
2020 Inspection Raul Carrega, CPA

(Headquartered in Newport Beach, California)

May 13, 2022

THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT



PCAOB RELEASE NO. 104-2022-139A

(Includes portions of Part II and Appendix A of the full report that were not included in PCAOB Release No. 104-2022-139)

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2020 INSPECTION

In the 2020 inspection of Raul Carrega, CPA, the Public Company Accounting Oversight Board (PCAOB) assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review one audit of an issuer with a fiscal year ending in 2019. For the issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

2020 Inspection Approach

In selecting issuer audits for review, we use a risk-based method of selection. We make selections based on (1) our internal evaluation of audits we believe have a heightened risk of material misstatement, including those with challenging audit areas, and (2) other risk-based characteristics, including issuer and firm considerations. In certain situations, we may select all of the firm's issuer audits for review.

When we review an audit, we do not review every aspect of the audit. Rather, we generally focus our attention on audit areas we believe to be of greater complexity, areas of greater significance or with a heightened risk of material misstatement to the issuer's financial statements, and areas of recurring deficiencies. We may also select some audit areas for review in a manner designed to incorporate unpredictability.

Our selection of audits for review does not constitute a representative sample of the firm's total population of issuer audits. Additionally, our inspection findings are specific to the particular portions of the issuer audits reviewed. They are not an assessment of all of the firm's audit work nor of all of the audit procedures performed for the audits reviewed.

View the details on the [scope of our inspections and our inspections procedures](#).

OVERVIEW OF THE 2020 INSPECTION

The following information provides an overview of our 2020 inspection, which was our first inspection of this firm. We use a risk-based method to select audits for review and to identify areas on which we focus our review. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and audit areas from inspection to inspection and firm to firm. Further, a firm's business, the applicable auditing standards, or other factors can change from the time of one inspection to the next. As a result of these variations, we caution that our inspection results are not necessarily comparable over time or among firms.

Firm Data and Audits Selected for Review

| | 2020 |
|--|------|
| Firm data | |
| Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures | 1 |
| Total engagement partners on issuer audit work ¹ | 1 |
| Audits reviewed | |
| Total audits reviewed ² | 1 |
| Audits in which the firm was the principal auditor | 1 |
| Integrated audits of financial statements and internal control over financial reporting (ICFR) | 0 |
| Audits with Part I.A deficiencies | 1 |

If we include a deficiency in Part I.A of our report, it does not necessarily mean that the firm has not addressed the deficiency. In many cases, the firm has performed remedial actions after the issue was identified. Depending on the circumstances, remedial actions may include performing additional audit procedures, informing management of the issuer of the need for changes to the financial statements or reporting on ICFR, or taking steps to prevent reliance on prior audit reports.

Our inspection may include a review, on a sample basis, of the adequacy of a firm's remedial actions, either with respect to previously identified deficiencies or deficiencies identified during the current

¹ The number of engagement partners on issuer audit work represents the total number of firm personnel (not necessarily limited to personnel with an ownership interest) who had primary responsibility for an issuer audit (as defined in AS 1201) during the twelve-month period preceding the outset of the inspection.

² The population of issuer audits from which audits are selected for review may differ from the issuer audits at the outset of the inspection procedures due to variations such as new issuer audit clients for which the firm has not yet issued an opinion or issuer audit clients lost prior to the outset of the inspection.

inspection. If a firm does not take appropriate actions to address deficiencies, we may criticize its system of quality control or pursue a disciplinary action.

If we include a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — it does not necessarily mean that the issuer’s financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. It is often not possible for us to reach a conclusion on those points based on our inspection procedures and related findings because, for example, we have only the information that the auditor retained and the issuer’s public disclosures. We do not have direct access to the issuer’s management, underlying books and records, and other information.

Audit Areas Most Frequently Reviewed

This table reflects the audit areas we have selected most frequently for review in the 2020 inspection. For the issuer audit selected for review, we selected these areas because they were generally significant to the issuer’s financial statements, may have included complex issues for auditors, and/or involved complex judgments in (1) estimating and auditing the reported value of related accounts and disclosures and (2) implementing and auditing the related controls.

| 2020 | |
|------------------------------|-----------------|
| Audit area | Audits reviewed |
| Revenue and related accounts | 1 |
| Debt | 1 |
| Derivatives | 1 |

PART I: INSPECTION OBSERVATIONS

Part I.A of our report discusses deficiencies, if any, that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.

