2021 Inspection
K. R. Margetson Ltd.

(Headquartered in North Vancouver, Canada)

December 1, 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

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PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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2021 INSPECTION

In the 2021 inspection of K. R. Margetson Ltd., 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. Our inspection was conducted in cooperation with the Canadian Public Accountability Board.

We selected for review one audit of an issuer with a fiscal year ending in 2020. For the issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

2021 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 necessarily 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 2021 INSPECTION AND HISTORICAL DATA BY INSPECTION YEAR

The following information provides an overview of our 2021 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

	2021	2019
Firm data		
Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures	1	3
Total issuer audits in which the firm was not the principal auditor	0	0
Total engagement partners on issuer audit work[1]	1	1
Audits reviewed		
Total audits reviewed[2]	1	3
Audits in which the firm was the principal auditor	1	3
Integrated audits of financial statements and internal control over financial reporting (ICFR)	0	0
Audits with Part I.A deficiencies	1	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 deficiency was identified. Depending on the circumstances, remedial actions may include performing additional

[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, *Supervision of the Audit Engagement*) or for the firm's role in an issuer audit 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 audit report or issuer audit clients lost prior to the outset of the inspection.

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 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 2021 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.

2021		2019	
Audit area	Audits reviewed	Audit area	Audits reviewed
Goodwill and intangible assets	1	**Cash and cash equivalents**	3
Debt	1	**Goodwill and intangible assets**	3
		Debt	1
		Equity and equity-related transactions	1
		Accruals and other liabilities	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 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 **Intangible Assets**.

Description of the deficiencies identified

The issuer entered into an agreement ("acquisition agreement") to acquire a license that granted it the rights to sell certain products, and it recorded the license agreement ("license agreement") as an intangible asset. The acquisition and license agreements required the issuer to, among other terms, pay royalty fees on future net sales (with guaranteed minimum royalty fees), pay an external party for future advisory services, and issue convertible preferred stock. The issuer recorded certain of the payments to the external party as part of accounting for the transaction.

The firm did not evaluate whether the future royalty payments should have been recorded as part of accounting for the transaction in conformity with FASB ASC Topic 805, *Business Combinations.* In addition, the firm did not evaluate whether it was appropriate to recognize certain of the payments to the external party as part of the accounting for the transaction, and not recognize the remaining payments, in conformity with FASB ASC Topic 805. (AS 2810.30)

The firm's approach for substantively testing the valuation of the convertible preferred stock that was issued was to test the issuer's process. The firm did not evaluate whether the method used by the issuer to determine the value of the convertible preferred stock was appropriate. (AS 2501.10) In addition, the firm did not perform procedures to evaluate the reasonableness of a significant assumption the issuer used to determine the fair value of the convertible preferred stock. (AS 2501.16)

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 equivalent related to (1) an overview of the overall audit strategy; (2) corrected misstatements; and (3) the results of the audit prior to the issuance of the auditor's report. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In the audit reviewed, the firm did not provide to management and the audit committee equivalent the required communications in writing of all material weaknesses identified during the audit. In this instance, the firm was non-compliant with AS 1305, *Communications About Control Deficiencies in an Audit of Financial Statements.*

- In the audit reviewed, the firm's audit report stated that there were no critical audit matters, but the firm did not perform procedures to determine whether or not matters that were communicated, or required to be communicated, to the audit committee equivalent, and that relate to accounts or disclosures that are material to the financial statements, were critical audit matters. In this instance, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. This instance of non-compliance does not necessarily mean that critical audit matters should have been communicated in the auditor's report.

- In the audit reviewed and in two previous audits of this issuer, the firm did not file its report on Form AP by the relevant deadline. In addition, these three reports on Form AP contained inaccurate information regarding the issuer CIK number. In these instances, 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.

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.

K. R. MARGETSON LTD.

Chartered Professional Accountant

331 East 5th Street
North Vancouver BC V7L 1M1
Canada
keith@krmargetson.com

Tel: 604.220.7704
Fax: 1.855.603.3228

August 15, 2022

Response to Draft Report of June 29, 2022

1. The firm did not evaluate whether the future royalty payments should have been recorded as part of the accounting for the transaction in conformity with FASB ASC Topic 805, *Business Combinations.*

Response.

The transaction was the assignment of a license with from a third party. The royalty payments are required under the license with the third party and are not part of the consideration paid for the license by the Company. It was noted in the file that there was no cash flow valuation performed at the time of the purchase. The comment on WP# 2006…. "ASC 845.10.30.1 – the value of the asset received should be based on the value of the assets surrendered.

In this instance, the future royalty payment are not part of the assets surrendered but rather part of the assets received and no evaluation of that cash flow was required.

2. In addition, the firm did not evaluate whether it was appropriate to recognize certain of the payments to the external party as part of the accounting for the transaction, and not recognize the remaining payments in conformity with FASB ASC Topic 805.

