

# NANOPHASE TECHNOLOGIES CORPORATION

## AUDIT AND FINANCE COMMITTEE PRE-APPROVAL POLICY

(As adopted on May 6, 2013)

### Statement of Principles

As reflected in its charter and under the Sarbanes-Oxley Act of 2002 (the "Act"), the Audit and Finance Committee (the "Audit Committee") is responsible for the appointment, compensation, retention and oversight of the work of the independent auditor for Nanophase Technologies Corporation (the "Company"). In connection with such responsibilities, the Audit Committee is required to approve the audit and non-audit services performed by the Company's independent auditor in order to assure that such services do not impair the auditor's independence. To implement these provisions of the Act, the Securities and Exchange Commission (the "SEC") has issued rules specifying the types of services that an independent auditor may not provide to its audit client, as well as the audit committee's administration of the engagement of the independent auditor. Accordingly, the Audit Committee has adopted this Pre-Approval Policy (this "Policy"), which sets forth the procedures and conditions for pre-approving audit and permitted non-audit services to be performed by the independent auditor. The Audit Committee will review this Policy periodically to ensure its continued appropriateness and compliance with applicable law and listing standards, including regulations of the SEC and the Public Company Accounting Oversight Board ("PCAOB").

The SEC's rules establish two different approaches to pre-approving services, which the SEC considers to be equally valid. Proposed services may be pre-approved without consideration of specific case-by-case services by the Audit Committee (i.e., "general pre-approval") or may be subject to case-by-case pre-approval by the Audit Committee (i.e., "specific pre-approval"). The Audit Committee believes that the combination of these two approaches in this Policy will result in an effective and efficient procedure to pre-approve services performed by the independent auditor. As set forth in this Policy, unless a type of service has received general pre-approval, it will require specific pre-approval by the Audit Committee if it is to be provided by the independent auditor. Any proposed services exceeding pre-approved cost levels or budgeted amounts will also require specific pre-approval by the Audit Committee.

For both types of pre-approval, the Audit Committee will consider whether the services to be performed by the auditor are consistent with applicable SEC and PCAOB rules on auditor independence. The Audit Committee also will consider whether the independent auditor is best positioned to provide the most effective and efficient service, for reasons such as its familiarity with the Company's business, people, culture, accounting systems, risk profile and other factors, and whether the service might enhance the Company's ability to manage or control risk or improve audit quality. All such factors will be considered as a whole, and no one factor should necessarily be determinative.

A list of the SEC's prohibited non-audit services is attached to this Policy as Schedule 1. The independent auditors shall not provide any of these services to the Company. The Audit Committee may determine to prohibit other services that in its view may compromise, or appear to compromise, the independence and objectivity of the independent auditor. The SEC's rules and relevant guidance, including without limitation, regulations, interpretations or other guidance promulgated by PCAOB, should be consulted to determine the appropriateness of any non-audit service, as well as for the precise definitions of prohibited services and the applicability of exceptions to certain of the prohibitions.

The Audit Committee will periodically approve the type and amount of audit, audit-related, tax and any other services to be performed by the Company's independent auditor taking into account the

guidelines set forth in this Policy. Any pre-approval will be reflected by resolution and will apply for a period of 12 months from the date of pre-approval, unless otherwise specified in the applicable resolution(s), provided that pre-approvals pursuant to the delegated authority in Section II below will be reflected in the minutes of the next scheduled meeting of the Audit Committee following exercise of such delegated authority.

### **Delegation**

To ensure prompt handling of unexpected matters, and as provided in the Act and the SEC rules, the Audit Committee delegates to the Chair of the Committee the authority individually to pre-approve the engagement of the independent auditor to provide permitted audit and non-audit services and/or to change the terms, conditions and/or fees of any previously approved services, provided that the Chair of the Committee believes such new engagement or change in terms is consistent with the SEC's rules on auditor independence and this Policy, and would not impair the independence of the auditor.

The Chair of the Committee will report, for informational purposes only, any interim pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee will not delegate its responsibilities to pre-approve services performed by the independent auditor to the Company's management.