Part I.B discusses deficiencies, if any, that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

Consistent with the Sarbanes-Oxley Act ("Act"), it is the Board's assessment that nothing in Part I of this report deals with a criticism of, or potential defect in, the firm's quality control system. We discuss any such criticisms or potential defects in Part II. Further, you should not infer from any Part I deficiency, or combination of deficiencies, that we identified a quality control finding in Part II. Section 104(g)(2) of the Act restricts us from publicly disclosing Part II deficiencies unless the firm does not address the criticisms or potential defects to the Board's satisfaction no later than 12 months after the issuance of this report.

Classification of Audits with Part I.A Deficiencies

Within Part I.A of this report, we classify each issuer audit in one of the categories discussed below based on the Part I.A deficiency or deficiencies identified in our review.

The sole purpose of this classification system is to group and present issuer audits by the number of Part I.A deficiencies we identified within the audit as well as to highlight audits with an incorrect opinion on the financial statements and/or ICFR.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

This classification includes instances where a deficiency was identified in connection with our inspection and, as a result, an issuer's financial statements were determined to be materially misstated, and the issuer restated its financial statements. It also includes instances where a deficiency was identified in connection with our inspection and, as a result, an issuer's ICFR was determined to be ineffective, or there were additional material weaknesses that the firm did not identify, and the firm withdrew its opinion, or revised its report, on ICFR. This classification does not include instances where, unrelated to our review, an issuer restated its financial statements and/or an issuer's ICFR was determined to be ineffective. We include any deficiencies identified in connection with our reviews of these audits in the audits with multiple deficiencies or audits with a single deficiency classification below.

Audits with Multiple Deficiencies

This classification includes instances where multiple deficiencies were identified that related to a combination of one or more financial statement accounts, disclosures, and/or important controls in an ICFR audit.

Audits with a Single Deficiency

This classification includes instances where a single deficiency was identified that related to a financial statement account or disclosure or to an important control in an ICFR audit.

PART I.A: AUDITS WITH UNSUPPORTED OPINIONS

This section of our report discusses the deficiencies identified, by specific issuer audit reviewed, in the audit work supporting the firm's opinion on the issuer's financial statements.

We identify each issuer by a letter (e.g., Issuer A) and industry sector. Each deficiency could relate to several auditing standards, but we reference the PCAOB standard(s) that most directly relates to the requirement with which the firm did not comply.

We present issuer audits below within their respective deficiency classifications (as discussed previously). Within the classifications, we generally present the audits based on our assessment as to the relative significance of the identified deficiencies, taking into account the significance of the financial statement accounts and/or disclosures affected, and/or the nature or extent of the deficiencies.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

None

Audits with Multiple Deficiencies

Issuer A – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement audit related to **Revenue**, **Convertible Notes Payable**, and **Journal Entries**.

Description of the deficiencies identified

With respect to **Revenue**:

The firm did not sufficiently evaluate whether the issuer recognized revenue in conformity with FASB ASC Topic 606, *Revenue from Contracts with Customers*, because it limited its procedures to verifying that the issuer received cash or that cash received agreed to a sales contract. (AS 2810.30)

With respect to **Convertible Notes Payable**:

The firm did not evaluate the issuer's equity classification of and accounting for warrants issued with certain convertible notes payable, including whether the warrants should have been classified and

accounted for as (i) derivative liabilities in conformity with FASB ASC Topic 815, *Derivatives and Hedging*, or (ii) liabilities in conformity with FASB ASC Topic 480, *Distinguishing Liabilities from Equity*. (AS 2810.30)

