

AUDIT COMMITTEE CHARTER

OF

NOVARAY MEDICAL, INC.

Purposes, Authority & Funding

The audit committee (the “**Committee**”) of the Board of Directors (the “**Board**”) of NovaRay Medical Inc., a Delaware corporation (the “**Company**”), is appointed by the Board for the purpose of overseeing the Company’s accounting and financial reporting processes, the performance of the independent registered public accounting firm in its audits of the Company’s financial statements and legal and ethical compliance processes. In so doing, the Committee shall endeavor to maintain free and open communication between the Company’s directors, independent registered public accounting firm and financial management.

The Committee shall have the authority to retain such independent legal, accounting or other advisers as it determines necessary to carry out its duties and, if necessary, to institute special investigations. The Company shall provide the Committee with appropriate funding, as determined by the Committee in its capacity as a committee of the Board, for the payments of: (1) compensation to 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; (2) compensation to any independent advisers retained by the Committee in carrying out its duties; and (3) ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties.

Notwithstanding the foregoing, the Committee's responsibilities are limited to oversight. Management of the Company is responsible for the preparation, presentation and integrity of the Company's financial statements as well as the Company's financial reporting process, accounting policies, internal accounting controls and disclosure controls and procedures. The independent registered public accounting firm is responsible for performing an audit of the Company's annual financial statements, expressing an opinion as to the conformity of such annual financial statements with generally accepted accounting principles and reviewing the Company's quarterly financial statements. It is not the responsibility of the Committee to plan or conduct audits or to determine that the Company's financial statements and disclosure are complete and accurate and in accordance with generally accepted accounting principles and applicable laws, rules and regulations. Each member of the Committee shall be entitled to rely on the integrity of those persons within the Company and of the professionals and experts (including contracted non-employees and audit or accounting firms engaged to provide internal audit services) and, absent actual knowledge to the contrary, the accuracy of the financial and other information provided to the Committee by such persons, professionals or experts.

Committee Membership

The members of the Committee (the “**Members**” or, individually, each a “**Member**”) shall be appointed by the Board and shall serve at the discretion of the Board. The Committee shall consist of at least three (3) Members, each of which shall be a member of the Board.

The following membership requirements shall also apply:

1. each Member must not have participated in the preparation of the financial statements of the Company or any current subsidiary of the Company at any time during the past three (3) years; and
2. each Member must be able to read and understand fundamental financial statements, including the Company’s balance sheet, income statement, and cash flow statement.

If the Committee fails to comply with the requirements set forth in this “Committee Membership” section of the Charter due to one vacancy on the Committee, and the cure period set forth in the preceding sentence is not otherwise being relied upon for another Member, the Company will have until the earlier of its next annual stockholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirements to rectify such non-compliance; provided, however, that if the next annual stockholders’ meeting occurs no later than 180 days following the event that caused the vacancy, the Company will instead have 180 days from such event to regain compliance.

Duties & Responsibilities

In fulfilling its purposes as stated in this Charter, the Committee shall undertake the specific duties and responsibilities listed below and such other duties and responsibilities as the Board shall from time to time prescribe, and shall have all powers necessary and proper to fulfill all such duties and responsibilities. Subject to applicable Board and stockholder approvals, the Committee shall:

- A. Financial Statement & Disclosure Matters
 1. Oversee the policies and procedures adopted by the Company to fulfill its responsibilities regarding the fair and accurate presentation of financial statements in accordance with U.S. generally accepted accounting principles (“**GAAP**”) and applicable rules and regulations of the U.S. Securities and Exchange Commission (the “**SEC**”);
 2. Oversee the Company’s accounting and financial reporting processes;
 3. Oversee audits of the Company’s financial statements;
 4. Review with the Company’s independent registered public accounting firm, management and internal auditors any significant or unusual items or events that are, or may need to be, reflected in the Company’s financial statements or any

filing with the SEC, and discuss any matters related thereto that have been raised by the Company's independent registered public accounting firm, management and internal auditors;

5. Review and discuss reports from the Company's independent registered public accounting firm 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, including ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the independent registered public accounting firm; and (c) other material written communications between the independent registered public accounting firm and management, such as any management letter or schedule of unadjusted differences;
6. Review and discuss with management the Company's audited financial statements and review with management the Company's financial statements (including disclosures made under "Management's Discussion and Analysis of Financial Condition and Results of Operations") prior to the filing of any report containing such financial statements with the SEC; and
7. If deemed appropriate, recommend to the Board that the Company's audited financial statements be included in its annual report for the last fiscal year subject to audit.

