

DAYBREAK OIL AND GAS, INC.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS CHARTER

Purpose and Authority

The purpose of the Audit Committee (the “*Committee*”) is to:

- A. Provide assistance to the Board of Directors (the “*Board*”) in fulfilling its responsibility to the shareholders, potential shareholders and investment community with respect to its oversight of:
 - (i) The quality and integrity of the Corporation’s financial statements;
 - (ii) The Corporation’s compliance with legal and regulatory requirements relating to financial reporting, accounting and controls;
 - (iii) The independent public accountants’ qualifications and independence;
 - (iv) The performance of the Corporation’s independent public accountants;
 - (v) The Corporation’s systems of internal control regarding finance and accounting; and
 - (vi) The business practices and ethical standards of the Corporation.

- B. Prepare a Committee report required to be included in the Corporation’s annual proxy statement pursuant to, and in accordance with, applicable rules and regulations of the Securities and Exchange Commission (the “*SEC*”).

The Committee is designated by the Board and receives its authority from the Board to whom it reports. The Board has vested in the Committee the authority to carry out the responsibilities required by law and as noted in this Charter, and any other duties which the Committee deems necessary to fulfill its obligations to the Board, shareholders and customers of the Corporation. To such end, the Committee is authorized to select, retain and/or replace, as needed, consultants to provide independent advice to the Committee. In the event the Committee retains a consultant, the Committee shall have the sole authority to approve such consultant’s fees and other retention terms, and the Corporation shall provide funding for such payments. In addition, the Corporation must provide funding for ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties.

Limitations of Responsibilities

In fulfilling their responsibilities hereunder, it is recognized that members of the Committee are not full-time employees of the Corporation and are not, and do not represent themselves to be, accountants or auditors by profession, or experts in the field of accounting or auditing. As such,

it is not the duty or responsibility of the Committee or its members to conduct “field work” or other types of auditing or accounting reviews or procedures, and each member of the Committee shall be entitled to rely on (a) the integrity of those persons and organizations within and outside the Corporation from which it receives information and (b) the accuracy or the financial and other information provided to the Committee by such persons or organizations absent actual knowledge to the contrary (which shall be promptly reported to the Board). Committee members shall be entitled to rely exclusively on advice from management and outside advisors on all matters relating to the existence and interpretation of federal or state law and shall not be deemed to provide any legal advice or expertise to the Board.

While the Committee has the responsibilities and authority set forth in this Charter, it is not the duty of the Committee to plan or conduct audits or to determine that the Corporation’s financial statements are complete and accurate and are in accordance with general accepted accounting principles. That is the responsibility of management and the independent public accountant. Nothing contained in this Charter is intended to expand applicable standards of liability under statutory or regulatory requirements for the directors of the Corporation or members of the Committee.

Membership

The Committee shall be comprised of three or more members, including a Chairman and two or more members of the Board. Members of the Committee (including the Chairman) shall be appointed annually by the Board and serve at the pleasure of the Board and thus may be removed at any time, with or without cause, by the Board.

All members of the Committee shall satisfy all requirements relating to independence prescribed from time to time by law or applicable stock exchange rules, including, but not limited to, Rule 10A-3(b)(1) under the Securities Exchange Act of 1934, as amended, and any applicable listing exchange rules. Additionally, no member of the Committee shall have participated in the preparation of the Corporation’s or any of its current subsidiary’s financial statements at any time during the past three years, and no director may serve on the Committee, without Board approval, if such director simultaneously serves on the audit committee of three or more other public companies.

If a member of the Committee ceases to be independent for reasons outside the member’s reasonable control, his or her membership on the Committee may, if so permitted under then applicable listing exchange rules, continue until the earlier of the Corporation’s next annual meeting of shareholders or one year from the occurrence of the event that caused the failure to qualify as independent.

All members of the Committee shall be financially literate, as determined by the Board, and at least one member of the Committee shall be an “audit committee financial expert” as defined by the SEC. Committee members may enhance their familiarity with finance and accounting by participating in educational programs conducted by the Corporation or an outside consultant.