In addition, the firm did not evaluate the issuer's classification of and accounting for embedded conversion options within certain convertible notes payable, including whether the conversion options should have been classified and accounted for as (i) derivatives and recorded at fair value in conformity with FASB ASC Subtopic 815-15, *Derivatives and Hedging— Embedded Derivatives*, or (ii) beneficial conversion features and recorded at intrinsic value in conformity with FASB ASC Subtopic 470-20, *Debt – Debt with Conversion and Other Options*. (AS 2810.30)

With respect to **Journal Entries**:

The firm scanned the general ledger but did not identify and test any journal entries and other adjustments. (AS 2401.58)

Audits with a Single Deficiency

None

PART I.B: OTHER INSTANCES OF NON-COMPLIANCE WITH PCAOB STANDARDS OR RULES

This section of our report discusses any deficiencies we identified that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

When we review an audit, we do not review every aspect of the audit. In some cases, we assess the firm's compliance with specific PCAOB standards or rules on other audits that were not reviewed and include any instances of non-compliance below.

The deficiencies below are presented in numerical order based on the PCAOB standard or rule with which the firm did not comply. We identified the following deficiencies:

- In the audit reviewed, the firm did not make certain required communications to the issuer's audit committee related to the significant risks identified through its risk assessment procedures. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.
- In the audit reviewed, the firm's report on Form AP omitted the issuer's CIK number. In this instance, the firm was non-compliant with PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

PART II: OBSERVATIONS RELATED TO QUALITY CONTROL

Part II of our report discusses criticisms of, and potential defects in, the firm's system of quality control.

We include deficiencies in Part II if an analysis of the inspection results, including the results of the reviews of individual audits, indicates that the firm's system of quality control does not provide reasonable assurance that firm personnel will comply with applicable professional standards and requirements. Generally, the report's description of quality control criticisms is based on observations from our inspection procedures.

This report does not reflect changes or improvements to the firm's system of quality control that the firm may have made subsequent to the period covered by our inspection. The Board does consider such changes or improvements in assessing whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

When we issue our reports, we do not make public criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified. If a firm does not address to the Board's satisfaction any criticism of, or potential defect in, the firm's system of quality control within 12 months after the issuance of our report, we will make public any such deficiency.

A. Testing Revenue

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel with respect to testing revenue will meet the requirements of AS 2810. (QC 20.03 and .17)

In one audit,³ which is included in Part I.A, the inspection team identified a deficiency related to the firm's substantive testing of revenue recognition.

B. Testing Convertible Notes Payable

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel to test convertible notes payable will meet the requirements of AS 2810. (QC 20.03 and .17)

In one audit,⁴ which is included in Part I.A, the inspection team identified deficiencies related to the firm's evaluation of the classification of and accounting for convertible notes payable, including related warrants.

³ Issuer A

⁴ Issuer A

C. Fraud Procedures

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm's personnel will perform the procedures necessary to comply with AS 2401. (QC 20.03 and .17)

In one audit,⁵ which is included in Part I.A, the firm scanned the general ledger but did not identify and test any journal entries and other adjustments.

D. Engagement Quality Review

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the review procedures performed by the firm's engagement quality review (EQR) partners will meet the requirements of AS 1220. (QC 20.03 and .17)

In one audit,⁶ which is included in Part I.A, the inspection team identified deficiencies in areas that the EQR partner was required to evaluate. In this audit, the EQR partner did not identify a deficiency in an area of significant risk, including in one case a fraud risk.

E. Practice Monitoring

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm is effectively monitoring its accounting and auditing practice. (QC 20.20)

Although the firm's policies and procedures for monitoring its accounting and auditing practice require the performance of annual internal inspections, the firm has not performed an internal inspection since it began its issuer audit practice in 2016.

F. Communications with Audit Committees

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm's personnel will comply with the requirements of AS 1301. (QC 20.03 and .17)

In one audit,⁷ the firm did not make certain required communications to the issuer's audit committee related to the significant risks identified through its risk assessment procedures.

⁵ Issuer A

⁶ Issuer A

⁷ Issuer A

G. State Practice Qualification Requirements

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm will comply with relevant requirements to practice in a jurisdiction. (QC 20.17)

The inspection team observed that the firm had performed audits of the financial statements of one issuer⁸ whose principal executive offices were located in a state that required either registration or licensure with the state as a prerequisite to performing audits of entities with home offices located in the state. The firm was not registered or licensed with this state.

