2020 Inspection
M&K CPAS, PLLC

(Headquartered in Houston, Texas)

June 9, 2022

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
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

PCAOB RELEASE NO. 104-2022-144A
(Includes portions of Part II of the full report
that were not included in PCAOB Release No. 104-2022-144)

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2020 INSPECTION

In the 2020 inspection of M&K CPAS, PLLC, 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 six audits of issuers with fiscal years generally ending in 2019. For each 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 AND HISTORICAL DATA BY INSPECTION YEAR

The following information provides an overview of our 2020 inspection as well as data from the previous inspection. 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	2017
Firm data		
Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures	63	53
Total engagement partners on issuer audit work[1]	3	3
Audits reviewed		
Total audits reviewed[2]	6	5
Audits in which the firm was the principal auditor	6	5
Integrated audits of financial statements and internal control over financial reporting (ICFR)	0	0
Audits with Part I.A deficiencies	3	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.

[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.

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 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 and the previous inspection. For the issuer audits 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		2017	
Audit area	Audits reviewed	Audit area	Audits reviewed
Revenue and related accounts	6	**Revenue and related accounts**	5
Debt	3	**Equity and equity-related transactions**	2
Business combinations	1	**Business combinations**	1
Long-lived assets	1	**Debt**	1
Derivatives	1	**Other income**	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). 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

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement audit related to **Business Combinations**.

Description of the deficiencies identified

During the year, the issuer acquired two businesses. With respect to one of these business combinations, the following deficiencies were identified:

- The purchase price for the acquisition included contingent consideration based on forecasted revenue. The issuer estimated the fair value of the initial contingent consideration using certain assumptions. The firm did not perform any procedures to evaluate the fair value of the contingent consideration. (AS 2502.15)

- The issuer subsequently remeasured the contingent consideration and recorded the change as an expense. The firm did not sufficiently evaluate whether the change was a result of events that occurred subsequent to the acquisition date and was appropriately recorded as an expense in conformity with FASB ASC Subtopic 805-30, *Business Combinations - Goodwill or Gain from Bargain Purchase, Including Consideration Transferred,* because the firm did not identify that the forecasted revenue the issuer used for the remeasurement was consistent with the historical revenue at the acquisition date. (AS 2810.03 and .30)

- The firm did not perform any procedures to test the fair value of an intangible asset. (AS 2502.15) In addition, the firm did not evaluate whether the method used to determine the fair value of this intangible asset was in conformity with FASB ASC 805, *Business Combinations*. (AS 2810.30)

- The firm did not perform any procedures to evaluate whether all identifiable assets acquired and liabilities assumed were identified and appropriately recorded. (AS 2301.08)

With respect to the other business combination, the following deficiencies were identified:

- The firm's approach for substantively testing the fair value of an acquired intangible asset was to review and test management's process. The firm did not perform procedures, beyond inquiry of management, to evaluate the reasonableness of certain assumptions used to determine the fair value of this asset. (AS 2502.26 and .28)

- The firm did not perform any substantive procedures to test the fair value of certain other assets acquired and liabilities assumed in this business combination. (AS 2502.15)

Issuer B – Information Technology

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement audit related to **Revenue** and **Debt**.

Description of the deficiencies identified

With respect to **Revenue**:

The firm selected for testing a sample of revenue transactions. In its evaluation of the issuer's revenue recognition, the firm did not evaluate whether the identification of performance obligations and the allocation of the transaction price to the performance obligations were appropriate given the existence of contradictory evidence. (AS 2301.08; AS 2810.03)

The firm used data from one of the issuer's systems to test certain revenue, but did not test, or in the alternative, identify and test controls over, the accuracy and completeness of this data. (AS 1105.10)

With respect to **Debt**:

The issuer reported certain convertible notes that included embedded conversion features that were effective after a certain period of time. The issuer recorded a derivative liability associated with these features after that period of time expired. The firm did not sufficiently evaluate whether the derivative liability should have been initially recorded on the issuance date of the convertible notes because it did not perform procedures to determine whether the feature met the definition of a derivative and whether the issuer had sufficient authorized and unissued shares to convert any of the notes at each note's issuance date and at year end. (AS 2301.08)

Certain of these notes contained default clauses related to the issuer's obligation to reserve a sufficient number of shares from its authorized and unissued common stock. The firm did not evaluate whether these notes were in default at the time of issuance and, therefore, the derivative liability should have been recorded at the time of issuance. (AS 2301.08; AS 2810.03)

Audits with a Single Deficiency

Issuer C – Energy

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Oil and Gas Properties**.

Description of the deficiency identified

To evaluate the possible impairment of proved oil and gas reserves and make certain required disclosures, the issuer engaged an external specialist to estimate the present value of future net cash flows from these reserves using the issuer's projected operating costs. The firm did not sufficiently test these projected operating costs because it limited its procedures to comparing the first year of projected operating costs to the prior-year actual operating costs. (AS 1210.12)

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(s) 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. As a result, the areas below were not necessarily reviewed on every 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 one of six audits reviewed, the engagement quality reviewer assumed certain responsibilities of the engagement team. In this instance, the firm was non-compliant with AS 1220, *Engagement Quality Review*.

- In six of six audits reviewed, the firm did not make a required communication to the issuer's audit committee, or equivalent, related to its evaluation of the quality of the company's financial reporting. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In three of six audits reviewed, the firm did not communicate to the issuer's audit committee, or equivalent, all of the significant risks identified through its risk assessment procedures. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In one of six audits reviewed, the firm did not make a required communication to the issuer's audit committee related to significant unusual transactions. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In one of six audits reviewed, the firm did not make a required communication to the issuer's audit committee related to the management representation letter. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees,* and AS 2805, *Management Representations*.

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.

* * * *

Testing Business Combinations

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 business combinations will meet the requirements of AS 2301 and AS 2810. (QC 20.03 and .17)

In one audit,[3] which is included in Part I.A, the inspection team identified deficiencies related to the firm's testing of business combinations.

* * * *

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)

The firm uses internal inspections as monitoring procedures of its accounting and auditing practice. The PCAOB inspected five issuer audits[4] that had also been reviewed under the firm's internal inspection

[3] Issuer A

[4] Issuers A, B, C, D, and F

program. In two of these audits where the same areas were reviewed,[5] the PCAOB identified Part I.A deficiencies that were not detected by the internal inspectors.

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 an area that the EQR partner was required to evaluate. In this audit, the EQR partner did not identify deficiencies in an area of fraud risk.

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[5] Issuers B and C

[6] Issuer B

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.

May 16, 2022

Mr. George Botic, Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006

Re: Response to Part 1 of the Draft Report on the 2020 Inspection of M&K CPAS, PLLC.

On behalf of M&K CPAS, PLLC, we are pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") Draft Report of May 5, 2022 in connection with the 2020 Inspection of our firm. We recognize the inspection process provides a valuable opportunity to improve the quality of our audits. We continue to support the PCAOB in its mission and are committed to furthering the public interest through the preparation of informative, accurate and independent audit reports.

We have reviewed the matters described in Part 1 of the Draft Report and are taking appropriate steps to address the comments in accordance with PCAOB Rules and best practices. We have not identified any changes to our overall conclusions or the related audit reports.

We appreciate this opportunity to provide a response to the PCAOB, and look forward to continuing to work with the PCAOB on our shared objective of improving audit quality.

Respectfully submitted,

/s/ M&K CPAS, PLLC

/s/Casey G. Kinchen, CPA
Managing Partner