All determinations as to member qualification and Committee representation shall be made by the Board in their reasonable business judgment based upon all relevant facts and circumstances to the extent permitted under law and applicable listing exchange rules.

Chairman

Unless a Chairman is elected by the full Board, the members of the Committee shall designate a Chairman by majority vote of the full Committee membership. The Chairman shall be entitled to vote as a regular Committee member and shall additionally be entitled to cast a second vote to resolve any ties. The Chairman will chair all regular sessions of the Committee and set the agendas for Committee meetings. In addition, the Chairman will report the Committee's actions to the Board from time to time (but at least once each year) as requested by the Board and shall maintain regular communication with the chief executive officer ("**CEO**"), the chief financial officer (the "**CFO**"), the lead partner of the independent public accountant and the senior officer responsible for the internal audit function, if any.

Administrative Procedures

The Committee shall meet as frequently as deemed necessary by the Chairman to fulfill the Committee's responsibilities, but no less than four times during the year. A quorum shall consist of a majority of members. The Committee may meet by telephone conference call or by any other means permitted by law or the Corporation's Bylaws. Minutes of the meetings shall be kept, which shall be recorded or filed with the books and records of the Corporation. Any member of the Board shall be provided with copies of such Committee minutes if requested. The Committee shall act on the affirmative vote of a majority of members present at a meeting at which a quorum is present. The regular attendance of non-members is permitted at the invitation of the Chairman. The Chairman shall report the Committee's activities to the Board, including any issues that arise with respect to the quality and integrity of the Corporation's financial statements, the Corporation's compliance with legal or regulatory requirements, the performance and independence of the Corporation's independent public accountants or the performance of the internal audit function.

The Committee may ask members of management, employees, outside counsel, the independent public accountants or others whose advice and counsel are relevant to the issues then being considered by the Committee to attend any meetings and to provide such pertinent information as the Committee may request.

Compensation

No member of the Committee shall receive compensation other than director's fees for service as a director of the Corporation, which includes reasonable compensation for serving on the Committee and regular benefits that other directors receive.

Independent Public Accountants

The Committee is directly responsible for the appointment, compensation, retention and oversight of the work of the independent public accountants for the purposes of preparing or issuing an audit report or performing other audit, review or attest services for the Corporation. The Committee shall approve all audit engagement fees and terms. The independent public accountants shall be informed that they report directly to the Committee.

With respect to the work of the independent public accountants, the Committee is responsible for (i) reviewing the scope of the audit; (ii) approving the nature and cost of all audit and non-audit services (non-audit services must be approved prior to commencement of the services); (iii) monitoring the independent public accountants performance; (iv) assuring that the auditor is independent; and (v) resolving any disagreement between management and the independent public accountants regarding financial reporting for the purpose of preparing or issuing an audit report or related work.

The Committee shall inquire regularly of the independent public accountants to ascertain that they are receiving the full cooperation of management, that all information desired is provided freely, that there are no significant deficiencies or material weaknesses in the internal control structure and that no fraud (whether or not material), with respect to management or other employees who have a significant role in the Corporation's internal controls, was uncovered in the course of its work and that management is diligent in conducting its business in accordance with the highest ethical standards.

The Committee shall periodically meet separately with the independent public accountants to discuss any matters that the Committee or the independent public accountants believe would be appropriate to discuss privately. In addition, the Committee shall meet with the independent public accountants and management quarterly to review the Corporation's financial statements and annual and quarterly reports required to be filed with the SEC.

The Committee shall approve in advance any audit and non-audit engagement or relationship between the Corporation and the independent public accountants, other than "prohibited non-auditing services". The Committee hereby delegates to the Chairman of the Committee the authority to approve in advance all audit or non-audit services to be provided by the independent public accountants so long as it is presented to the full Committee at its next scheduled meeting.

The following are "prohibited non-auditing services": (i) bookkeeping or other services related to the accounting records or financial statements of the audit client; (ii) financial information systems design and implementation; (iii) appraisal or valuation services, providing fairness opinions or preparing contribution-in-kind reports; (iv) actuarial services; (v) internal audit outsourcing services; (vi) management functions or human resources; (vii) broker or dealer, investment adviser or investment banking services; (viii) legal services and expert services unrelated to the audit; and (ix) any other service that the Public Company Accounting Oversight Board prohibits through regulation.

