



Trends in material weaknesses

KPMG 2023 Study

October, 2023

About this study

2023 material weakness study

Purpose

The purpose of this study was to identify the common themes and business process areas associated with material weaknesses (MW) reported by public companies. The statistics that follow stem from a study performed by KPMG in the summer of 2023.



Approach

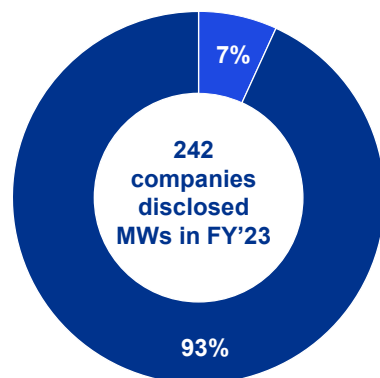
The study analyzed annual filings released by SEC-registered public companies between July 2018 and June 2023. Data was reviewed from the third-party research database Audit Analytics, and all MWs reported were aggregated and then summarized based on the underlying themes and affected business processes related to the MW.

For purposes of this report, the 2023 year considers MWs reported in any public company filing that was released between July 2022 and June 2023. The MWs reported in this year's study came from companies with year-ends through June 30, 2023. KPMG notes that the data set underlying this study does not include S-1s for IPO companies that were first time filers during the time period of the report, but includes all companies once they have filed a 10-K.



2019-2023 material weaknesses study – background statistics

Comparison of MW percentages over the last five years of the study



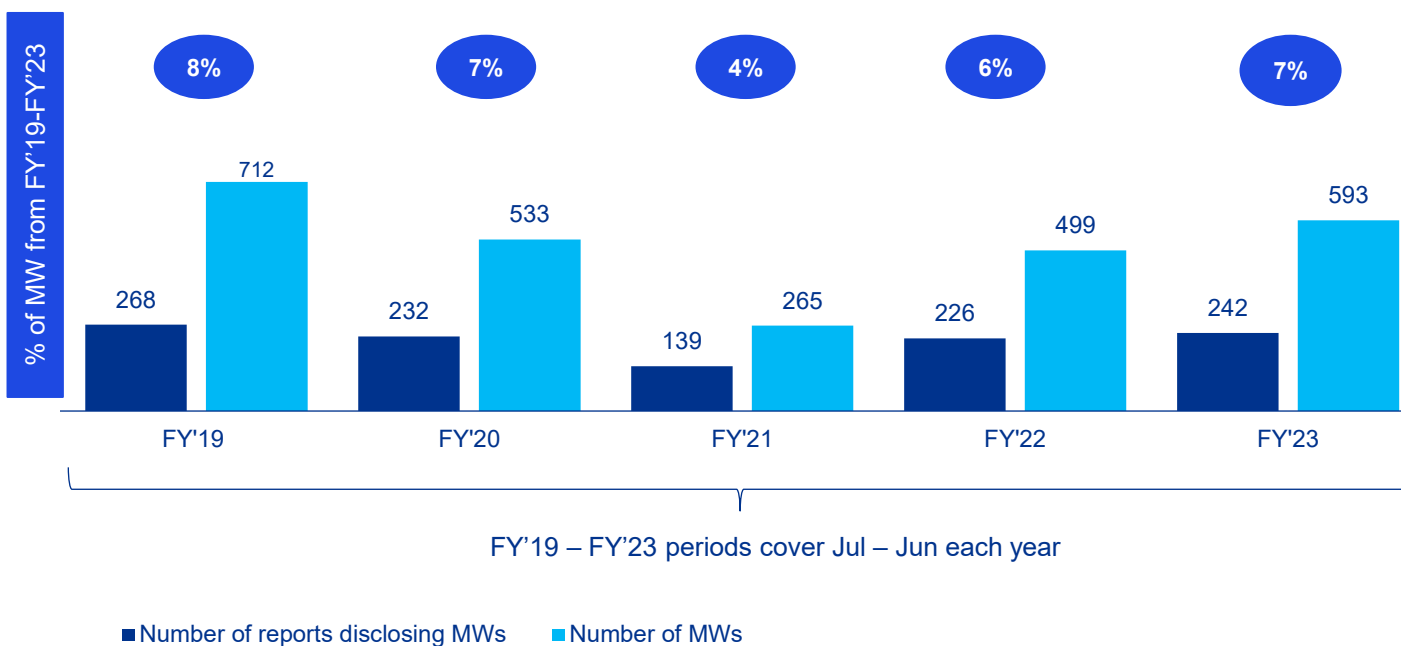
Of the **3,549 annual reports** filed in the 2022/2023 year, **242 companies (7%)** disclosed MWs in their filings as of June 30, 2023.

