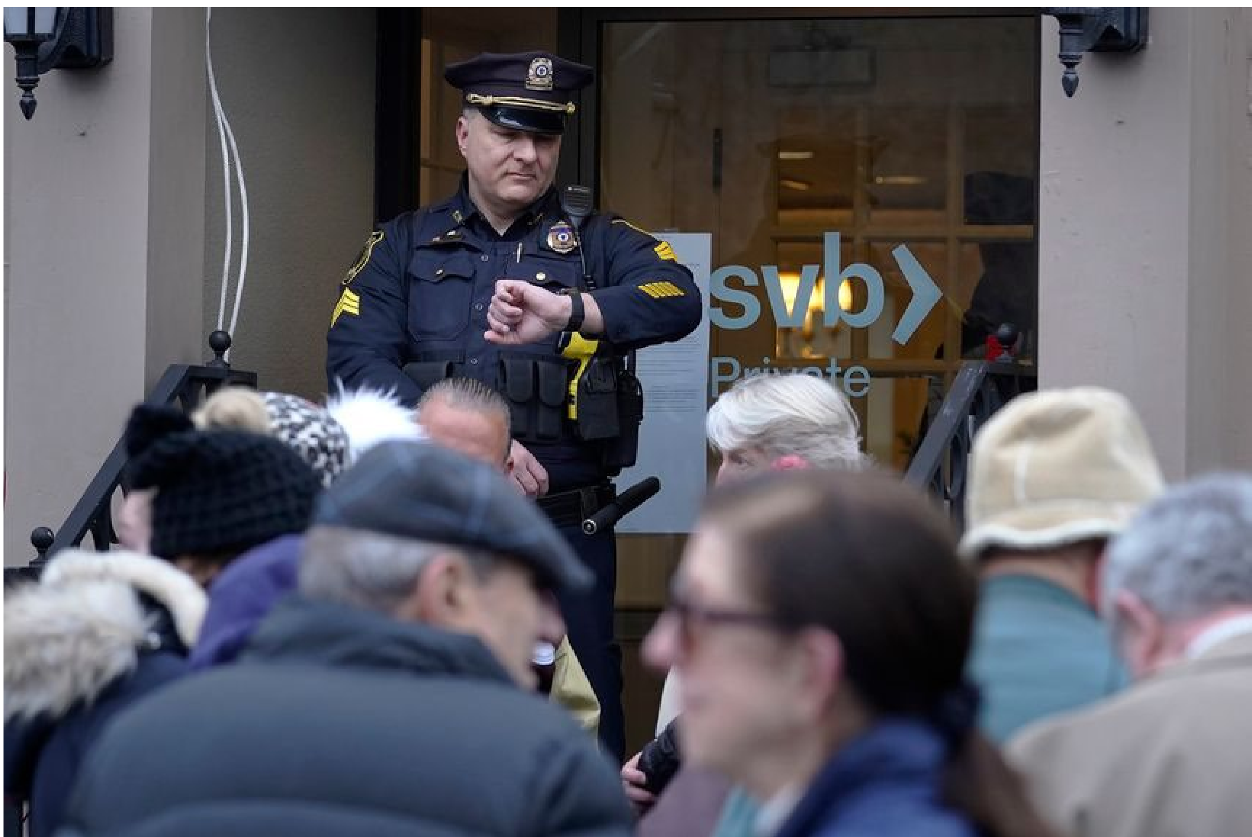
THE WALL STREET JOURNAL.

KPMG Gave SVB, Signature Bank Clean Bill of Health Weeks Before Collapse

Accounting firm faces scrutiny for audits of failed banks



A Silicon Valley Bank branch in Wellesley, Mass., before opening on Monday morning. Photo: Steven Senne/Associated Press

By Jonathan Weil and Jean Eaglesham
Updated March 13, 2023 12:21 pm ET

Silicon Valley Bank failed just 14 days after KPMG LLP gave the lender a clean bill of health. Signature Bank went down 11 days after the accounting firm signed off on its audit.

What KPMG knew about the two banks' financial situation and what it missed will likely be the subject of regulatory scrutiny and lawsuits.

KPMG signed the audit report for Silicon Valley Bank's parent, SVB Financial Group SIVB 0.00%increase; green up pointing triangle, on Feb. 24. Regulators seized the bank on March 10 after a surge of withdrawals threatened to leave it short of cash.

"Common sense tells you that an auditor issuing a clean report, a clean bill of health, on the 16th-largest bank in the United States that within two weeks fails without any warning, is trouble for the auditor," said Lynn Turner, who was chief accountant of the Securities and Exchange Commission from 1998 to 2001.

Two crucial facts for determining whether KPMG missed the banks' problems are when the bank runs began in earnest and when the bank's management and KPMG's auditors became aware of the crisis.

