United States Court of Appeals

FIFTH CIRCUIT
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July 16, 2019

No. 17-20364 Patrick Collins, et al v. Steven Mnuchin,
Secretary, et al
USDC No. 4:16-CV-3113

Joseph H. Marren
5 Crawford Road
Harrison, New York 10528
914-967-6420
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Dear Mr. Marren

We received your Letter to the court and news article. In light of not being a party in this case, we are taking no action on these documents.

Sincerely,

LYLE W. CAYCE, Clerk

By: ___________________________
Casey A. Sullivan, Deputy Clerk
504-310-7642

cc:
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July 12, 2019

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Judge James C. Ho
Judge Stuart Kyle Duncan
Judge Kurt D. Engelhardt
Judge Andrew S. Oldham

U.S. Court of Appeals for the Fifth Circuit
600 S. Maestri Place
Suite 115
New Orleans, LA 70130

Dear Chief Judge Stewart and Judges of the Fifth Circuit:

RE: Have the Treasury Department and FHFA Perpetrated a Fraud on the Court in Collins v. Mnuchin?

This letter and accompanying memorandum *"Have the Treasury Department and FHFA Perpetrated a Fraud on the Court in Collins v. Mnuchin?"* are provided to place the Court on notice that Treasury Department and the Federal Housing Finance Agency ("FHFA" and together with Treasury the "Agencies") appear to have misled the Court in their pleadings about the circumstances surrounding Fannie Mae and Freddie Mac (the "GSEs") being placed into conservatorship in 2008. As a result, the Court may conclude that:

- the Agencies pleadings were in bad faith and that Federal Rule of Civil Procedure ("FRCP") 11 has been violated; and
- the Agencies have committed a fraud on the court under FRCP 60.

There appear to be significant misrepresentations and omissions when one compares the Agencies pleadings and certain material facts described by former Treasury Secretary Hank Paulson ("Paulson"), and Phillip Swagel ("Swagel'), recently appointed Director of the Congressional Budget Office ("CBO").

The material misrepresentations and omissions include:

- Paulson and Swagel have indicated that the GSEs were insolvent when they were put into conservatorship. Meanwhile, the Agencies pleadings indicate that the GSEs were solvent at that time. If the GSEs were insolvent this apparent misrepresentation

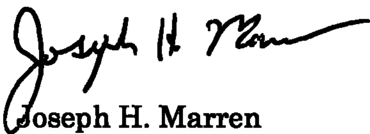
is material because the common and preferred shareholders should have been wiped out in any restructuring.[1]

- Paulson indicated that President Bush told him that he did not want to nationalize the GSEs. This material fact is omitted from the Agencies pleadings.
- Swagel indicated that Treasury elected to structure the Preferred Stock Purchase Agreements ("PSPAs") and opted for conservatorship instead of receivership because it did not want the GSEs consolidated on the government's balance sheet. If consolidated, it feared that the ratings agencies would downgrade the debt of the U.S. Government. This is the reason why common and preferred stockholders' interests were not eliminated. This material fact is omitted from the Agencies pleadings.

I am a member of the New York State Bar and I am obligated to report potential frauds on the court. I have been admitted to practice before the United States Supreme Court. I have particular expertise with respect to whether federal financial reporting complies with the United States Constitution as I have written numerous articles, testified before the Federal Accounting Standards Advisory Board and sponsored a conference at Fordham Law School.[2]

I recognize that the memorandum does not conform to the Fifth Circuit's prescribed standards. However, I beg the Court's indulgence given one of its purposes is to have the Court understand that, in my opinion, it is dealing with a meaningful piece of the largest financial fraud in history. My Barron's magazine article published January 4, 2014 *"No Accounting for Government Cost"* describes the extent of the problem. It is included in the memorandum as Appendix B. An updated analysis of the problem is included in Appendix A.

Sincerely,



Joseph H. Marren
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Cell 914-525-3216

cc: Nancy F. Atlas, Senior United States District Judge

[1] The staff of the Federal Reserve Bank of New York makes that point explicitly in *"The Rescue of Fannie Mae and Freddie Mac,"* Staff Report No. 719.