The percentage of companies disclosing MWs in 2023 was similar to the prior year and was consistent with pre-pandemic levels.

There were 90 companies with MWs that were first time filers over the last 5 years, of which 18 were from 2023.

Percent of companies disclosing MWs, by year[^]

The % of MWs is consistently in the 6% - 8% range during years covered by the study with a decline in FY'21



[^] % represents # of companies that disclosed material weaknesses over the total number of filings for that year

Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings



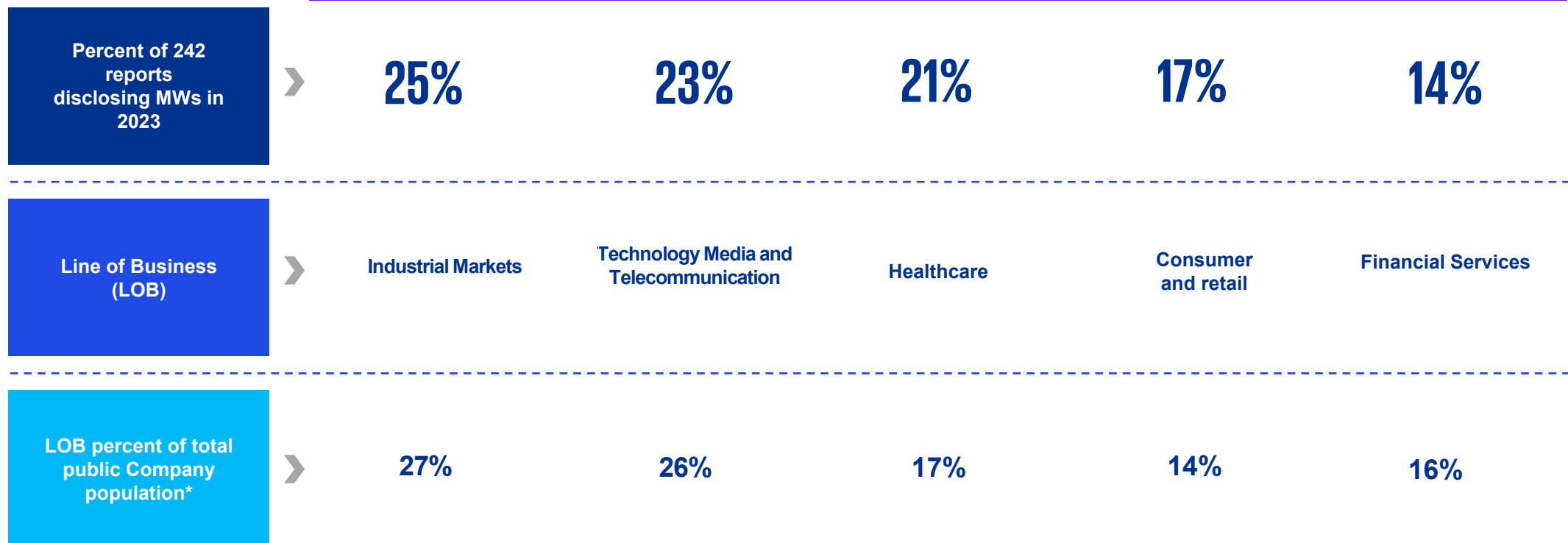
© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Public

2023 material weaknesses study – background statistics

Industry breakdown of companies that disclosed MWs in their filings in the year 2023

As a percentage of MWs reported compared to the size of the industry sector, Healthcare shows the highest incidence of MWs. These percentages are consistent with the trend noted in prior years.