Response.

The issue revolves around the following part of the agreement. "For advisory services in connection with the acquisition and S-1 Registration Statement, (the Company) shall enter into an advisory agreement on the Closing Date and as consideration therefore, (the Company) shall issue a Convertible Promissory Note in the amount of $100,000 as an upfront payment and a $25,000 Convertible Promissory Note each month beginning 90 days from the closing date."

On the audit working page number N.201, the above paragraph is referenced as follows, "Enter into Advisory agreement and issue conv prom not for $100,000 as an upfront payment and $25,000/m 90 days thereafter. Beside that comment it is noted "This paragraph is part of the assignment agreement …. And the $100,000 is noted as being 'upfront'….conclusion is that it is part of the cost of obtaining the assignment.

In other words, it was a cost of acquisition paid at the time of signing and should be part of the cost. The later payments, as part of an advisory agreement, are not part of the cost of obtaining the license but rather are ongoing costs more appropriately associated with ongoing expenses. To support this position, is the understanding that it is not feasible that a payment of $25,000 per month be made for ever. We noted in the file (wp#41) that there were invoices sent for advisory services for the last three months of the year (and none after that). The Firm believes the facts support the accounting.

3. The firm's approach for substantively testing the valuation of the convertible preferred stock that was issued was to test the issuer's process. The firm did not evaluation whether the method used by the issuer to determine the value of the convertible preferred stock was

appropriate. In addition, the firm did not preform procedures to evaluate the reasonableness of a significant assumption the issuer used to determine the fair value of the convertible preferred stock.

Response

On working paper #2006 – the following was disclosed:

1. What is the value of the license?

ASC 845.10.30.1 – the value of the asset received should be based on the value of the assets surrendered. There is also comment that if that is difficult to determine, then the value could be based on asset received. In this instance there was no cash flow analysis on the (party "A") license so it not possible to base the value of the asset received. (party "B") was presumably interested in a public vehicle which would enable it to raise funding for the project.

Prior to the agreement, the shares of (the Company) were very lightly traded – at $0.04 share. One could argue that there was no market for the shares. At the time of the transaction (July 23, 2020) there were 18,057,565 shares outstanding, indicating a market cap of $722,302.60. The client had discounted this by 50% to account for the lack of trading and to acknowledge that selling all the shares at once would have to be done at a price below what I share was selling at.

The price, based on 95% of 40% of the market was $343,094. The expenses and outlays brought the price up to $488,094. In discussion with market makers in Vancouver, they suggested that shells were selling between $400,000 - $500, 000 CDN…. Which is a little less than this. In another file, we had used a 30 % discount which had been reviewed during a PCAOB audit and essentially accepted. Our conclusion is that some discount off the price is required – at least 30% - and that the price determined above is reasonable and defensible.

On working paper#3000 – *Risk Planning Memo,* under the intangible asset analysis and under 'Specific procedures to address risks identified in RAS' it is noted "get expert opinion on share allocation." On working paper #N – *Intangible assets'* there is a reference "Value is determined as 50% of the market value of common shares that pref shares can be converted into. This approximates what a "Shell" is worth on open market. See N.204." On N.204, there is a copy of an email that states – "Shells are going for about CAD $400-500K. Delivering about 90% of the stock."

Finally, as noted on wp#N.201, "the Company was very lightly traded prior to July 20th, it had no assets, significant losses and considerable debt. Its value was only in its attractiveness as a vehicle to go public…….To check on value KRML asked noted company buyer and seller what the current price was of a public company. Andrew said between $400-500k CDN, if you could deliver over 90% of the Company. Conclusion: the value of $361,151 is reasonable."

In my opinion the above comments from the file conclude -

That the method used to value the convertible preferred stock was appropriate:

- Value is based on the value of asset surrendered.
- Pref shares were the asset surrendered.

- Pref shares had essentially no value themselves but were convertible into common shares. Value is therefore based on the value of the common shares converted.
- The shares are traded, so the value is based on the market value of the shares.

Reasonableness of assumption – to use 50% of the trading value as the value surrendered.

- The shares are lightly traded – one might conclude essentially not traded at all. A discount of some amount is certainly required.
- Noted that in a past PCAOB review a discount of 30% was considered appropriate. (To be accurate, a 30% discount was used and there was no comment that the rate was inappropriate.)
- Noted what a "Shell" sells for (which the Company was as it had no assets and no business) by discussion with an expert and comparing this price favourably to the 50% value used.

Part B – Other instances of non-compliance with PCAOB Standards or Rules

While there were circumstances with some of the comments, I have cannot dispute their accuracy. Again, there is considerable overlap with the previous 2019 review. I have engaged a quality control expert to improve this areas.

Yours truly,

K. Margetson

Keith Margetson, CPA, CA, CPA (Illinois)