[2] Joseph H. Marren is the President, Chief Executive Officer and Chief Compliance Officer of KStone Partners LLC, an SEC registered investment adviser founded in 2008 that is based in Valhalla, New York. He spent the twenty-three years prior to starting KStone in investment banking primarily as head of the business development function in the M&A departments at several leading firms including Citigroup, Credit-Suisse, DLJ and Sagent Advisors. Mr. Marren is the author of two finance books, taught a finance course for several years as an Adjunct Professor at NYU Stern School of Business and, in recent years, has been a guest lecturer on finance and accounting topics at Fordham Law, Columbia Law and Columbia Business School. Mr. Marren received a BBA from the College of William & Mary, a JD from Fordham University School of Law and an MBA from NYU Stern School of Business. Early in his career he was a certified public accountant ("CPA") at Price Waterhouse & Co. His current status as a CPA is "inactive."

Have the Treasury Department and FHFA Perpetrated a Fraud on the Court in Collins v. Mnuchin? [1]

Joseph H. Marren

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[1] The basic framework for the analysis contained in this memorandum was created for a first-of-its-kind conference "***Representation Without Accountability?***" (hereafter the "Conference") hosted by the Fordham Corporate Law Center on January 23, 2012. It addressed the federal government's actual expenditures, its current financial reporting and questions surrounding the Statement and Account Clause including whether financial reporting by the federal government comports with Constitutional requirements. The speakers included the Hon. David Walker, former Comptroller General, David Mosso, former Chairman of the Federal Accounting Standards Advisory Board ("FASAB"), Professor Brian Fitzpatrick, a constitutional law professor at Vanderbilt Law School and Joseph Marren, President and CEO of KStone Partners LLC. Professor Sean Griffith, the T.J. Maloney Chair in Business Law and Director, Fordham Corporate Law Center delivered opening remarks and acted as moderator. The brochure may be found at http://bit.ly/2zMMavI, the video at https://vimeo.com/35574753, and the transcript at http://bit.ly/2zKLLtD. The Conference was sponsored by Joseph and Joan Marren and KStone Partners LLC The views expressed in this memorandum do not represent the views of KStone Partners LLC ("KStone") or any of its other Members.

I. Executive Summary

This letter and accompanying memorandum *"Have the Treasury Department and FHFA Perpetrated a Fraud on the Court in Collins v. Mnuchin?"* represent notice to the District Court and the Court of Appeals for the Fifth Circuit (collectively, the "Court") that the Treasury Department ("Treasury") and the Federal Housing Finance Agency ("FHFA" and together with Treasury, the "Agencies") appear to have misled the Court in their pleadings about the circumstances surrounding Fannie Mae ("Fannie") and Freddie Mac (Freddie, and together with Fannie, the "GSEs") being placed into conservatorship in 2008. As a result, the Court may conclude that:

1) the Agencies pleadings were in bad faith and that Federal Rule of Civil Procedure ("FRCP") 11 has been violated; and

2) the Agencies have committed a fraud on the court under FRCP 60.

There appear to be material misrepresentations and omissions when one compares the pleadings of the Treasury and FHFA in *Collins v. Mnuchin* and certain material facts described by former Treasury Secretary Hank Paulson ("Paulson"), and Phillip Swagel ("Swagel"),[2] who was recently appointed Director of the Congressional Budget Office ("CBO"). Both worked at the Treasury Department in 2008. Other articles referenced in this memorandum were written by the staff of the Federal Reserve Bank of New York, the CBO, analysts of the Senate Budget Committee, and various academics.

This Court has been focused on defendants-appellees' motions to dismiss for lack of jurisdiction and failure to state a claim. In ruling on these motions, the Court must take the well-pleaded facts as true. However, given that there is publicly available evidence from reputable insiders that appears to directly contradict the Agencies pleadings the Court should consider stepping back from this analysis and either return the litigation to the District Court to determine whether the Agencies' pleadings are in bad faith or consider determining, *sua sponte*, that the pleadings are in bad faith.

