GAETA & EVESON, P.A.
Attorneys at Law

8305 Falls of Neuse Road, Suite 203
Raleigh, North Carolina 27615
(919) 845-2558 Telephone
(919) 518-2146 Facsimile

www.banklawnc.com

January 25, 2008

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Notice of Proposed Rulemaking
Annual Independent Audits and Reporting Requirements
12 CFR § 363

Dear Mr. Secretary:

We appreciate the opportunity to comment on the proposal of the Federal Deposit Insurance Corporation ("FDIC") to amend Part 363 of the FDIC regulations regarding annual independent audit and reporting requirements for insured depository institutions. Our firm currently serves as legal counsel for over 30 community banks headquartered within the state of North Carolina, including several North Carolina community banks in organization.

Allocating the resources required to achieve and maintain compliance with the federal and state regulations applicable to banks is undoubtedly a challenge for all financial institutions. This is especially true for community banks, which often have very limited human and budgetary resources compared to larger industry participants. In Section VI of the proposed rule release, the FDIC cites the particular challenges faced by community banks, while also pointing out that community banks may "present a different risk profile" than do larger institutions.[1]

While we support the overall thrust of the proposed rule, we believe that community banks will be most affected by the proposed rule and we therefore wish to offer the following comments from the community bank perspective:

1. As stated in the proposed rule, the requirement that management's assessment and the independent accountants' attestation report identify the internal control framework used to evaluate internal control over financial reporting essentially imposes requirements similar to those of the Securities and Exchange Commission ("SEC") regulations

[1] Annual Independent Audits and Reporting Requirements, 72 Fed. Reg. 62,310, 62,321 (Nov. 2, 2007).

implementing Section 404 of the Sarbanes Oxley Act of 2002. We believe that the cost of compliance with this requirement, both in dollars and in management hours, will be excessive for many community banks, forcing some to consider a merger or acquisition when they might otherwise have not. Some institutions currently covered by the $1 billion asset size threshold are not public companies registered under the Securities Exchange Act of 1934 (the "Exchange Act") or subsidiaries of public companies and are not, therefore, otherwise required to engage an independent accounting firm to prepare an attestation report on management's assessment of the effectiveness of internal control over financial reporting. Many such institutions have remained private, because of the high cost of compliance with these requirements.

We believe that an asset size threshold of $3 billion for internal control assessments would ease the compliance burden for community banks while also recognizing the reduced risk profile that they present. In addition to increasing the $1 billion asset size threshold, or as an alternative thereto, we would also urge the FDIC to consider a delayed phase-in of the requirements of Part 363.2(c)(3) and Part 363.3(b) similar to the delayed phase-in utilized by the SEC in connection with its implementation of Section 404 of the Sarbanes Oxley Act of 2002.

Additionally, we would strongly urge the FDIC to consider raising the asset size threshold for all other requirements of Part 363 from $500 million to $1 billion. As stated in the Background Section of the proposed rule release, the $500 million asset size threshold has been in effect since Part 363 was originally introduced in 1993. At the time it was introduced, it covered approximately 7.1% of the industry. It now covers approximately 18.6% of the industry. Accordingly, we believe an increase in the asset size threshold in Part 363.1(a) is appropriate in light of the current profile of the banking industry and the 15 years that have elapsed since the $500 million threshold was originally set.[2]

2. We support the extension of the time period for non-public institutions to file their Part 363 annual reports from 90 to 120 days. We believe that this proposed amendment to Part 363.4(a) will materially aid many community banks in complying with the requirements of Part 363 and may also serve to reduce the cost of obtaining the required independent auditors' attestation report.

   We would also support a similar, but temporary, extension of the filing deadline for public companies and subsidiaries of public companies, in the unlikely event that the SEC further delays the compliance date for inclusion of the independent auditors'

[2] Without taking into consideration the consolidation in the banking industry that has more than doubled the percentage of industry participants with over $500 million in total assets, inflation adjustment alone would support an increase in the asset size threshold of Part 363.1(a) to approximately $750 million (based on the consumer price index as reported in the *Statistical Abstracts of the United States*).

attestation report required to be filed by public companies that are non-accelerated filers (currently applicable for fiscal years ending on or after December 15, 2008[3]).

We believe that the proposed addition of Part 363.4(e), which replaces the "extraordinary circumstances beyond its reasonable control" standard with a more generally available standard for extensions, will make compliance with Part 363 more attainable for community banks. We also believe that the addition of Part 363.4(e) will bring the FDIC standards for obtaining filing extensions more in line with the "unreasonable effort or expense" standard currently employed by the Securities and Exchange Commission in Rule 12b-25 under the Exchange Act, which we believe to be a fair standard.

We have no comments on the proposed amendments to guideline 23.

3. We strongly support the proposed relief from annual reporting requirements for institutions that are merged out of existence prior to the filing deadlines associated therewith. Given that requests for relief from the filing requirements of Part 363 are regularly granted by the FDIC where an institution is merged out of existence after its fiscal year end but prior to the filing deadline required in Part 363.4(a), we believe that the proposed amendment will reduce both regulatory burden and uncertainty.

4. We support the relief from reporting on internal control over financial reporting for businesses acquired during the fiscal year that would be provided by proposed guideline 8B.