What is known about Silicon Valley Bank is that deposit outflows accelerated last month. In its March 8 statement, Silicon Valley Bank said "client cash burn has remained elevated and increased further in February." The bank said its deposits at the end of February were lower than it had predicted in January.

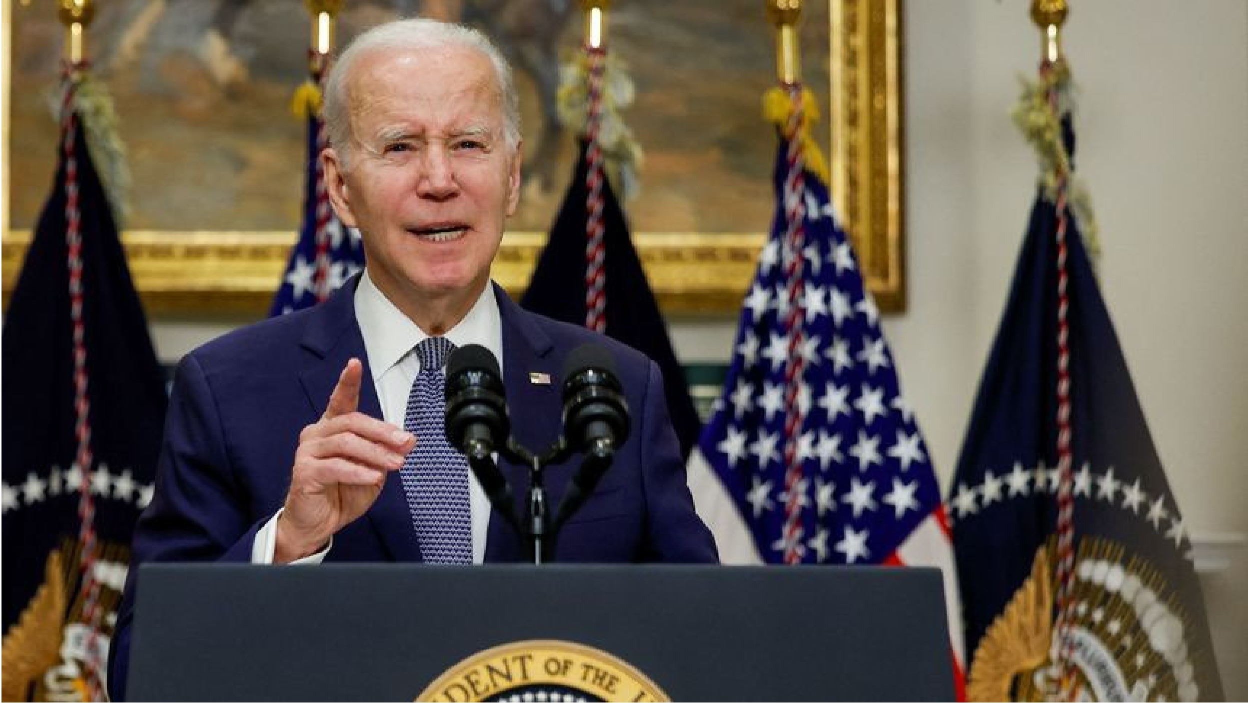
Both bank audits were for 2022, so auditors weren't scrubbing the banks' books for the time period when they ran into trouble. But auditors are supposed to highlight risks faced by the companies they audit. They are also supposed to raise important issues that occur after companies close their books and before the audit is completed.

A spokesman for KPMG declined to comment on the specific audits, due to client confidentiality. In a statement, the firm said it isn't responsible for things that happen after an audit is completed.

Silicon Valley Bank's deposits peaked at the end of the first quarter of 2022 and fell $25 billion, or 13%, during the final nine months of the year. That means deposits were declining during the period of KPMG's audit. If the decline was affecting the bank's liquidity when KPMG signed off on the audit report, that information likely should have been included. Since it wasn't, the question becomes, did KPMG know or should it have known what was going on?

Auditors are supposed to warn investors if companies are in trouble. They are required to evaluate "whether there is substantial doubt about the entity's ability to continue as a going concern" for the next 12 months after the financial statements are issued.

Auditors also use their reports to highlight "critical audit matters" that involve challenging, subjective or complex judgments. KPMG in that section of its report focused on the accounting for credit losses at Silicon Valley Bank. But it didn't address Silicon Valley Bank's ability to continue holding debt securities to maturity—which, in the end, the bank lacked.



President Biden said the banking system is safe in remarks on Monday, aiming to shore up confidence in the financial system. The remarks come just days after Silicon Valley Bank collapsed after a run on deposits. Photo: Evelyn Hockstein/Reuters

Even if the bank wasn't struggling last year, KPMG was required to evaluate developments that occurred after the balance-sheet date so the company's financials were presented fairly.

