periodically and, if necessary, the Committee shall be reconstituted by the Board.

Meetings

The Committee shall meet at least four times a year and at such other times as it deems necessary to fulfill its responsibilities.

The Committee shall periodically meet separately, in executive session, with management, the outside auditor and the Company's internal audit personnel, and report (either as a committee or through the Committee chair) regularly to the Board with respect to its activities.

Duties and Responsibilities

The following shall be the common recurring activities and responsibilities of the Committee in carrying out its oversight functions. These activities and responsibilities are set forth below as a guide to the Committee with the understanding that the Committee may alter or supplement them as appropriate under the circumstances to the extent permitted by applicable law, regulation or listing standard:

Audits and the Relationship with the Outside Auditor

- The Committee shall be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company. The outside auditor and any other registered public accounting firm engaged by the Company shall report directly to the Committee.
- In furtherance of the above, the Committee shall, on an annual basis, evaluate the independent auditors' qualifications, performance and independence. To assist in this undertaking, the Committee shall request information and consider (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 accounting firm or by any inquiry or investigations by governmental or professional authorities (within the preceding five years) respecting one or more independent audits carried out by the independent auditors, and any steps taken to deal with any such issues and (c) all relationships the independent auditors have with the Company and relevant third parties in order to determine the impact, if any, of such relationships on the independent auditors' independence. In making its determination, the Committee shall consider not only auditing and other traditional accounting functions performed by the independent auditors, but also non-audit services performed or proposed to be performed.
- Annually, the Committee shall select the outside auditor, and subsequently inform the Board of Directors. Factors considered in making the selection include the auditor's independence, effectiveness and fees. In particular, the Committee shall consider whether the outside auditor's quality controls are adequate and

whether the provision of non-audit services by the outside auditor is compatible with maintaining the outside auditor's independence.

- The Committee shall ensure the regular rotation of the lead audit partner and audit review partner as required by law.
- The Committee shall adopt and implement procedures for the review and pre-approval of audit and permissible non-audit services, and review and approve the fees and terms for all such services. Specifically, the Committee shall approve in advance, in accordance with guidelines established by the Committee, all auditing services and permissible non-audit services, including tax services, to be performed by the registered public accounting firm outside of its regular audit engagement.
- The Committee may delegate to one or more of its members the authority to pre-approve non-audit services between regularly scheduled meetings, provided that such approvals are reported to the full Committee at its next meeting.
- The Committee shall, at least annually and more frequently as circumstances dictate: (a) obtain and review from the outside auditor a formal written statement delineating all relationships between the auditor and the Company consistent with the Independence Standards Board Standard No. 1, as amended; and (b) actively engage in a dialogue with the outside auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the outside auditor and be responsible for taking, or recommending that the board of directors take, appropriate action to oversee the independence of the outside auditor.
- The Committee shall review with the outside auditor any problems or difficulties encountered during the course of its audit work, any management letter provided by the auditor and the Company's response to such letter, and any disputes between management and the outside auditor. The Committee shall also obtain and review timely reports from the outside auditor with respect to material written communications between management and the auditor and related matters.
- The Committee shall meet with the outside auditor to review the planning of the audit, including the scope, staffing, locations, reliance on management, and general audit approach.
- The Committee shall periodically consult with the outside auditor out of the presence of management about internal controls and the fullness and accuracy of the Company's financial statements.

Financial Statements and Disclosure

- The Committee shall review and discuss with financial management and the outside auditor the audited financial statements to be included in the Company's Annual Report on Form 10-K (or the Annual Report to Stockholders if distributed prior to the filing of the Form 10-K) and the report thereon, and including any disclosures with respect thereto in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," and review and consider with the outside auditor the matters required to be discussed by Statement of Auditing Standards ("SAS") No. 61. Such review shall take place prior to the publication of the annual audited financial statements, and the Committee shall make its recommendation to the Board with respect to their inclusion in the Company's Annual Report on Form 10-K or Annual Report to Stockholders, as appropriate. Similarly, the Committee shall review and discuss any other financial information submitted to any governmental body, or the public, including any certification, report, opinion, or review rendered by the Company's registered public accounting firm.
- As a whole, or between meetings through the Committee chair, the Committee shall review with financial management and the outside auditor the Company's

interim financial results to be included in the Company's quarterly reports to be filed with the SEC, and including any disclosures with respect thereto in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the matters required to be discussed by SAS Nos. 61 and 71. Such review will occur prior to the Company's publication of the interim financial results.