[2] Phillip Swagel became the 10th Director of the Congressional Budget Office on June 3, 2019. Previously, he was a professor at the University of Maryland's School of Public Policy and a visiting scholar at the American Enterprise Institute and the Milken Institute. He has also taught at Northwestern University, the University of Chicago's Booth School of Business, and Georgetown University. His research has involved financial market reform, international trade policy, and China's role in the global economy. From 2006 to 2009, Dr. Swagel was Assistant Secretary for Economic Policy at the Treasury Department, where he was responsible for analysis of a wide range of economic issues, including policies relating to the financial crisis and the Troubled Asset Relief Program. He has also served as chief of staff and senior economist at the Council of Economic Advisers in the White House and as an economist at the Federal Reserve Board and the International Monetary Fund. He earned his Ph.D. in economics from Harvard University and his A.B. in economics from Princeton University.

Treasury and FHFA appear to have misled the Court in the case at hand. Their pleadings appear not to adhere to the FRCP requirement of good faith.[3] The material misrepresentations and omissions include:

- Paulson and Swagel have indicated that the GSEs were insolvent when they were put into conservatorship. They do not describe the GSEs as failing to meet any definition of adequate capitalization made-up by Congress. They describe both GSEs in August 2008 as having the market value of their liabilities exceed the market value of their assets.

  Immediately after the Housing and Economic Recovery Act of 2008 ("HERA") was passed on July 24, 2008 Paulson directed Treasury to hire financial advisors to assist in evaluating whether the GSEs were solvent. It hired Morgan Stanley. After examining the GSEs financial records in August 2008 the Federal Reserve, Office of Comptroller of the Currency ("OCC"), as well as Treasury's financial advisor Morgan Stanley, and Blackrock, a financial advisor with a long-term relationship with Freddie concluded, that both Fannie and Freddie had, in Paulson's words *"true, economic capital holes amounting to tens of billions of dollars."* The Treasury Secretary indicates in his book *"On the Brink"*[4] that, due to their insolvency, he wanted to put both GSEs into receivership in August 2008.

  Swagel describes in his article *"The Financial Crisis: An Inside View"*[5] that *"The Morgan Stanley team came back several weeks later in August with a bleak analysis: both Fannie and Freddie looked to be deeply insolvent with Freddie the worse of the two.....the Treasury worked with the GSEs' regulator...to set out an air-tight case of insolvency..."* .

  Meanwhile, the Agencies pleadings indicate that the GSEs were solvent at that time. Various courts have adopted Treasury's fact pattern that the GSEs were solvent.[6] This apparent misrepresentation that the GSEs were solvent is

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[3] See FED. R. Civ. P. 11(a) ("Every pleading...must be signed by at least one attorney of record."). Rule 11(b)(3) states that the required signature is a certification that, among other things, "the factual contentions have evidentiary support").

[4] See chapters 1, 6 and 7.

[5] See Swagel, Philip, The Financial Crisis: An Inside View, Brookings Papers on Economic Activity, (Spring 2009), available at http://www.brookings.edu/economics/bpea/-/media/Fies/Programs/ES/BPEA/2009-spring _bpea-papers/2009_springbpea-swagel.pdf.

[6] Treas. Br. 1. *"By September 2008, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) found themselves on the brink of insolvency."* See also The Memorandum of Defendants Federal Housing Finance Agency as Conservator for Fannie Mae and Freddie Mac and FHFA Director Melvin L. Watt in Support of Motion to Dismiss, Footnote 2, 5. *"The Complaint includes allegations that appear to question the placement of the GSEs into conservatorship.* See, e.g., Compl para 58 (*alleging that the GSEs "were not in financial distress" in September 2008 and that their directors consented to conservatorship only because they*

material because, if the GSEs were insolvent, their existing common and preferred shareholders should have been wiped out in any restructuring. The Federal Reserve Bank of New York Staff Report No. 719 *"The Rescue of Fannie Mae and Freddie Mac"* ("FRBNY Staff Report") explicitly stated that in the authors opinion an optimal intervention would have involved *"The value of the common and preferred equity in the two firms would have been extinguished, reflecting their insolvent financial position."*

It is important to note that neither the plaintiffs in this litigation nor similarly situated plaintiffs in any of the cases filed in any jurisdiction have or had any motivation to unearth facts that would support the notion that the GSEs were insolvent on a mark-to-market basis[7] and that the existing common and preferred shareholders of Fannie and Freddie should have been wiped out when the government put them into conservatorship in September 2008.[8] All plaintiffs focused on arranging facts and legal arguments designed to maximize any potential recovery. Pleading the facts described above would likely limit their recovery to the purchase price paid for applicable GSE securities.

