

HANCOCK FABRICS, INC.
CHARTER OF THE AUDIT COMMITTEE

Purpose

The Audit Committee will assist the Board of Directors in fulfilling its oversight responsibilities. The Audit Committee will oversee the Company's accounting and financial reporting process, and the audits of its financial statements, and will assist the Board in monitoring the integrity of the Company's financial statements, the independent auditors qualifications and independence, the performance of the Company's internal audit function, and the Company's compliance with laws and regulations and with the Code of Business Conduct and Ethics.

Membership

The Audit Committee shall be composed of three or more members of the Board of the Company, who shall meet the independence and experience requirements of the New York Stock Exchange, the Securities Exchange Act of 1934 (the "Exchange Act") and the rules and regulations of the Securities and Exchange Commission (the "Commission"). No member may serve on more than three public company Audit Committees unless the Board determines (and discloses in the proxy statement) that such service will not impair that member's ability to effectively serve on the Company's committee.

The Chairman shall have accounting or related financial management expertise, and at least one member shall be a "financial expert" as defined by the Commission. All other members shall be financially literate. To effectively perform his or her role, each committee member will obtain an understanding of the detailed responsibilities of committee membership as well as the Company's business, operations and risks. Members shall be appointed by the Board on the recommendation of the Corporate Governance and Nominating Committee. Members may be replaced by the Board.

Meetings

The Audit Committee shall meet at least quarterly, but it may be appropriate to meet more frequently. The Audit Committee may request any officer or employee of the Company or the Company's outside counsel or independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee. A portion of each meeting may be set aside for a private session with any officer or employee of the Company or the Company's outside counsel or independent auditor, or consultants to the Committee. The Committee shall meet periodically with management, the internal auditors and the independent auditors in separate executive sessions.

A meeting of the Audit Committee may be called at any time by its Chairman, without notice to or the consent of the Board of Directors or management, for the purpose of discussing or reviewing matters under its authority.

Responsibilities

1. It is not the Committee's duty to plan or conduct audits or to determine that the Company's financial statements are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the independent auditor.
2. The Committee shall, in its capacity as a committee of the Board, have the sole authority to appoint or replace the independent auditor. The Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work. The independent auditor shall report directly to the Committee.
3. The Committee shall pre-approve all auditing services, internal control-related services and permitted non-audit services (including the fees and terms thereof) to be performed for the Company by its independent auditor, subject to the de minimis exceptions for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act which are approved by the Committee prior to the completion of the audit pursuant to the Company's Pre-Approval Policy.
4. The Committee shall meet with the independent auditor prior to the audit to review the planning and staffing of the audit.
5. The Committee shall review and evaluate the lead partner of the independent auditor team; evaluate the qualifications, performance and independence of the independent auditor, including whether the auditor's quality controls are adequate and whether the provision of permitted non-audit services is compatible with maintaining the auditor's independence, and taking into account the opinions of management and the internal auditor; and present its conclusions to the Board.
6. The Committee shall ensure that the lead audit partner and the reviewing partner rotate, as required by law, and consider whether there should be a regular rotation of the independent auditing firm.

7. The Committee shall discuss with management and independent auditors significant financial reporting issues and judgments made in connection with preparation of the Company's financial statements, including significant changes in the selection or application of accounting principles, major issues as to the adequacy of internal controls, and any special steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control over financial reporting.
8. The Committee shall review and discuss with management and the independent auditors the Company's internal controls report and the independent auditor's attestation of the report prior to the filing of the Company's Form 10-K.
9. The Committee shall review and discuss with management and the independent auditors the annual audited financial statements, including disclosures in Managements' Discussion and Analysis, and recommend to the Board whether the financial statements should be included in the Form 10-K.
10. The Committee shall review disclosures made by the Company's Chief Executive Officer and Chief Financial Officer during their certification process for the Form 10-K and Forms 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.
11. The Committee shall discuss with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.
12. The Committee shall discuss with the independent auditor any matters of audit quality and consistency or issues on which the national office was consulted.
13. The Committee shall review with the Company's General Counsel legal matters that may have a material impact on the financial statements.
14. The Committee shall meet annually with the independent public accountants to:
 - Obtain and review a report from the independent auditor regarding the independent auditor's internal quality-control procedures, any material issues raised by the most recent internal quality-control or peer review of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding 5 years, any steps taken to deal with any such issues, and all relationships between the independent auditor and the Company.
 - Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.