- The Committee, as a whole or between meetings through the Committee chair, shall review with management and the outside auditor the Company's earnings press releases (including the use of "pro forma" or "adjusted" non-GAAP information) prior to their release to the public, and periodically review and discuss the financial information and earnings guidance, if any, provided to analysts by the Company.
- The Committee shall discuss with management and the outside auditor any significant issues regarding the accounting principles, practices and judgments made in connection with the preparation of the Company's financial statements. In this regard, the Committee shall obtain and review a report from the outside auditor regarding all critical accounting policies and practices to be used in the Company's financial statements and any major changes thereto, all alternative treatments of financial information within GAAP that have been discussed with management, the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the outside auditor, and other material written communications between the outside auditor and management.
- The Committee shall develop and review the Company's disclosure controls and procedures, and management's assessment thereof.
- As necessary, the Committee shall review with the outside auditor and management:
 - a. significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements;
 - b. the clarity of the financial disclosures made by the Company;
 - c. potential changes in GAAP and other regulatory and accounting initiatives, and their effect on the Company's financial statements; and
 - d. the effect of off-balance sheet structures and aggregate contractual obligations on the Company's financial statements.

Internal Controls

- The Committee shall review and discuss with management and the outside auditor the quality, adequacy and effectiveness of the Company's accounting, financial and other internal controls and procedures, and elicit recommendations for the improvement of such internal control procedures or particular areas where new or more detailed controls or procedures are desirable.
- The Committee shall obtain from management and the outside auditor and review the disclosures made in connection with the certification process regarding the effectiveness of the Company's internal control structure and procedures for financial reporting, including all significant deficiencies and material weaknesses in the design and operation of internal control over financial reporting, any fraud (whether or not material) that involves management or other employees having a significant role in internal control over financial reporting, and all changes to internal control over financial reporting, including corrective actions, since the last report.

Compliance Oversight and Other Responsibilities

- The Committee shall establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal

accounting controls and auditing matters, and the confidential (to the extent consistent with conducting the investigation and taking any appropriate remedial action, in accordance with applicable law) and anonymous submission by employees of the Company of concerns regarding allegedly questionable accounting or auditing matters.

- The Committee shall review and assess with the Company's counsel any legal matters that could have a material impact on the organization's financial statements, the Company's compliance with applicable laws and regulations, and the Company's Code of Business Conduct and Ethics, and any material reports or inquiries received from, or correspondence with, regulators or governmental agencies.
- The Committee shall discuss with the outside auditor the annual review of the executive officers' and directors' expense accounts and perquisites.
- The Committee shall obtain and review from the outside auditor the reports required to be furnished under Section 10A of the Securities Exchange Act of 1934, as amended, and any information with respect to illegal or improper acts in accordance therewith.
- The Committee shall review and determine whether to approve any transactions between the Company, members of management, directors, and associates and affiliates thereof, in accordance with the rules and regulations of NASDAQ.
- The Committee shall review and discuss guidelines and policies by which the Company undertakes risk assessment and risk management, and discuss with management the Company's major financial risk exposures and the steps taken or to be taken to monitor and control such exposures.

Reports and Communications

The Committee shall prepare the report of the Committee required by the rules of the SEC to be included in the Company's annual proxy statement. In addition, the Committee shall disclose all approvals by the Committee of non-audit services to be performed by the Company's outside auditors in the Quarterly and Annual Reports on Forms 10-Q and 10-K required to be filed by the Company with the Securities and Exchange Commission.

The Committee is expected to maintain free and open communications with the Company's outside auditor, internal audit personnel, and management.

Evaluation

The Committee shall review the adequacy of this Charter on an annual basis and recommend any proposed changes to the Board. The Committee shall also engage in an annual self-assessment with the goal of continuing improvement.

Clarification of Audit Committee's Role

While the Committee has the responsibilities and powers set forth in this Charter, the Committee's role is one of oversight. The Committee is not responsible for either the preparation of the financial statements or the auditing of the financial statements. Management has the responsibility for preparing the financial statements and implementing internal controls and the independent accountants have the responsibility for auditing the financial statements and monitoring the effectiveness of the internal controls. The review of the financial statements by the Committee is not of the same quality as the audit performed by the independent accountants. The Committee recognizes that members of the Company's financial management team, as well as the outside auditor, have more time, knowledge and detailed information about the Company than do Committee members. Consequently, in carrying out its oversight responsibilities, the

Committee is not providing any expert or special assurance as to the Company's financial statements or any professional certification as to the outside auditor's work.

Nothing contained in this Charter is intended to expand applicable standards of liability under statutory or regulatory requirements for the directors of the Company or members of the Committee. The purposes and responsibilities outlined in this Charter are meant to serve as guidelines rather than as inflexible rules and the Committee is encouraged to adopt such additional procedures and standards as it deems necessary from time to time to fulfill its responsibilities. This Charter, and any amendments thereto, shall be displayed on the Company's web site and a printed copy of such shall be made available to any shareholder of the Company who requests it.