   We believe that the rule requiring depository institutions acquired during the fiscal year, but not merged prior to the deadline prescribed in Part 363.4(a), to comply with the filing requirements of Part 363 is logical, however, we believe that there may be instances where such institutions should be permitted to satisfy the filing requirements of Part 363 by invoking the 75% rule in Part 363.1(b). For example, an institution acquired during the first quarter of the fiscal year that, together with the other depository institution(s) under the same holding company comprises 75% or more of the consolidated total assets of that holding company, should also be able permitted to satisfy its Part 363 filing requirements by filing consolidated financial statements of the holding company.

5. We believe that the proposed amendment to Part 363.2(b)(2), adding the requirement that the assessment of compliance with designated safety and soundness laws and regulations include management's conclusions regarding compliance with such laws and regulations, should include a "materiality," "reasonableness" or other qualifier due to the fact that technical violations of the regulations governing loans to executive officers, directors and principal shareholders may exist even where management believes in good faith that there is total compliance. We believe that the absence of a materiality or other qualifier

[3]Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, 71 Fed. Reg. 76,580 (Dec. 21, 2006).

will unfairly subject management to heightened liability in situations where compliance with Federal Reserve Board Regulation O has been observed in all material respects, but where there is a technical violation of the regulation.

We note that other elements of the reports required under Part 363 are subject to "materiality" and "reasonableness" qualifiers. Specifically, the Illustrative Management Reports pertaining to management's assessment of internal control over financial reporting included in Appendix B of the proposed regulation recognize that there are "inherent limitations" in internal control over financial reporting and provides the following model language:

> The Institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Institution; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Institution are being made only in accordance with authorizations of management and directors of the Institution; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Institution's assets that could have a material effect on the financial statements.[4]

Similarly, we also note that the disclosure regarding internal control over financial reporting required by Item 308 of SEC Regulation S-K requires the disclosure of material weaknesses in internal control.[5] Accordingly, we think there is precedent for the inclusion of a "materiality," "reasonableness" or other qualifier in management's assessment of compliance with designated safety and soundness laws and regulations.

Having stated this, we do not believe that a "materiality," "reasonableness" or other qualifier is necessary or desirable in management's assessment of compliance with safety and soundness laws and regulations pertaining to prohibitions on withdrawal of capital, restrictions on capital distributions, declaration of dividends and the like.

6. We agree with and support the clarifications regarding the independence standards with which independent public accountants must comply and the inclusion of Part 363.3(f) as proposed. We believe that coordination with applicable standards of the AICPA, the SEC and the PCAOB will reduce uncertainty in this context.

7. We support specification of the required composition of the audit committee and its duties in connection with the appointment, compensation and oversight of the independent public accounting firm, as specified in proposed Part 363.5(a), as well as the

[4] Annual Independent Audits and Reporting Requirements, 72 Fed. Reg. 62,310, 62,332 (Nov. 2, 2007) (emphasis added).
[5] 17 CFR Part 229.308 (emphasis added).

communications between independent public accounting firms and community bank audit committees required by 363.3(d).

We regularly counsel our non-public community bank clients that the audit committee standards applicable to public companies should generally be followed as best practices. The proposed rules would effectively implement these best practices as regulatory requirements. Furthermore, we believe that the amendments to guideline 28, particularly paragraphs (c) and (d) thereof, will reduce uncertainty for institutions with securities listed on a national securities exchange while also providing a safe harbor for compliance by all institutions. Accordingly, we strongly support this proposal.

We also support the latitude of Part 363.5(a)(2) designed to address hardships occasionally faced by smaller institutions in recruiting and retaining a sufficient number of qualified independent outside directors to serve as audit committee members. We believe that this latitude will be invoked infrequently, but that it will ease the compliance burden for certain community banks, particularly those not located in the vicinity of metropolitan areas.

While no revision to Part 363.5(b) has been proposed, we would suggest that this Part, and/or guideline 28, clarify the extent to which persons meeting the SEC's definition of "audit committee financial expert" will be deemed to have "banking or related financial management expertise" or vice versa.

8. We generally agree with the inclusion of proposed Part 363.5(c)(1). However, with respect to the last clause of Part 363(c)(1)(ii) and Part 363(c)(2), we believe there may be public policy arguments weighing against the inclusion of provisions waiving claims for punitive damages and alternate dispute resolution provisions in audit engagement letters. Having stated this, we believe that the proposed rule fairly balances the necessity of reliable audits against their cost. We also note that this proposed rule is in line with prior interagency guidance issued on this matter in February, 2006.[6] Accordingly, we have no comment on the addition of Part 363.5(c) as proposed.

9. We support the 75% threshold in Part 363.1(b) for use in determining whether depository institutions that are subsidiaries of bank holding companies, including multi-bank holding companies, may comply with the reporting requirements on a consolidated basis at the holding company level.

10. We support and appreciate the inclusion of illustrative management reports in Appendix B in order to assist institutions in complying with the annual reporting requirements. We

[6] Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 Fed. Reg. 6,847 (Feb. 9, 2006); External Audit Engagement Letters Unsafe and Unsound Use of Limitation of Liability Provisions, FDIC Financial Institution Letter 13-2006 (February 9, 2006).

believe that this will help to mitigate the regulatory burden that the proposed rules will impose.

11. We have no comment on the proposal to amend Part 308, subpart U regarding removal, suspension or debarment of accountants and accounting firms from performing audit services required by Section 36 of the Federal Deposit Insurance Act.

Once again, we appreciate the opportunity to comment on the proposed rule. Please do not hesitate to contact the undersigned should you wish to discuss any questions with respect to this letter.

Yours very truly,

GAETA & EVESON, P.A.

Todd H. Eveson