Provided by KPMG US Market Intelligence
 Source(s): Audit Analytics, SEC Edgar filings



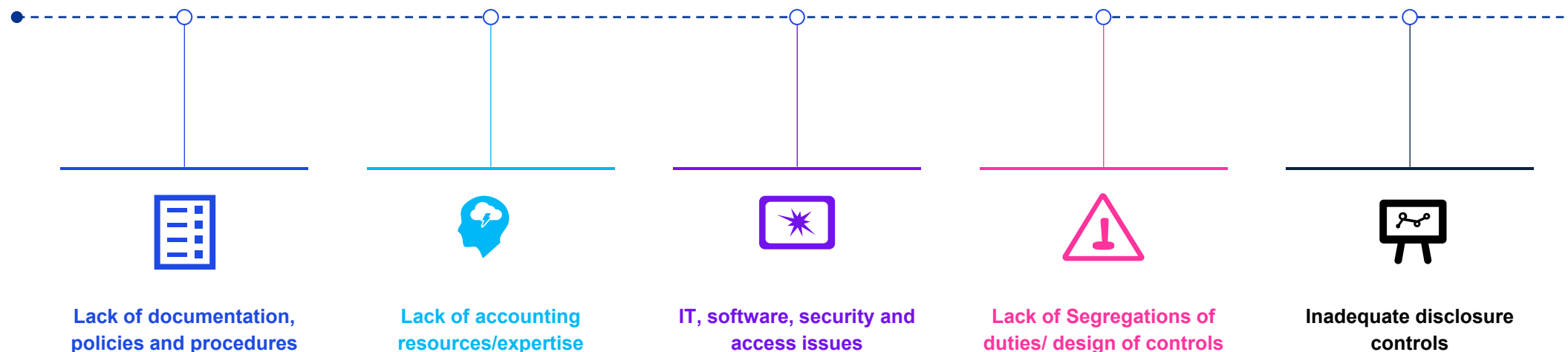
© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Summary of material weakness themes reported

Issues contributing to MWs in 2023

The top five primary themes of material weaknesses noted in 2023 are consistent with the same top themes in noted in 2022.

The five primary themes for 2023 MW root causes



Apart from the top five primary themes of material weaknesses noted above, 11% of companies have reported issues related to *restatement of company filings*.

Note: Key themes are defined as those which applied to 20% or more of companies reporting MWs.

Provided by KPMG US Market Intelligence

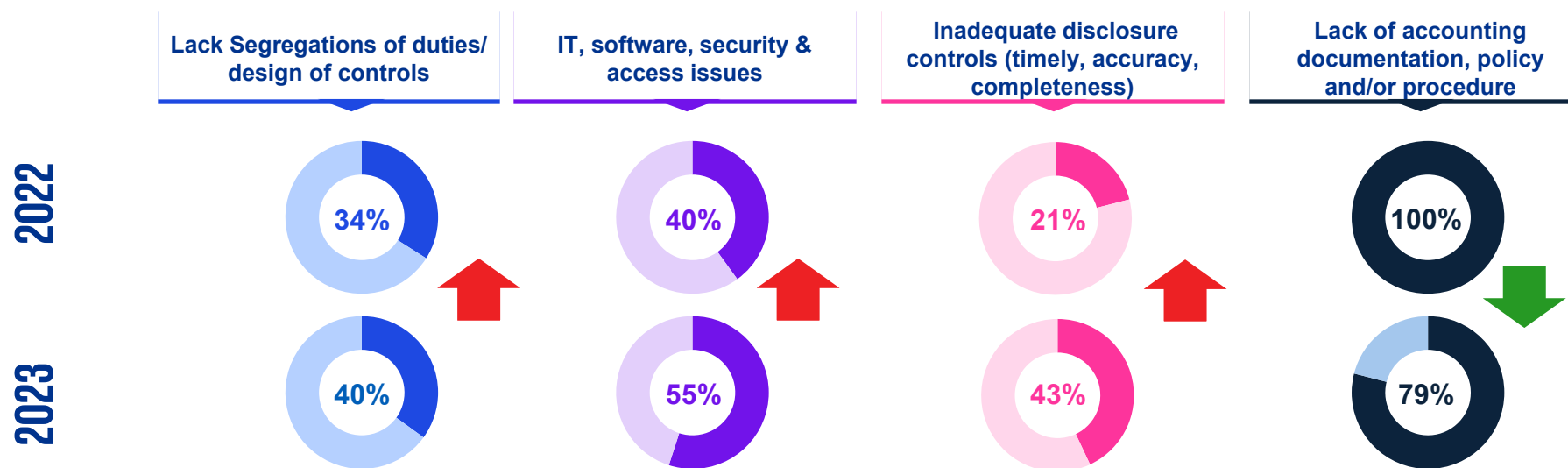
Source(s): Audit Analytics, SEC Edgar filings



