1810-100 Comment Letter No. 1065



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Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: FASB Reference No. 1810-100, Proposed Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Thank you for the opportunity to comment on this proposed accounting standard, which will mark the single largest "sea change" in accounting theory if adopted as proposed.

Background of Commenter

Davis Kinard & Co, PC is a three office regional Texas certified public accounting firm with approximately 100 total personnel serving more than 75 financial institution clients in six states. Virtually all of our financial institution clients are community banks, which in most cases are the backbone of their community and the driver of small business opportunity. Our relationship with many of our financial institution clients spans a period of more than 50 years. We know the industry, we advise our financial institution clients on complex accounting matters frequently, and our views on the proposed standard represent the views of our clients.

Comments

The accounting treatment for financial instruments should follow the business model and strategies of the operating entity. The same financial asset could be held by two different entities with entirely different intentions with respect to that financial instrument.

For example, entity 1 could have a long-term investment strategy with respect to a financial asset, and therefore, valuing the asset at a short-term fair value, does not reflect that intent or the reality that the amount recorded on the balance sheet most likely will not represent the ultimate cash realized upon liquidation or disposition of that financial asset. This entity's business model and strategy is to hold and collect contractual cash flows on financial assets, thus carrying these assets at fair value is not reflective of the financial asset's true value to the organization at any point in time. Amortized cost, net of expected credit losses, provides a value that is more closely aligned with the strategy the entity employed when it initially acquired the financial asset. The fair value of any liability incurred by entity 1 to fund the purchase of the financial asset is irrelevant. On the other hand, entity 2 could use the same financial asset in a completely different manner, employing a business strategy based on buying and selling financial assets in search of a series of short-term gains. In this case, carrying this financial asset at its short-term fair value accurately reflects the expected cash realized upon liquidation or disposition of the financial asset. Fair value information on any liability incurred by entity 2 to fund the purchase of the financial asset is useful and relevant to a financial statement reader.

In both cases referred to above, we believe current accounting standards are far superior in reflecting the business model and strategies in accounting for financial assets and liabilities than the proposed standard. Financial reporting based on the business model and intentions of a company is more informative, consistent and more useful to all parties in evaluating and comparing financial statements of various entities.

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A similar case can be made for the accounting treatment for the financial liabilities. Financial liabilities are generally incurred with the express purpose of funding asset purchases. If a financial liability is incurred to fund the purchase of a long-term asset, it makes little sense to carry that financial liability at fair value. In the fundamental business model, productive assets are acquired with capital or liabilities for the express purpose of creating profits. If financial assets are held with the intent of producing profits for the long term, measuring any financial liabilities at fair value does not produce a fair view of the productivity of the financial asset over time as the income statement or comprehensive income statement would reflect changes in the fair value of the financial liabilities which have nothing to do with the performance of the financial assets or an entity's true profitability. It is particularly troubling to consider measuring financial liabilities at fair value when the clear intent of an entity is not to liquidate those liabilities in the short-term, but to make orderly contractual payments.

The recent liquidity crisis in the mortgage-backed security industry is a stark reminder that measuring long-term assets at a short-term fair value is a recipe for disaster. The fair values of financial assets and liabilities are often impacted by various forces that make measurement of fair value questionable at best and inaccurate at worst. A predictable series of cash flows is just one factor in determining the fair value of a financial asset or liability.

Finally, in the public interest, it is crucial that the Board understand that its actions on this proposed standard will have a consequence in driving behavior. Entities will be encouraged to invest in assets with shorter durations to avoid volatility in their financial statements, thus fundamentally changing the financial markets. Comparing the performance of one company with another will be virtually impossible without an in-depth understanding of valuation techniques leaving common investing only for the elites.

We encourage the Board to consider revision of the proposed standard with respect to carrying financial assets and liabilities at fair value.

Yours respectfully,

DAVIS KINARD & CO, PC

Scott McDonald, CPA

Chairman of the Board