⁸ Issuer A

APPENDIX A: FIRM'S RESPONSE TO THE 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, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

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 some cases, the result may be that none of a firm's response is made publicly available.

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. 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.

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January 10, 2022

Via Email
ResponsestoDraftReport@pcaob.org

Re: Response to Report on 2020 Inspection of Raul Carrega, CPA,
Part 1.A and Part 1.B

This is in response to the Draft report of Inspection issued by the PCAOB on December 8, 2021.

These are responses only and perhaps announcements to the public. We are not asserting that we disagree nor that we agree. Since these comments will be seen by the public, we feel that it is important that the public see our point of view and our interpretation of standards. These responses should be viewed as comments and possibly as counsel.

The PCAOB inspector identified deficiencies in Revenue, Convertible Note Payable, and Journal Entries. This inspection was done remotely due to Covid 19. The auditors were never physically present and all workpapers, documents, excel files were scanned and emailed. This inspection auditing approach, we feel may have limited auditor's judgement, vision, and conclusions.

Responses to Part 1.A

With Respect to Revenue the PCAOB auditor concludes that the firm did not sufficiently evaluate whether the issuer recognized revenue in conformity with FASB ASC Topic 606. Revenue Procedures were done and mentioned by the PCAOB auditor in their report. The impact of ASC 606 is no difference from previous law since the company is not a software or retailer company.

With Respect to Convertible Notes Payable the PCAOB auditor concludes that the firm did not evaluate issuer's equity classification of and accounting for warrants issued with certain convertible notes payable, including whether the warrants should have been classified and accounted for as (i) derivative liabilities in conformity with FASB ASC Subtopic 815-15. Or liabilities in Conformity with FASB 480, distinguishing liabilities from equity. I would like to point out that the auditor's comment is an opinion that may give the impression to the public "we do not understand derivative accounting". As a result, it is important that we comment and announce our position. From the workpapers given to the PCAOB auditor, the firm explained and walk-through numerous items, not one line entry did the PCAOB auditor conclude was not done properly and according to standards. For an auditor to suggest that we did not understand the evaluation, we feel is not appropriate when the auditor has no evidence that suggests the evaluation and workpaper breakdown was not done accordingly to AS 2810-30 and the beneficial conversion feature and recorded at intrinsic value were in conformity with FASB ASC 470-20. We feel this comment has no merit.

With Respect to Journal Entries the PCAOB auditor confirms that procedures were done.

Responses to Part 1.B

With Respect to Communication the firm communicates with the issuer by memo and by phone. The firm sent a letter to the issuer regarding independence. The firm prepares a planning memo which includes items that are communicated to the audit committee. This memo is workpaper GP-1A. The planning memo includes risk communication.

With Respect to Form AP the firm complies and is up to date with listing information on the mandatory Form AP (Auditor Reporting of Certain Audit Participants). The firm was not aware of the input field nor the importance of the CIK number when the information was inputted on the annual AP form.

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January 10, 2022

Via Email
ResponsestoDraftReport@pcaob.org

Re: Response to Report on 2020 Inspection of Raul Carrega, CPA,
Part II, Observation related to Quality Control

This is in response to the Draft report of Inspection issued by the PCAOB on December 8, 2021.

These are responses only and perhaps announcements to the public. We are not asserting that we disagree nor that we agree.

With Respect to Testing Revenue the firm has no comments.

With Respect to Testing Convertible Notes Payable the firm has no comments.

With Respect to Fraud Procedures the firm has no comments.

With Respect to Engagement Quality Review the firm has no comments.

With Respect to Practice Monitoring the firm has no comments.

With Respect to Communication with audit Committees the firm has no comments.

With Respect to State Practice Qualification Requirements the firm is a registered PCAOB accounting firm. The firm is a California Licensed CPA firm. The firm has paid all license fees and is in good standing. All comments and discussions regarding this issue were made with my audit response. If any state legal issue exists, then that is a legal issue between Raul Carrega, CPA, and the State. The firm has a license to issue financials.

Very truly yours,

Raul Carrega

