

**POWER EFFICIENCY CORPORATION
CHARTER OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS**

(As amended July 2006)

I. PURPOSE

The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its fiduciary obligations by reviewing:

- The financial reports, reports on internal controls, and other financial information provided by the Corporation to its shareholders, the public, the SEC, NASDAQ and any other governmental or regulatory body,
- The Corporation's systems of internal controls regarding finance, accounting, legal compliance and ethics that management and the Board have established; and
- The Corporation's auditing, accounting and financial reporting processes generally.

The Audit Committee, to the extent consistent with this function, should encourage continuous improvement of, and should foster adherence to, the Corporation's policies, procedures and practices at all levels. The Audit Committee's primary duties and responsibilities are to:

- Serve as an independent and objective party to monitor the Corporation's financial reporting process and internal control system.
- Retain and appraise the audit efforts of the Corporation's independent accountants, determine the compensation to be paid to the Corporation's independent auditors, review and approve all non-audit services to be performed by the Corporation's independent accountants; including tax services before they are rendered and serve as the point of contact for reports to be made by the independent accountant concerning the Corporation's critical accounting policies and practices and other communications relating to the Corporation's financial matters.
- Provide an open avenue of communication among the Corporation's independent accountants, financial and senior management and the entire Board of Directors.

The Audit Committee should fulfill these responsibilities primarily by carrying out the activities enumerated in Section IV of this Charter.

II. COMPOSITION

The Audit Committee shall be comprised of two or more directors as determined by the Board, each of whom shall be independent directors (as such term is now or hereafter defined by securities laws and SEC and NASDAQ rules and regulations), and free from any relationship that, in the opinion of the Board, would interfere with the exercise of his or her independent judgement as a member of the Committee. All members of the Committee shall have a working familiarity with basic finance and accounting practices, and at least one member of the Committee shall have accounting or related financial management expertise (including, without limitation, at least one member who meets the definition of “financial expert” as such term is defined from time to time by the SEC as required by the Sarbanes-Oxley Act of 2002). No member of the Audit Committee may receive any consulting, advisory or other compensatory fees from the Corporation (other than director’s fees, which may include a higher fee for serving on the Audit Committee). Committee members may enhance their familiarity with finance and accounting by participating in educational programs conducted by the Corporation or an outside consultant, including director education programs developed by NASDAQ. The members of the Committee (and its chairperson) shall be elected by the Board at its annual organizational meeting or at such other time as the Board may determine. Committee members shall serve until their successors shall be duly elected and qualified.

III. MEETINGS

The Committee shall meet at least four times annually, or more frequently as circumstances dictate. As part of its responsibility to foster open communication, the Committee or its chair should meet periodically with management and the independent accountants in separate executive sessions to discuss any matters that the Committee or each of these groups believe should be discussed privately. In addition, the Committee or at least its Chair should meet with the independent accountants and management quarterly to review the Corporation’s financial statements consistent with IV. below.

IV. RESPONSIBILITIES AND DUTIES

The Audit Committee’s policies and procedures should remain flexible in order to best react to changing conditions and to ensure to the Board of Directors and shareholders that the accounting and reporting practices of the Corporation are in accordance with all requirements and are of the highest quality.

In carrying out these responsibilities, the Audit Committee will:

Documents/Reports Review

1. Review annually and, if necessary, update this Charter periodically as conditions dictate.
2. Review the Corporation’s annual financial statements. Determine, based on review and discussion of the audited financial statements with management and the independent accountants, whether the Committee should recommend to the Board that the audited

financial statements and any internal control report be included in the Company's Annual Report on Form 10-K.

3. Review with financial management and the independent accountants the 10-Q prior to its filing or prior to the release of earnings. The Chair of the Committee may represent the entire Committee for purposes of this review.

Independent Accountants

4. Appoint the Corporation's independent accountants, considering independence and effectiveness, and approve the fees and other compensation to be paid to the independent accountants. On an annual basis, the Committee should review and discuss with the accountants all significant relationships the accountants have with the Corporation to determine the accountants' independence.
5. Pre-approve all auditing and permitted non-audit services to be provided by the independent accountants (including determining whether any proposed non-audit services fall within the categories of non-audit services prohibited under the Sarbanes-Oxley Act of 2002) with the possible exception of *de minimus* non-audit services (as such term is defined in the Sarbanes-Oxley Act); the Committee may delegate pre-approval authority to one or more of its members, with the proviso that any decision taken by the delegated members be presented to the Committee at its regular meetings.
6. Review the annual audit plans with the Chief Financial Officer and the independent accountants, and discuss the degree of coordination of the respective plans.
7. Review the performance of the independent accountants and make any change of the independent accountants when circumstances warrant.
8. Periodically (but not less frequently than annually) consult with the independent accountants out of the presence of management about internal controls and the fullness and accuracy of the Corporation's financial statements.
9. Instruct the independent accountants that they report to the Audit Committee.

Financial Reporting Processes

10. In consultation with the independent accountants, review the integrity of the Corporation's financial reporting processes and controls, both internal and external. It will also request a letter from the independent accountants concerning any significant weaknesses or breaches of internal control discovered during the course of their audit.
11. Review reports by the independent accountants concerning critical accounting policies and practices used, alternative treatments of financial information and their ramifications that have been discussed with management including adjusting journal entries and a schedule of unadjusted differences and other written communications between the independent accountants and management, and resolve any disputes between the independent accountants and management regarding financial reporting matters.
12. Consider and recommend to the Board, if appropriate, major changes to the Corporation's auditing and accounting principles and practices as suggested by the independent accountants or management.
13. Inquire of the CEO and CFO regarding the "quality of earnings" of the company from a subjective as well as an objective standpoint.

Process Improvement

14. Establish regular and separate systems of reporting to the Audit Committee by each of management and the independent accountants regarding any significant judgments made in management's preparation of the financial statements and the view of each as to appropriateness of such judgments.
15. Following completion of the annual audit, review separately with each of management and the independent accountants any significant difficulties encountered during the course of the audit, including any restrictions on the scope of work or access to required information.
16. Review any significant disagreement among management and the independent accountants in connection with the preparation of the financial statements and resolve such disagreements.
17. Review with the independent accountants and management the extent to which changes or improvements in financial or accounting practices, as approved by the Audit Committee or the Board have been implemented.
18. Review, with management and the independent accountants, proposed accounting standards or rules proposed by FASB or the SEC that will have a significant effect on the company's financial statements.
19. Determine whether there are any significant items in dispute with the IRS which might result or have resulted in litigation; and inquire as to the status of related tax reserves and interest accruals.

Ethical and Legal Compliance

20. Review, with the Corporation's counsel, legal compliance matters including corporate securities trading and reporting policies.
21. Review with management the policies and procedures with respect to officers' expense accounts and perquisites, including their use of corporate assets.
22. Review, with the Corporation's counsel, any legal matter that could have a significant impact on the Corporation's financial statements.
23. Engage independent counsel or other advisers as deemed advisable by the Committee.

24. Perform any other activities consistent with this Charter, the Corporation's By-laws and governing law, as the Committee or the Board deems necessary or appropriate.
25. Review the procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters that may be submitted by any party internal or external to the organization. Review any complaints that might have been received, current status, and resolution if one has been reached.
26. Review procedures for the confidential, anonymous submission by employees of the organization of concerns regarding any accounting or auditing matters. Review any submissions that have been received, the current status, and the resolution if one has been reached.