The Committee shall review, at least annually, the qualifications, performance and independence of the independent public accountants. In conducting its review and evaluation, the Committee shall:

- (a) Discuss with the independent public accountants their independence;
- (b) Obtain and review a report by the Corporation's independent public accountants describing: (i) the auditing firm's internal quality-control procedures; (ii) any

material issues raised by the most recent internal quality-control review, or peer review of the auditing firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the auditing firm, and any steps taken to deal with any such issues; and (iii) all relationships between the independent public accountants and the Corporation so that the Corporation may assess the independent public accountants' independence;

- (c) Ensure the rotation of the lead audit partner having primary responsibility for the Corporation's audit at least every five years and consider whether there should be regular rotation of the audit firm itself;
- (d) Review and evaluate the lead audit partner of the independent public accountant's audit team.
- (e) Confirm with any independent public accountants retained to provide audit services for any fiscal year that the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for review of the audit, has not performed audit services for the Corporation in each of the five previous fiscal years of that Corporation; and
- (f) Discuss with the independent public accountant material issues on which the national office of the independent public accountant was consulted by the Corporation's audit team.

Financial Statements and Internal Accounting Control

The Committee shall review with management and the independent public accountants prior to public dissemination the Corporation's annual audited financial statements and quarterly financial statements, including the Corporation's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations." The review should include discussions with management and the independent public accountants of significant issues regarding accounting principles, practices and judgments. These include, but are not limited to, issues relating to any significant changes in the Corporation's selection or application of accounting principles, the judgments of each of management and the independent public accountant as to the quality and appropriateness of the Corporation's accounting principles as applied in its financial reporting and matters set forth in SAS No. 61.

The Committee shall review and discuss with management and the independent public accountants management's report on internal control over financial reporting, including the adequacy of the disclosures about changes in internal control over financial reporting, and the independent public accountants' attestation of the report prior to the filing of the Corporation's Form 10-K.

As part of its quarterly review, the independent public accountants will discuss with management any judgmental areas, adjustments, disclosures and all material changes in accounting principles. Management will report to the Committee, in writing, any material items or discussions resulting

from such review. Management will also provide the Committee, upon issuance, copies of the quarterly reports to shareholders and related filings with the SEC. In addition, the Committee, or at the minimum its Chairman, should communicate with management and the independent public accountants on a quarterly basis (prior to the filing of the Corporation's Form 10-Q) to review the Corporation's financial statements and significant findings based upon the independent public accountants' review procedures. Any significant changes to the Corporation's accounting principles and any items required to be communicated by the independent public accountants in accordance with SAS No. 61 should also be discussed.

The Committee shall also review and discuss with management and the independent public accountants the Corporation's earnings press releases, if any, (paying attention to the use of any "pro forma" or "adjusted" non-GAAP information), as well as financial information and earnings guidance, if any, provided to analysts and rating agencies. The Committee's discussion in this regard may be general in nature (i.e., discussion of the types of information to be disclosed and the type of presentation to be made) and need not take place in advance of each earnings release or each instance in which the Corporation may provide earnings guidance.

At least once during the year, the Committee shall obtain assurances from the independent public accountants, and management that the system of internal controls is adequate and functional. Moreover, in connection with the filing of any financial statements with the SEC or any required certification relating to the internal accounting and disclosure controls of the Corporation, management shall review with the Committee all changes effected in the Corporation's controls and all tests and other procedures implemented to test the efficacy of the Corporation's controls, as well as the results of such tests and procedures.

The Committee shall also perform any functions required to be performed by it or otherwise appropriate under applicable law, rules or regulations, the Corporation's by-laws and the resolutions or directives of the Board, including review of any certification required to be reviewed in accordance with applicable law or regulations of the SEC.