Trends in material weakness themes reported

Notable changes between FY'23 and FY'22 trends in MWs

MWs related to lack of segregation of duties, IT, software, security & access, and inadequate disclosure controls (timely, accuracy, completeness) issues all showed significant increases in 2023, while the lack of accounting documentation, policy and/or procedure showed the first decrease in the five year period. All of these issues were primary themes in 2022 and 2023.



- Material weaknesses reported were often the result of more than one overlapping issue/challenge
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of reports in the stated year. Individual companies may be reported in multiple years.

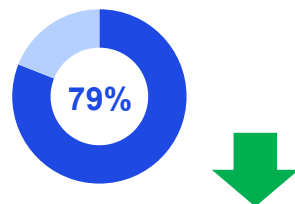
Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings



Trends in material weakness themes reported (continued)

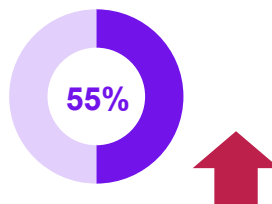
The following issues contributing to MWs showed notable trends over the last five years from 2019 - 2023, as depicted below.

Lack of documentation, policies & procedures



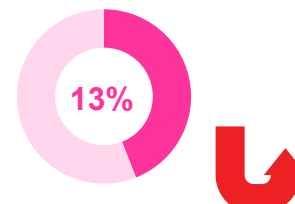
Held steady at 99%-100% between 2019-2022 and declined to 79% in 2023. This means that at least one of the root causes for the MW was related to lack of documentation, policies and procedures; but additional causes may also be identified for each MW.

Lack of accounting resources/expertise



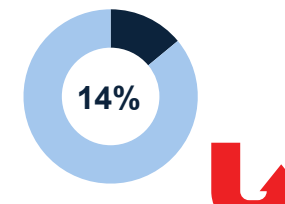
Steadily increased from 2021 through 2023. This issue was at a 5-year low of 34% in 2021, followed by an increase to 48% in 2022 and 55% in 2023.

Non-routine transaction control issues



Steadily decreased from 11% to 8% between 2019 and 2021, followed by an increase back to 12% in 2022 and 13% in 2023.

Journal entry control issues



Increased for 3 consecutive years from 2019-2021 from 7% to 12%, followed by a decrease to 9% in 2022, with a subsequent increase to 14% in 2023.

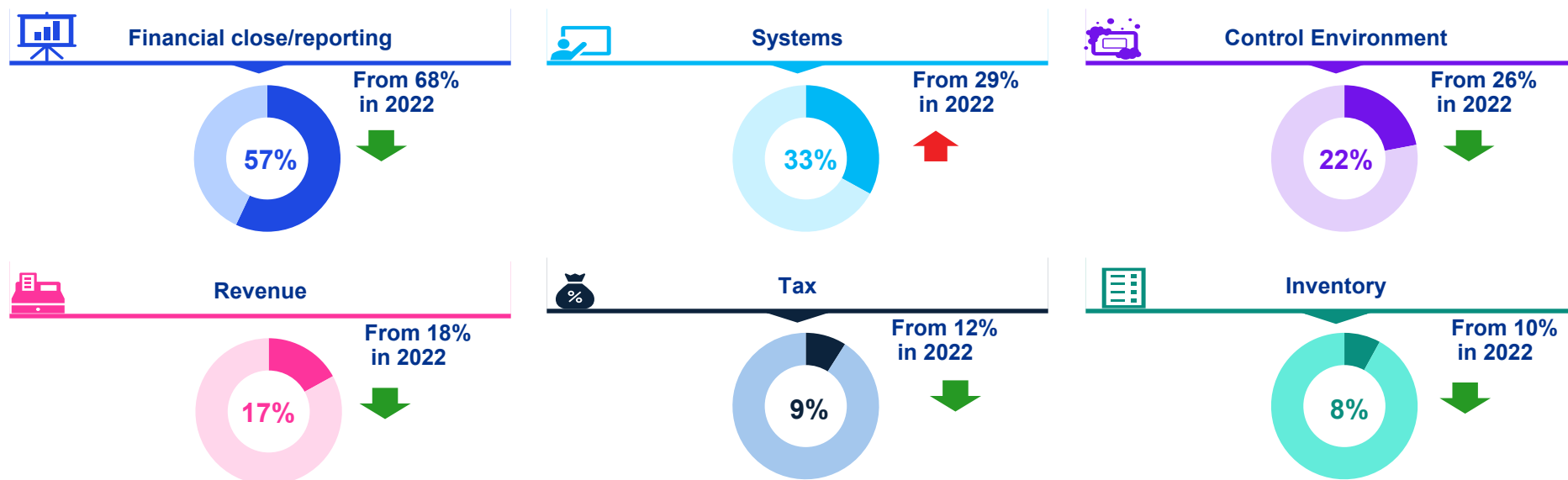
- Material weaknesses reported were often the result of more than one overlapping issue/challenge
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of reports between 2019-2023 (1,107). Individual companies may be reported in multiple years.

Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings

Trends in material weakness process areas

Process areas with highest concentration of MWs in 2023

The graphs below represent the percentage of MWs by process area reported in 2023, with notable percentage changes indicated next to the relevant process area.



- Material weaknesses reported often impacted multiple process areas
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of companies that reported MWs (242) for 2023.

Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings

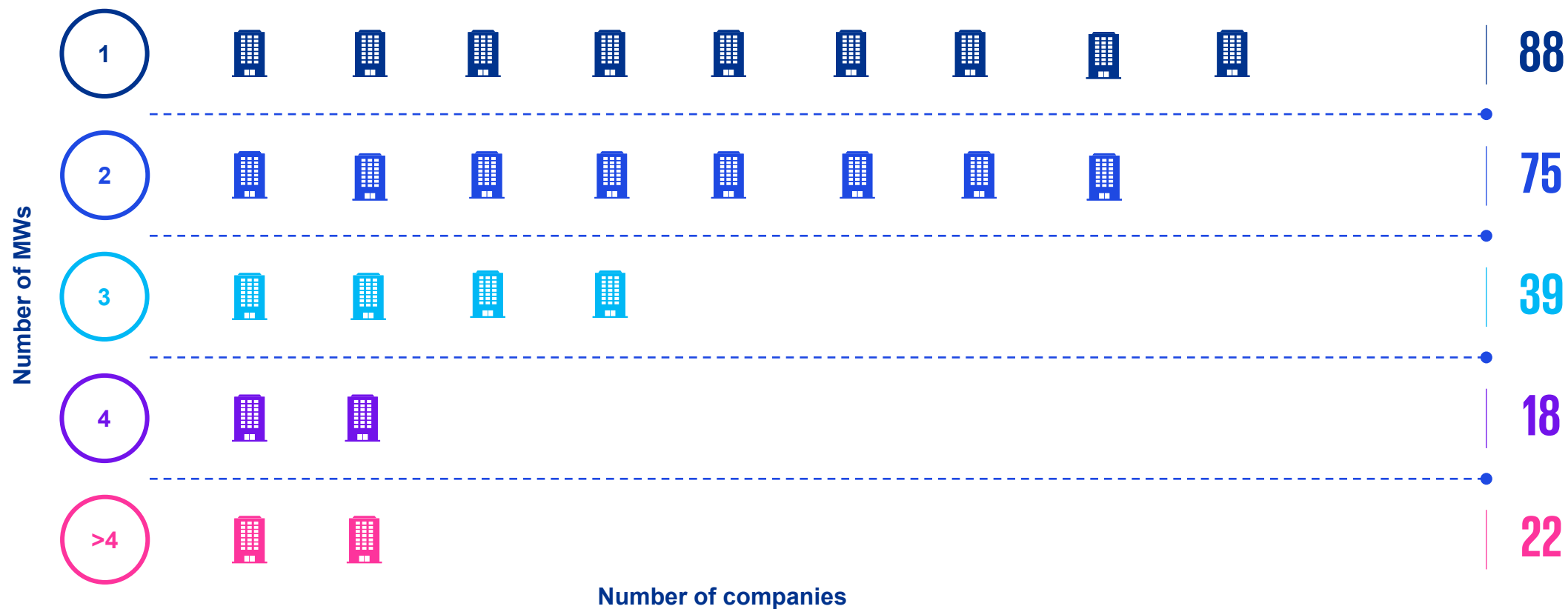


© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Public

Summary of material weaknesses reported in 2023

Number of companies by total material weaknesses disclosed



Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings



© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

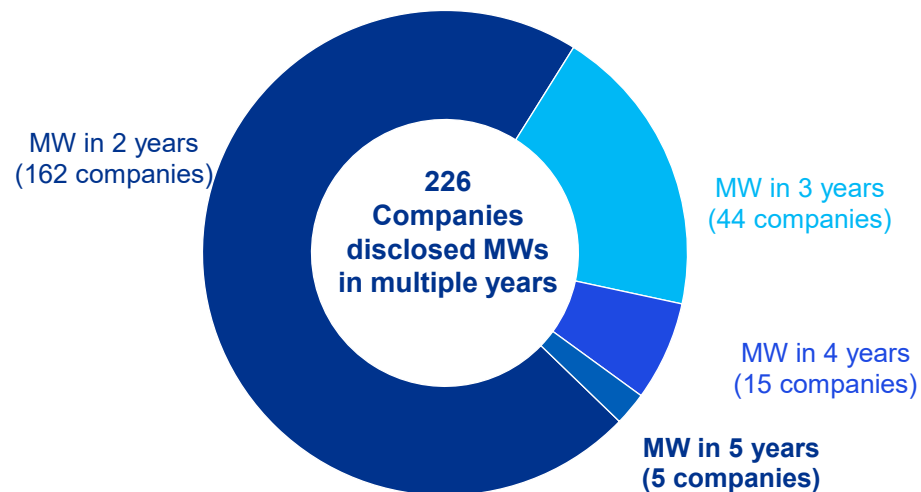
Material weaknesses in multiple years

Trends in MWs over multiple years

Between 2019–2023*, there were 226 companies that reported MWs in multiple years, which represents 29% of the total companies filing a report with a MW during the time period.

MWs reported in multiple years

Of the 768[^] companies that filed a report with an MW between 2019-2023, **226 companies (29%)** disclosed MWs in multiple years



* This analysis is based on the data sets included in our current and previous studies, dating back to KPMG's 2019 Material Weakness study.

[^] The 768 companies reported in the table above represent the unique count of companies filing a report with a MW between 2019-2023 (i.e. excluding duplicative company counts in which there was a multiple MW reported or multiple filings in one year).

Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings



Examples of material weaknesses

Common themes in 2023



Lack of documentation, policies and procedures

“The material weaknesses were driven by...lack of documented policies and procedures in relation to our business process and entity level controls as well as lack of evidence of performing controls...”



Lack of accounting resources/expertise