- Paulson indicated that President Bush told him that he did not want to nationalize the GSEs. The FRBNY Staff Report also referenced the notion that *"[A]s Paulson (2010) describes in his book, the Bush administration was opposed to nationalization or anything that looked like open-ended government involvement."* This material fact is omitted from the Agencies pleadings.

- A key omission from the Agencies pleadings is that Congress reorganized Fannie Mae as a private company in 1968 in order to remove it from the federal budget. For example, the Senate Budget Committee's *"Budget Perspectives for Fannie and Freddie"* published on July 14, 2016 indicates that *"The 1967 Presidential Concepts Commission established criteria for determining whether a GSE should be included in the federal budget...The commission*

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wanted to avoid "intense scrutiny from federal agencies.") These allegations are not only inconsistent with the factual record and reflect speculation, but are irrelevant because Plaintiffs seek no relief with respect to the placement of the GSEs into conservatorship....."

[7] "Insolvent on a mark-to-market basis" means that the market value of a firm's liabilities exceeds the market value of its assets. See: Congressional Budget Office, Effects of Repealing Fannie Mae and Freddie Mac's SEC Exemptions.

[8] See also Plaintiffs-Appellants Br. 4. "The Companies took a relatively conservative approach to investing in risky mortgages issued during the national run-up in home prices from 2004-2007. ROA.9, 26-27. As a result, they remained in a comparatively strong financial condition in 2008 that made it possible for them to rescue America's home mortgage system by providing mortgage funding even as distressed banks exited the marketplace. *See* ROA.9-10." See also Reply Brief of Plaintiffs-Appellants, 7-8. "2. For the first time on appeal, Treasury argues that vacating the Net Worth Sweep while leaving the original PSPAs in place would improperly allow Plaintiffs to "benefit from agency action they now insist is unlawful. Treas. Br. 52-53. But Plaintiffs did not benefit from the original PSPAs. To the contrary, the Complaint alleges that the Companies never needed Treasury's financial support and only drew on its funding commitment due to erroneous accounting decisions imposed on FHFA's leadership. ROA.26-28, 41-44."

recommended that entirely privately owned GSEs should be omitted from the budget. Despite their government originations, both Fannie and Freddie had become entirely privately owned. Consequently, the two GSEs met the standard for exclusion from the budget, which remained the case in the budget until the housing-finance crisis of the latter-2000s."

This omission is critically important because of another important related omission by the Agencies. Congress and the Agencies knew, or must be deemed to have known, that as a result of an agreement made on October 5, 1953 ("1953 Agreement") among the Secretary of the Treasury, the Director of the Bureau of the Budget ("BOB" which is now the Office of Management and Budget ("OMB"), and the Comptroller General who was head of the Governmental Accountability Office ("GAO"), the Combined Statement of Receipts, Outlays and Balances ("Combined Statement") would, subsequent to the sale of one hundred percent of Fannie Mae's common stock to the public in 1968, not include the operations of Fannie. The Combined Statement is the "official" Statement and Account required to be published by Congress under Article I, Section 9, clause 7.

The 1953 Agreement and subsequent regulations issued by certain parties to the agreement, coupled with legislation passed in 1950, are described in several of the Combined Statements published during the 1950s. It is noteworthy that Section 115 of the Budget and Accounting Procedures Act of 1950 permitted, for the first time, the netting of receipts against expenditures in the Combined Statement. It is not apparent to this author that this law complies with Article I, Section 9, clause 7 of the U.S. Constitution.

After the excerpts from several Combined Statements published in the 1950s will be excerpts from the Combined Statement for 1968. [9]

1) The Foreword for the 1954 Combined Statement contained the following:

"Legislative Requirement for the Report

...The exercise and performance of this duty was broadened by Section 114 of the Budget and Accounting Procedures Act of 1950 (64 Stat. 832),.... In accordance with this provision of law and under the objectives of the Joint Accounting Improvement Program a proposal for improved reporting was approved on October 5, 1953 by the Secretary of the Treasury, Director of the

[9] See the commentary (including the cover letter, Foreword, Requirement of Law, Basis of Figures, Explanation of Terms, Nonbudget Accounts, Major Changes in Reporting Concepts, Introduction, The Explanation of Transactions) at the beginning of the Combined Statements for the following years: 1872, 1927, 1928, 1954, 1955, 1959, 1960, 1968, 1976, 2001 and 2018. Particular attention should be paid to the years 1954, 1955, 1959, 1960 and 1968. These reports are available on the Treasury Departments' website at https://fiscal.treasury.gov/reports-statements/combined-statement/.

