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KPMG Aided New Century Missteps, Report Says

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A court-appointed investigator looking into the collapse of **New Century Financial** Corp. said in a report that its auditor, KPMG LLP, devised some of the improper accounting strategies that allowed the company to hide its financial problems for years.

The investigator, Michael J. Missal, said the company might be able to recover money for its creditors by suing KPMG for professional negligence and negligent misrepresentation. He also recommended the company sue several of its former top executives to recover millions of dollars in bonuses and other compensation paid to them.

KPMG "contributed to certain of these accounting and financial reporting deficiencies by enabling them to persist and, in some instances, precipitating the company's departure from applicable accounting standards," Mr. Missal said in a 550-page report filed with the U.S. Bankruptcy Court in Wilmington, Del., and released Wednesday.

Dan Ginsburg, a spokesman for KPMG, said, "We strongly disagree with the report's conclusion concerning KPMG. We believe that an objective review of the facts and circumstances will affirm our position."

The Justice Department, as part of its investigation into New Century's collapse, is looking at individuals at KPMG who audited the company, according to people familiar with the case. But these individuals are not currently a target of the investigation, according to a person familiar with the matter. The Justice Department inquiry is being handled out of the Santa Ana office of the U.S. attorney for California's central district, based in Los Angeles. A spokesman for KPMG declined to comment.

A spokesperson for New Century said in a statement: "The Company is pleased that the Examiner's report is finally completed and that we can take the next steps of confirming the plan of liquidation, therefore substantially concluding the bankruptcy process."

In his report, Mr. Missal said that in one instance, a KPMG partner who led the New Century audit team castigated a subordinate who had questioned one of the company's accounting practices as it prepared to file its 2005 annual report with the Securities and Exchange Commission.

According to Mr. Missal, the KPMG partner told the subordinate in an email: "I am very disappointed we are still discussing this. As far as I am concerned, we are done. The client thinks we are done. All we are going to do is p- everybody off."

New Century, based in Irvine, Calif., was once one of the country's biggest providers of mortgages to people with poor credit histories. In 2006, it originated nearly $60 billion in subprime mortgages. It collapsed in April 2007 after its accounting problems came to light, accelerating the meltdown in the subprime-mortgage market. That meltdown precipitated the biggest credit crunch in at least a decade.

In his report, Mr. Missal said New Century had "a brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy." Its loan-production department, he said, was "the dominant force in the company," which trained mortgage brokers in sessions it referred to as "CloseMore University."

The company had low standards for originating loans, Mr. Missal said. "The predominant standard for loan quality was whether the loans New Century originated could be initially sold or securitized in the secondary market," he said. "The increasingly risky nature of New Century's loan originations created a ticking time bomb that detonated in 2007."

New Century owes its creditors more than $1 billion, but it has said in court papers that they are likely to recover no more than 17 cents of every dollar they are owed. Because the company has few assets left, much of that funding is likely to come from lawsuits against parties responsible for the company's collapse.

In an interview Wednesday, Mr. Missal said KPMG "didn't have the healthy skepticism that you would expect from your outside independent auditors." One of the accounting errors Mr. Missal identified involved a decision not to account for a "growing backlog" of troubled loans New Century was obligated to repurchase.

Senior New Century executives knew as far back as 2004 that the subprime-mortgage boom was doomed to go bust, Mr. Missal said. But he said its accounting practices allowed those dangers to be disguised.

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