### **Audit Services**

The engagement terms and fees for the Company's annual audit of its consolidated financial statements will be subject to the specific approval of the Audit Committee. Audit services include, but are not limited to, the annual financial statement audit (including required quarterly reviews), consents, accounting consultations for significant or unusual transactions and other procedures required to be performed by the independent auditor to be able to form an opinion on the Company's consolidated financial statements. These other procedures include information systems and procedural reviews and testing performed in order to understand and place reliance on the systems of internal control over financial reporting and consultations relating to the audit or quarterly review. Audit services also include attestation services that generally only the independent auditor can provide (such as any required internal control over financial reporting report under §404 of the Act). The Audit Committee will monitor the annual audit engagement on a quarterly basis or more often if circumstances warrant, and also will approve, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope, Company structure or other items.

In addition to the annual audit engagement, the Audit Committee may approve other audit services, which are those services that only the independent auditor reasonably can provide. Other audit services may include statutory audits or financial audits for subsidiaries or affiliates of the Company and services associated with SEC registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings.

### **Audit-Related Services**

Audit-related services are assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements or that are traditionally performed by the independent auditor. The Audit Committee may pre-approve audit-related services, including, but not limited to:

- due diligence services pertaining to potential business acquisitions or dispositions;

- accounting consultations related to accounting, financial reporting or disclosure matters not classified as audit services;
- assistance with understanding and implementing new accounting and financial reporting guidance from rulemaking authorities;
- financial audits of employee benefit plans;
- agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters; and
- assistance with internal control reporting requirements.

### **Tax Services**

The Audit Committee may pre-approve those tax services that have historically been provided by the auditor (such as tax planning and tax compliance services) that the Audit Committee has reviewed and believes would not impair the independence of the auditor and are consistent with the SEC's rules on auditor independence. The Audit Committee will not permit the retention of the independent auditor in connection with a transaction initially recommended by the independent auditor, the sole business purpose of which may be tax avoidance and the tax treatment of which may not be supported in the Internal Revenue Code and related regulations. Additionally, no income tax services shall be permitted for which the fees to be paid are contingent on the results of the services provided. The Audit Committee may consult with management or its independent advisors, including counsel, to determine that the tax planning and reporting positions are consistent with this Policy.

### **Other Services**

The Audit Committee may pre-approve other services that the Audit Committee has reviewed and believes would not impair the independence of the auditor and are consistent with the SEC's rules on auditor independence. These services include permitted corporate finance services and certain advisory services such as real estate, treasury, employee benefit plans and risk management.

### **Fee Levels**

Fee levels for all services to be provided by the independent auditor will be established annually by the Audit Committee and reviewed as the Audit Committee deems appropriate. Any proposed services exceeding these levels or amounts will require specific approval by the Audit Committee or a Designee. The Audit Committee is mindful of the overall relationship of fees for audit and non-audit services in determining whether to approve any such services. In this regard, the Audit Committee may, but will not be required to, determine, for each fiscal year, the appropriate ratio between the total amount of fees for audit, audit-related and tax services and the total amount of fees for certain permissible non-audit services classified as all other services.

### **Documentation**

With respect to each proposed approved service, the independent auditor will provide detailed documentation to the Company's management and to the Audit Committee regarding the specific services to be provided.

## **Monitoring Procedures**

The Audit Committee has designated the Chief Financial Officer to monitor the performance of all services provided by the independent auditor and to determine whether such services are in compliance with this Policy. The Chief Financial Officer will report promptly to the Chair of the Audit Committee any non-compliance (or attempted non-compliance) with this Policy of which the Chief Financial Officer becomes aware.

**PROHIBITED NON-AUDIT SERVICES**

- BOOKKEEPING OR OTHER SERVICES RELATED TO THE ACCOUNTING RECORDS OR FINANCIAL STATEMENTS OF THE AUDIT CLIENT
- FINANCIAL INFORMATION SYSTEMS DESIGN AND IMPLEMENTATION
- APPRAISAL OR VALUATION SERVICES, FAIRNESS OPINIONS OR CONTRIBUTION-IN-KIND REPORTS
- ACTUARIAL SERVICES
- INTERNAL AUDIT OUTSOURCING SERVICES
- MANAGEMENT FUNCTIONS
- HUMAN RESOURCES
- BROKER-DEALER, INVESTMENT ADVISER OR INVESTMENT BANKING SERVICES
- LEGAL SERVICES
- EXPERT SERVICES UNRELATED TO THE AUDIT
- TAX SERVICES TO INDIVIDUAL EXECUTIVES