Bureau of the Budget, and the Comptroller General of the United States. Treasury Department Circular No. 940, dated February 17, 1954, provided for reporting of cash transactions and the instructions issued thereunder set the pattern of uniform reports which serve as the basis for the Monthly Statement of Receipts and Expenditures of the United States Government as well as this report.

BASES OF FIGURES
Receipts - Section 305 of the Revised Statutes (31 U.S.C. 147) provides that receipts for all moneys received by the Treasurer of the United States shall be endorsed upon warrants signed by the Secretary of the Treasury, without which warrants, so signed, no acknowledgment of money received into the Public Treasury shall be valid. Pursuant to Section 115 of the Budget and Accounting Procedures Act of 1950, the procedure was modified to permit certain receipts to be deposited direct to disbursing officers' checking accounts without the issuance of covering warrants....

Expenditures (net) - Check-issued basis. - .....Where appropriations are credited with reimbursements or refunds of moneys previously expended, as authorized by law, the expenditures reflected in this report are reduced by such amounts."

2) The Foreword to the 1955 Combined Statement contains the following:

"REQUIREMENTS OF LAW
This report has been compiled in accordance with the following requirements of law:

Section 15 of the Act of July 31, 1894 (5 U. S. C. 264) which provides, "It shall be the duty of the Secretary of the Treasury annually to lay before Congress, on the first day of the regular session thereof, an accurate combined statement of the receipts and expenditures during the last preceding fiscal year of all public moneys...., designating the amount of the receipts, whenever practicable, by ports, districts, and States, and the expenditures by each separate head of appropriation," and

The Department also publishes under authority of Section 114 of the Act of September 12, 1950, monthly statements of receipts and expenditures of the United States Government which currently reflect the budget surplus or deficit. There is prepared after the close of the fiscal year a final statement of Receipts and Expenditures which includes receipt and expenditure data for the fiscal year which is in agreement with corresponding data for the fiscal year included in this report and in the Budget of the United States Government.

BASES OF FIGURES
....Section 115 of Public Law 784, 81st Congress, approved September 12, 1950, modified Section 305 of the Revised Statutes by authorizing the Secretary of the Treasury and the Comptroller General of the United States, under certain conditions, to issue joint regulations waiving the requirements for the issuance and countersignature of warrants for the receipt and disbursement of public money. Pursuant to this authority, joint regulations were issued during the fiscal year 1951 under which all collections representing repayments to appropriations are covered into the Treasury and credited directly to the accounts of disbursing officers without issuing covering warrants...."

3) The Foreword for the 1959 Combined Statement contains the following:

"EXPLANATION OF TERMS AND BASES OF FIGURES
....Section 115 of Public Law 784, 81st Congress, approved September 12, 1950, modified Section 305 of the Revised Statutes by authorizing the Secretary of the Treasury and the Comptroller General of the United States, under certain conditions, to issue joint regulations, waiving the requirements for the issuance and countersignature of warrants for the receipt and disbursement of public money. Pursuant to this authority, joint regulation No. I, effective November 1, 1950, was issued and provided for all collections representing repayments to appropriations to be covered into the Treasury and credited directly to the accounts of disbursing officers without issuing covering warrants; also joint regulation No.3, effective July I, 1951, was issued and provided that certain special fund and trust fund receipts be credited directly to the accounts and made immediately available to the collecting agency."

4) The Foreword for the 1968 Combined Statement contains the following:

"MAJOR CHANGES IN REPORTING CONCEPTS
This combined statement of receipts and expenditures incorporates for the first time the changes in the President's Budget for 1969, in consonance with those recommendations of the President's Commission on Budget Concepts which were adopted and implemented during fiscal year 1968.

....Certain accounts formerly in the trust and deposit fund category remain outside the budget, coordinate with the Commission's recommendations. These are primarily the Federal Land Banks and Federal Home Loan Banks, which are entirely under private ownership."