Signature Bank, which was seized by regulators on Sunday, also faced a run last week but it didn't have the same balance-sheet issues as Silicon Valley Bank. KPMG signed off on its audit on March 1.

Signature's bet on the crypto industry led to a surge in deposits, which went into reverse as that market struggled. A large amount of its deposits were uninsured, making it more likely the customers would flee at any sign of trouble. But it hadn't disclosed the same losses on its investments as Silicon Valley Bank, giving it a greater ability to pay depositors.

The auditing firm could face additional scrutiny. KPMG also audited First Republic Bank, whose shares were down 76% Monday morning, even after the bank got a liquidity boost from JPMorgan Chase and the Federal Reserve.

KPMG's audit work likely will be scrutinized by regulators, including the Public Company Accounting Oversight Board and the SEC, as well as private litigants that lost money when Silicon Valley Bank collapsed, said Erik Gordon, a professor at the University of Michigan's Ross School of Business. A shareholder lawsuit against the firm concerning its Silicon Valley Bank audit "won't be an easy one for people to win, even though the timing is spectacularly embarrassing for KPMG," Mr. Gordon said.

A PCAOB spokeswoman said the regulator "cannot comment on ongoing inspection or enforcement matters." An SEC spokesman declined to comment on the Silicon Valley Bank audit.

One argument KPMG could try in court is that the run on the bank started after the firm signed its audit report. A state banking regulator, the California Department of Financial Protection and Innovation, in a filing Friday said the bank was "in sound financial condition prior to March 9," when depositors withdrew $42 billion.

Douglas Carmichael, the PCAOB's chief auditor from 2003 to 2006, said it was unclear how the California regulator could have determined the bank's financial condition. "It seems like a premature analysis. How could they know without examining?" he said.

"Auditors are always under the microscope when the company fails shortly after the issuance of a clean opinion," Mr. Carmichael said. "The shorter the period, the greater the concern would have to be."

Silicon Valley Bank almost doubled its assets and deposits during 2021. It got in trouble because it bought long-term, low-yielding bonds with short-term funding from depositors that was repayable upon demand. Accounting rules said it didn't have to recognize losses on the assets as long as it didn't sell them. When rising interest rates caused the bonds' value to drop, it got stuck in them, and they kept falling. Silicon Valley Bank still had to maintain enough liquidity to pay withdrawals, which became increasingly difficult.

The $1.8 billion investment loss Silicon Valley Bank disclosed last week stemmed from Silicon Valley Bank's decision to sell all its "available for sale" securities during the first quarter. Silicon Valley Bank didn't say when it started or when it completed the sales. It isn't clear if Silicon Valley Bank used the proceeds of those sales to help cover withdrawals.

In the March 8 disclosure, Silicon Valley Bank said it expected to reinvest proceeds from the sales. But money is fungible, and it is unclear if selling the available-for-sale securities may have freed up other sources of cash to help pay departing customers.

Most of the capital hole in Silicon Valley Bank's balance sheet was in government-sponsored mortgage bonds that Silicon Valley Bank classified as "held to maturity." That label allowed Silicon Valley Bank to exclude unrealized losses on those holdings from its earnings, equity and regulatory capital.

In a footnote, Silicon Valley Bank said the fair-market value of its held-to-maturity securities was $76.2 billion as of Dec. 31, or $15.1 billion below their balance-sheet value. The fair-value gap was almost as large as Silicon Valley Bank's $16.3 billion of total equity—which, KPMG could point out, is something anyone reading the financial statements could have seen.

Silicon Valley Bank stuck to its position that it intended—and had the ability—to hold those bonds to maturity. KPMG allowed the accounting treatment. Now it will be up to the Federal Deposit Insurance Corp. to sell the securities.

The bank's troubles put KPMG in a no-win situation. If it had called attention to Silicon Valley Bank's falling deposits, or issued a warning about Silicon Valley Bank's ability to continue as a going concern, it could have set off a run on the bank. By not raising these issues, it will face questions about how it missed the signs that the bank was headed for trouble.

One of the agencies likely to ask pointed questions of KPMG is the FDIC. After a bank fails, the FDIC's Office of Inspector General regularly conducts investigations and publishes detailed reports called failed-bank reviews that identify the causes of the collapse and the parties most responsible.

Such reports are studied carefully by private litigants eyeing defendants to sue for damages. On that front KPMG caught a break over the weekend: The government said it would backstop all of both banks' uninsured depositors, in effect helping to bail out KPMG as well. The backstop won't affect losses suffered by the banks' shareholders.

Write to Jonathan Weil at jonathan.weil@wsj.com and Jean Eaglesham at Jean.Eaglesham@wsj.com