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**Inspection of
Davis, Kinard & Co.
(Headquartered in Abilene, Texas)**

**Issued by the
Public Company Accounting Oversight Board
December 21, 2009**

**THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT
PORTIONS OF THE COMPLETE REPORT ARE OMITTED
FROM THIS DOCUMENT IN ORDER TO COMPLY WITH
SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002**

PCAOB RELEASE NO. 104-2009-192



Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



INSPECTION OF DAVIS, KINARD & CO.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Davis, Kinard & Co.^{1/} ("the Firm"). The Board is issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report.^{2/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{3/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

^{1/} The Firm has issued audit reports under the name of Davis, Kinard & Co., P.C.

^{2/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

^{3/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from May 11, 2009 to May 15, 2009. These procedures were tailored to the nature of the Firm, certain aspects of which the inspection team understood at the outset of the inspection to be as follows:

Number of offices	1 (Abilene, Texas)
Ownership structure	Professional corporation
Number of partners	8
Number of professional staff ^{4/}	42
Number of issuer audit clients ^{5/}	1

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{6/} To achieve that goal, Board

^{4/} "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel. The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers or are "associated persons" (as defined in the Act) of the Firm.

^{5/} The number of issuer audit clients shown here is based on the Firm's self-reporting and the inspection team's review of certain information for inspection planning purposes. It does not reflect any Board determination concerning which, or how many, of the Firm's audit clients are "issuers" as defined in the Act. In some circumstances, a Board inspection may include a review of a firm's audit of financial statements of an issuer that ceased to be an audit client before the inspection, and any such former clients are not included in the number shown here.

^{6/} This focus necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{7/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements, are free of any deficiencies not specifically described in an inspection report.

A. Review of Audit Engagement

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of one issuer. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

The inspection team identified what it considered to be audit deficiencies.^{8/} The deficiencies identified in the audit reviewed included a deficiency of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent

^{7/} When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

^{8/} PCAOB standards require a firm to take appropriate actions to assess the importance of audit deficiencies identified after the date of the audit report to the firm's present ability to support its previously expressed opinions. See AU 390, *Consideration of Omitted Procedures After the Report Date*, and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T). Failure to comply with these PCAOB standards could be a basis for Board disciplinary sanctions.

evidential matter to support its opinion on the issuer's financial statements.^{9/} That deficiency was the failure to perform sufficient procedures to support the Firm's reliance on controls at a service organization in auditing the valuation of available-for-sale securities.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on a specific audit, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures. As described above, any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

^{9/} In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"), provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

PARTS II AND III OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

PART IV

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{10/}

^{10/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.



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October 27, 2009

Mr. George H. Diacont
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Re: Response to Public Company Accounting Oversight Board (PCAOB)
Report of 2009 Inspection of Davis Kinard & Co, PC

Mr. Diacont:

Thank you for the opportunity to review the report of the PCAOB's 2009 Inspection of Davis Kinard & Co, PC (the firm). We support the PCAOB in its mission and we believe the inspection process is vital in improving audit quality and protecting the public interest. The inspection team was thorough, technically proficient, courteous and professional.

We agree with the statements embodied in the report that indicate that the inspection process is designed to identify deficiencies and is not necessarily reflective of a firm's practice in general. As such, the report cannot and does not provide a means to reflect the overall high quality of our audit practice.

We accept the PCAOB's deficiency noted in the report. We do not agree, however, that the severity of the deficiency noted in the report is such that a conclusion can be drawn that the firm did not obtain sufficient, competent evidential matter to support its opinion. The sufficiency of competent, evidential matter required to support an audit opinion is determined through professional judgment based on particular facts and circumstances. We recognize that there may be matters of disagreement with respect to professional judgment and we view the comments provided by the PCAOB to be constructive and insightful.

With respect to the specific deficiencies noted in Part 1 of the report, the following represents our comments on the matter that was elemental in our determination that the firm obtained sufficient, competent evidential matters to support its opinion.

The comment speaks to the firm's reliance on a service auditor report addressing controls at a service organization in auditing the valuation of available-for-sale securities. More specifically, we understand that the comment is derived from the fact that the service auditor's report covers internal controls for a period that does not cover the entire period under audit, which is accurate. Internal controls, by their very nature, are static, requiring conscious decisions by management to change the design of the controls. It is also our observation that operating effectiveness of controls is generally consistent in service organizations subject to annual service auditor procedures. In concluding that the firm could rely on the service auditor report on the service organization controls, we noted this was the third year of our audit of the issuer and there has been little change in the design or operating effectiveness of internal controls at the portfolio servicer. These facts, coupled with the fact that the service auditor has not changed, provided evidence that there was a low risk that the design of the controls or their operating effectiveness of controls would change in the near term.

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The service auditor report was verified as accurate and reliable by the firm's testing of transactions recorded by the portfolio servicer. The firm also performed a persuasive analytical review of the fair values of securities. Each security's fair value was compared to the amortized cost, considering 1) the current pricing for current similar securities with a comparable yield, and 2) the fact that most of the Bank's debt securities were mortgage backed, with adequate performance, good credit support, favorable ratings from agencies and other factors that eliminated most of the credit risk component. As with most community bank investment security portfolios, fluctuations in values were determined to be primarily from shifts in interest rates.

We will communicate the findings of the PCAOB inspection report to our professional staff. In addition, the matters noted will be included in future training programs to assist us in improving our audit performance. Finally, these findings will be given specific attention in our monitoring procedures.

We appreciate the opportunity to provide this response and we would be pleased to discuss this with you further prior to the issuance of the final report. Davis Kinard & Co, PC has a deep commitment to audit quality and we thank the PCAOB for their insightful comments that will enhance our audit performance in the future.

Respectfully submitted,

A handwritten signature in black ink that reads "Davis Kinard & Co, PC". The signature is written in a cursive, flowing style.

DAVIS KINARD & CO, PC