“Management has identified that the Company lacks sufficient accounting resources with deep technical knowledge to identify and timely resolve complex accounting issues under accounting principles generally accepted in the US”



IT, software, security and access issues

“...identified deficiencies in the operation of information technology general controls (ITGCs) in the areas of logical access, change management and security administration over information technology (IT) system that support the Company’s financial reporting processes...”



Segregations of duties/ design of controls

“.. identified several material weaknesses in our internal control over financial reporting such as lack of competence accounting personnel at entity level and proper segregation of duties implemented. ...”



Inadequate disclosure controls

“... Company’s disclosure controls and procedures did not adequately ensure the accumulation and communication to management of information known to organization”

Provided by KPMG US Market Intelligence
Source(s): Audit Analytics, SEC Edgar filings



© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Examples of material weaknesses

Top two process areas in 2023



Financial Close/Reporting

“...did not design and maintain formal accounting policies, procedures and controls over significant accounts and disclosures to achieve complete, accurate and timely financial accounting, reporting and disclosures, including accounting for complex features associated with warrants, segregation of duties and adequate controls related to the preparation and review of journal entries...”



Systems

“...The information technology general controls (ITGCs) related to the Company's information technology (IT) systems were ineffective. Therefore, the automated process-level controls and manual controls dependent upon the accuracy and completeness of information derived from those IT systems were also ineffective, because they could have been adversely impacted;”



Contact Us



Sue King

Partner

E: susanking@kpmg.com



Nikki McCandless

Director

E: nmccandless@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.



kpmg.com/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Document Classification: KPMG Public