- Discuss items which could provide a material risk to the Company in the future.
 - Obtain from the independent auditor assurance that Section 10A(b) of the Securities Exchange Act of 1934 has not been implicated.
 - Discuss matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit, and in particular:
 - The auditor’s responsibility under generally accepted auditing standards.
 - Significant accounting policies.
 - Management judgments and accounting estimates.
 - Audit adjustments.
 - Auditor’s judgments about the quality of the entity’s accounting principles.
 - Other information in documents containing audited financial statements.
 - Disagreements with management.
 - Consultation with other accountants.
 - Major issues discussed with management prior to retention.
 - Any restrictions on the scope of activities or access to requested information.
 - Difficulties encountered in performing the audit.
15. The Committee shall oversee the hiring of any current or former independent audit firm personnel into positions within the Company, to ensure compliance with the hiring restrictions of the Sarbanes-Oxley Act.
16. The Committee shall discuss with management and the independent auditor the Company’s earnings press releases, including the use of “pro forma” or “adjusted” non-GAAP information, as well as financial information and earnings guidance provided to analyst and rating agencies. Such discussion may be done generally (consisting of discussing the types of information to be disclosed and the types of presentations to be made).

17. The Committee shall review and discuss with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including the results of the independent auditor's reviews of the quarterly financial statements and disclosures in Management's Discussion and Analysis, including, but not limited to:
 - All critical accounting policies and practices to be used.
 - All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor.
 - Other material written communications between the independent auditor and management, including any engagement letter, independence letter, management representation letter, schedule of unadjusted audit differences, listing of adjustments and reclassifications not recorded, management letter, or report on observations and recommendations on internal controls, and the Company's response to any such letter or report.
18. The Committee shall discuss with management and the independent auditor any correspondence with regulators or governmental agencies and any published reports that raise material issues regarding the Company's financial statements or accounting policies.
19. The Committee shall establish 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 concerns regarding questionable accounting or auditing matters.
20. The Committee shall review the appointment and replacement of the senior internal auditor and discuss with the independent auditor and management the internal audit department responsibilities, budget and staffing and any recommended changes in the planned scope of the internal audit.
21. The Committee shall review the Executive Summary prepared by the internal auditing department and meet privately with the internal audit manager each quarter to discuss concerns relating to internal controls or accounting and auditing matters.
22. The Committee shall meet with Company senior management periodically to review:
 - Major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.

- Material legal issues.
 - Plans for disaster recovery.
 - Business issues which may affect financial results.
 - Ethical standards and conduct.
 - Management Information Systems activities.
23. The Committee shall have the authority to retain, to the extent it deems necessary or appropriate, independent legal, accounting or other advisors. The Company shall provide for appropriate funding, as determined by the Committee in its capacity as a committee of the Board, for payment of compensation to the independent auditor for the purpose of rendering or issuing an audit report and to any advisors employed by the Committee, compensation to any advisors employed by the Committee, and ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties.
 24. The Committee shall prepare the report required by the rules of the Commission to be included in the Company's annual proxy statement.
 25. The Committee shall direct any special investigations deemed necessary or appropriate by the Board of Directors or any of its Committees.
 26. The Committee shall review reports and disclosures of insider and affiliated party transactions.
 27. The Committee shall make regular reports to the Board with respect to actions taken by the Committee.
 28. The Audit Committee may form and delegate authority to subcommittees consisting of one or more members when appropriate, including the authority to grant pre-approvals of audit and permitted non-audit services, provided that decisions of such subcommittee to grant pre-approvals shall be presented to the full Committee at its next scheduled meeting.
 29. The Committee shall review and reassess the adequacy of this committee's charter annually and recommend any proposed changes to the Board for approval.
 30. The Committee shall annually review its own performance.