

**CHARTER OF AUDIT COMMITTEE
OF
FRED'S, INC.**

I. Organization:

There shall be an Audit Committee (the "Committee") of the Board of Directors (the "Directors") of Fred's, Inc. (the "Corporation"). The Committee shall be composed of at least three directors who meet the independence and experience requirements of the NASDAQ Stock Market, the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the rules and regulations of the Securities and Exchange Commission (the "Commission"). If one member of the Committee is not an "audit committee financial expert" as defined by the Commission, then that fact shall be disclosed as required by the Commission.

II. Statement of Policy:

The purpose of the Committee is to oversee the accounting and financial reporting processes of the Corporation and the audits of the financial statements of the Corporation. In so doing, it is the responsibility of the Committee to maintain free and open means of communication between the Directors, the independent auditors, the internal audit function, and the management of the Corporation.

III. Responsibilities:

In carrying out its responsibilities, the Committee believes its policies and procedures should remain flexible, in order to best react to changing conditions and to ensure 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 Committee will:

- 1) Have the sole authority to appoint, compensate, replace and oversee the work of the independent auditor, including resolution of disagreements between management and the independent auditor regarding financial reporting. The independent auditor shall report directly to the Committee.
- 2) Establish procedures for (a) the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters, and (b) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing practices.
- 3) Pre-approve all audit services and permitted non-audit services (including the fees and terms thereof) to be performed for the Corporation 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 Corporation's Pre-Approval Policy.
- 4) Review the financial statements and the Corporation's disclosures in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section contained in the quarterly reports on Form 10-Q and the annual report on Form 10-K and ensure that the independent auditor is satisfied with the disclosure and content of such reports. Review any changes in accounting principles.
- 5) Review and discuss with management (including the head of the internal audit function) and the independent auditor:
 - the Corporation's disclosure controls and procedures and its internal controls and procedures for financial reporting, including the conclusions of the Corporation's chief executive officer and chief financial officer regarding the effectiveness of both sets of controls and procedures reached as part of their certification process for the quarterly reports on Form 10-Q and the annual report on Form 10-K, and their evaluation process;
 - the Corporation's internal controls report and the independent auditor's attestation report on the effectiveness of internal control over financial reporting; and
 - any recommendations for the improvement of such internal control procedures or particular areas where new or more detailed controls or procedures are desirable, with particular emphasis on the adequacy of such internal controls to expose any payments, transactions, or procedures that might be deemed illegal or otherwise improper.
- 6) Have the authority to retain, to the extent it deems necessary or appropriate, independent legal, accounting or other advisors. The Corporation shall provide for appropriate funding, as determined by the Committee, 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, and ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties.

- 7) Pursuant to Independence Standards Board Standard 1:
 - ensure that it receives from the independent auditor a formal written statement delineating all relationships between the independent auditor and the Corporation;
 - actively engage in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditor; and
 - take, or recommend that the Directors take, appropriate action to oversee the independence of the independent auditor.
- 8) Meet with the independent auditors and management of the Corporation to review the scope of the proposed audit for the current year and the audit procedures to be utilized, and, at the conclusion thereof, review such audit, including any comments or recommendations of the independent auditors.
- 9) Discuss with the independent auditors matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit, and in particular any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information and any significant disagreements with management.
- 10) Review and discuss with the independent auditors:
 - all critical accounting policies and practices to be used;
 - all alternative treatments of financial information within generally accepted accounting principles ("GAAP") that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor; and
 - any material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.
- 11) Review, prior to each meeting, a summary of findings from completed internal audits, and a progress report on the proposed internal audit plan, with explanations for any deviations from the original plan.
- 12) Periodically review the Corporation's adherence to the code of conduct and investigate any matter brought to its attention within the scope of its duties.
- 13) Review all related-party transactions, if any, for potential conflict of interest situations.
- 14) Each quarter, provide sufficient opportunity for the internal audit function and the independent auditor to meet with the members of the Audit Committee without members of management present. Among the items to be discussed in these meetings are the independent auditors' evaluation of the Corporation's financial, accounting, and auditing personnel, and the cooperation that the independent auditors received during the course of the audit.
- 15) Ensure that the lead, concurring, and other audit partners are rotated off the independent auditor's audit engagement team as necessary to assure the independence of the independent auditor. Consider rotating the independent auditor on a regular basis in order to assure continuing auditor independence.
- 16) Obtain from the independent auditor assurance that Section 10A(b) of the Exchange Act has not been implicated.
- 17) Submit the minutes of all meetings of the audit committee to, or discuss the matters discussed at each committee meeting with, the Directors.
- 18) Prepare the report of the Committee to be included in the Corporation's annual proxy statement as required by the rules of the Commission, including disclosures of pre-approval policies and auditors' fees, and cause this Charter to be included in the proxy statement periodically.
- 19) Review and reassess the adequacy of this Charter on an annual basis.

While the Committee has the authority, powers, and responsibilities 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 and disclosures are complete and accurate and are in accordance with GAAP and applicable legal, accounting, and other requirements. These are the responsibilities of the Corporation's management and the independent auditor.