Financial Reporting Process

In consultation with the independent public accountants and management, the Committee shall review the integrity of the Corporation's financial reporting processes, both internal and external. In connection therewith, the Committee should obtain and discuss with management and the independent public accountants reports from management and the independent public accountants regarding: (i) all critical accounting policies and practices to be used by the Corporation; (ii) analyses prepared by management and/or the independent public accountants setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including all alternative treatments of financial information within generally accepted accounting principles that have been discussed with the Corporation's management, the ramifications of the use of alternative disclosures and treatments, and the treatment preferred by the independent public accountants; (iii) major issues regarding accounting principles and financial statement presentations, including any significant changes in the Corporation's selection or application of accounting principles; (iv) major issues as to the adequacy of the Corporation's internal controls and any specific audit steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control

over financial reporting; and (v) any other material written communications between the independent public accountants and the Corporation's management, such as any management letter or schedule of unadjusted differences.

The Management and the independent public accountants along with the Committee shall review periodically the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the Corporation.

The Committee shall also review, with the independent public accountants, (i) any audit problems or other difficulties encountered by the independent public accountants in the course of the audit process, including any restrictions on the scope of the independent public accountants' activities or on access to requested information; (ii) any significant disagreements with management that arose in the course of the audit process; and (iii) management's response to such matters. Without excluding other possibilities, the Committee may wish to review with the independent public accountants (i) any accounting adjustments that were noted or proposed by the independent public accountants but were "passed" upon (as immaterial or otherwise); (ii) any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and (iii) any "management" or "internal control" letter issued, or proposed to be issued, by the independent public accountants to the Corporation.

The Committee shall review disclosures made to the Committee by the Corporation's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal control over financial reporting or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Corporation's internal control over financial reporting.

Other Duties

The Committee shall meet separately with management in order to perform its oversight functions effectively.

The Committee shall discuss with management and the independent public accountants the Corporation's guidelines and policies with respect to risk assessment and risk management. The Committee should discuss the Corporation's major financial risk exposures and the steps management has taken to monitor and control such exposures. The Committee is not required to be the sole body responsible for risk assessment and management, but the Committee must discuss guidelines and policies to govern the process in which such assessment is undertaken.

The Committee shall set clear hiring policies for employees or former employees of the independent public accountants. At a minimum, these policies should provide that any registered public accounting firm may not provide audit services to the Corporation if the CEO, Controller, CFO, Chief Accounting Officer or any person serving in an equivalent capacity for the Corporation was employed by the registered public accounting firm and participated in the audit of the Corporation within one year of the initiation of the current audit.

The Committee shall review policies and procedures that the Corporation has implemented regarding compliance with applicable federal, state and local laws and regulations and with the Corporation's Code of Business Conduct and Ethics, monitor the effectiveness of those policies and procedures for compliance with the U.S. Federal Sentencing Guidelines, as amended, and institute any changes or revisions to such policies and procedures as may be deemed warranted or necessary.

The Committee shall obtain from the independent public accountant assurance that Section 10A(b) of the Securities Exchange Act of 1934 has not been implicated.

The Committee shall provide or approve a report for inclusion in the Corporation's proxy statement for its annual meeting of shareholders, in accordance with applicable SEC rules and regulations.

The Committee shall establish procedures for (i) the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters; and (ii) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

The Committee shall maintain continuing vigilance for any procedures or practices which might impair the Corporation's financial and business integrity. Annually the Committee will receive a report from the Corporate Secretary on compliance with the Corporation's Ethical Business Conduct Policy, including signed statements from financial officers, and shall make inquiries as necessary to assure itself that the highest standards of business conduct are being followed.

Periodically, the Corporate Secretary may report to the Committee on the Corporate Ethics Program any significant events that have occurred and any actions taken by management in response thereto.

Once a year, the Committee shall review and assess the adequacy of this Charter. In addition, the Committee shall submit this Charter for publication in the proxy statement at least once every three years and any year in which the Charter is amended.

Annual Performance Evaluation

The Committee shall coordinate with the Nominating and Governance Committee of the Board to perform a review and evaluation, at least annually, of the performance of the Committee. The results of the review and evaluation shall be presented in a report to the Board in conjunction with the Board's annual meeting, or at such other time as prescribed by the Board.

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