B. Matters Regarding Oversight of the Company's Independent Registered Public Accounting Firm

1. Be directly responsible, in its capacity as a committee of the Board, for the appointment, compensation, retention and oversight of the work of any independent registered public accounting firm engaged (including resolution of disagreements between management and such firm regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company; provided also that each such registered public accounting firm shall report directly to the Committee;
2. Receive and review a formal written statement and letter from the Company's independent registered public accounting firm delineating all relationships between the independent registered public accounting firm and the Company, consistent with Independence Standards Board Standard 1, as may be modified or supplemented;
3. Actively engage in a dialogue with the Company's independent registered public accounting firm with respect to any disclosed relationship or services that may impact the objectivity and independence of the independent registered public accounting firm;

4. Take, or recommend that the Board take, appropriate action to oversee and ensure the independence of the Company's independent registered public accounting firm;
 5. Confirm that any chief executive officer, controller, chief financial officer, chief accounting officer or any person serving in an equivalent position hired by the Company in the future was not both employed by the independent registered public accounting firm and participated in any capacity in the audit of the Company during the one-year period preceding the date of the initiation of the audit.
 6. Establish policies and procedures for review and pre-approval by the Committee of all audit services and permissible non-audit services (including the fees and terms thereof) to be performed by the Company's independent registered public accounting firm, with exceptions provided for *de minimis* amounts under certain circumstances as permitted by law; provided, however, that: (a) the Committee may delegate to one (1) or more Members the authority to grant such pre-approvals if the pre-approval decisions of any such delegate Member(s) are presented to the Committee at its next-scheduled meeting; and (b) all approvals of non-audit services to be performed by the independent registered public accounting firm must be disclosed in the Company's periodic reports if required by Section 13(a) of the Act;
 7. Discuss with the Company's independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61, as may be modified or supplemented, relating to the conduct of the audit; and
 8. The Committee shall review with the independent registered accounting firm any problems or difficulties the independent registered accounting firm may have encountered during the course of the audit work, including any restrictions on the scope of activities or access to required information or any significant disagreements with management and management's responses to such matters. Among the items that the Committee should consider reviewing with the independent registered accounting firm are: (A) any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); (B) any communications between the audit team and independent registered accounting firm 's national office respecting auditing or accounting issues presented by the engagement; and (C) any "management" or "internal control" letter issued, or proposed to be issued, by the independent auditor to the Company.
- C. Matters Regarding Establishment and Oversight of the Company's Internal Control Function
1. Supervise the adequacy and effectiveness of internal controls that could significantly affect the Company's financial statements; and

2. Oversee the coordination of the Company's independent registered public accounting firm and management of the Company.

D. Matters Regarding Oversight of Compliance Responsibilities

1. Obtain reports from the Company's management and independent registered public accounting firm that the Company's subsidiaries and foreign affiliated entities are in compliance with applicable legal requirements, including the Foreign Corrupt Practices Act;
2. Establish and oversee procedures for: (a) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and (b) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters;
3. Review all related party transactions for potential conflict of interest situations on an ongoing basis and approve all such transactions (if such transactions are not approved by another independent body of the Board);
4. Obtain from the Company's independent registered public accounting firm assurance that it has complied with Section 10A of the Act; and
5. Review and evaluate the Company's internal financial controls and policies with respect to risk assessment and risk management.

E. Additional Duties & Responsibilities

1. Review and reassess the adequacy of this Charter periodically;
2. Review with the Company counsel any legal matters that may have a material impact on the financial statements, the Company's compliance policies and any material reports or inquiries received from regulators or governmental agencies;
3. Provide oversight and review of the Company's asset management policies, including an annual review of the Company's investment policies and performance for cash and short-term investments; and
4. Take any other actions that the Committee deems necessary or proper to fulfill the purposes and intent of this Charter.

Nothing contained in this Charter is intended to alter or impair the operation of the "business judgment rule" as interpreted by the courts under any applicable law. Further, nothing contained in this Charter is intended to alter or impair the right of the Members to rely, in discharging their duties and responsibilities, on the records of the Company and on other information presented to the Committee, Board or Company by its officers or employees or by outside experts and advisers such as the Company's independent registered public accounting firm.

Structure & Meetings

The Committee shall conduct its business and meetings in accordance with this Charter, the Company's charter documents and any direction set forth by the Board. The chairperson of the Committee shall be designated by the Board or, in the absence of such a designation, by a majority of the Members. The designated chairperson shall preside at each meeting of the Committee and, in consultation with the other Members, shall set the frequency of meetings. In the absence of the designated chairperson at any meeting of the Committee, the Members present at such meeting shall designate a chairperson *pro tem* to serve in that capacity for the purposes of such meeting (not to include any adjournment thereof) by majority vote.

The Committee shall meet as often as it determines to be necessary and appropriate, but not less than four times each year. The chairperson of the Committee or a majority of the Members may call special meetings of the Committee upon notice as is required for special meetings of the Board in accordance with the Company's charter documents. A majority of the appointed Members, but not less than two (2) Members, shall constitute a quorum for the transaction of business. Members may participate in a meeting through use of conference telephone or similar communications equipment, so long as all Members participating in such meeting can hear one another, and such participation shall constitute presence in person at such meeting.

The Committee shall meet with the Company's independent registered public accounting firm, at such times as the Committee deems appropriate, to review the independent registered public accounting firm's examination and management report. The Committee will meet separately with the Chief Executive Officer of the Company and separately with the Chief Financial Officer of the Company at least annually to review the financial affairs of the Company.

Unless the Committee by resolution determines otherwise, any action required or permitted to be taken by the Committee may be taken without a meeting if all Members consent thereto in writing and the writing or writings are filed with the minutes of the proceedings of the Committee. The Committee may form and delegate authority to subcommittees when appropriate.

Minutes

The Committee shall maintain written minutes of its meetings, which minutes shall be filed with the minutes of the meetings of the Board.