In summary, the above passages from several Combined Statements describe the hijacking of the Combined Statement from a statement depicting the receipts and expenditures of all public money to another document supporting the President's Budget. The rationale for keeping the GSEs off-budget is omitted from the Agencies pleadings. This is

understandable given that the Agencies were trying to perpetuate a fact pattern that they believed allowed them to continue the accounting practices that they began following the *"Report of the President's Commission on Budget Concepts"* issued in October 1967 recommending off-budget treatment for Fannie Mae if one hundred percent of its common stock was sold to the public, subsequent legislation by Congress in 1968 that directed the sale of Fannie's common stock and the actual sale of this common stock.

The only roadblock to the preferred off-budget accounting treatment in the conservatorship was that the Treasury bought warrants for 79.9% of the common stock of each GSE. Therefore, Treasury proclaimed that there was an accounting rule that indicated that the government did not have to consolidate the GSEs on its balance sheet if it owned less than 80% of the common stock. The Agencies omitted the fact that Treasury made up the accounting rule.

- Swagel indicated that Treasury elected to structure the Preferred Stock Purchase Agreements ("PSPAs") and opted for conservatorship instead of receivership because it did not want the GSEs consolidated on the government's balance sheet. This material fact is omitted from the Agencies pleadings.

The PSPAs were specifically structured to keep in place a meaningful equity stake by existing shareholders in order to maintain the ruse concocted by the President's Commission on Budget Concepts and enacted by Congress in 1968 to sell 100% of the common equity of Fannie Mae to justify Fannie Mae being put off-budget, were facts that were in the Agencies possession.

Treasury did not want the GSEs consolidated for an entirely practical reason. If the GSEs were consolidated the ratings agencies might downgrade the debt of the United States Government. In the middle of a financial crisis this was an outcome that Treasury wanted to avoid at all costs. *"[E]ven putting the GSEs into conservatorship raised questions about whether their $5 trillion in liabilities would be added to the public balance sheet.....But the prospect that ratings agencies might respond by downgrading U.S. sovereign debt was unappealing."* This is the reason why common and preferred stockholders' interests were not eliminated. *"The U.S. Government ended up as a 79.9 percent owner of the GSEs, receiving preferred stock on terms that essentially crushed the existing shareholders. (The precise level of ownership was chosen in light of accounting rules that would have brought GSE assets and liabilities onto the government balance sheet at 80 percent ownership."* If Treasury had elected to go the receivership route it would have nationalized the GSEs and owned both of them one hundred percent. Under this scenario it would be

unlikely that the ratings agencies would not factor the GSEs consolidated results into their projections for the U.S. Government.

- Another omission from the Agencies pleadings is that they did not appropriately describe how Congress had passed extensive legislation to control the GSEs including creating substantial ambiguity in the marketplace regarding whether the federal government had agreed to guarantee the GSEs obligations. Congress put a very small fig leaf in front of the GSEs in the form of a very thin layer of public equity to achieve its goal of obtaining off-budget accounting treatment. Yet, the American public remained on the hook for the GSEs enormous debt obligations. Article I, Section 8, clause 2 grants Congress the power to borrow money on the credit of the United States. Does the Constitution permit Congress to borrow money on the credit of a publicly-owned entity? The marketplace correctly believed that the federal government would never let the GSEs fail. The failure to adequately describe the off-balance sheet guarantees of the GSEs that Congress created in light of the federal government's accounting for the GSEs is an important omission.

- Another omission relates to whether the GSEs were spending public money that should have been reported in the Combined Statement either before or after being placed into conservatorship is an important issue relative to the correct accounting for the GSEs.

- Even if the Agencies attorneys believed their pleadings to be true any reasonable person completing the simplest of inquiries (a "Google" search) into the facts of the case would have found most, if not all, of the "smoking gun" book and articles that appear to contradict the Agencies pleadings.

Finally, the lawyers that drafted the PSPAs wrote them suggesting that the GSEs were insolvent. Both of the initial "AMENDED AND RESTATED SENIOR PREFERRED STOCK PURCHASE AGREEMENTs" between the United States Department of the Treasury and Fannie Mae and Freddie Mac contained the following excerpted language in the Background section: *"Conservator has determined that entry into this Agreement is (i) necessary to put Seller in a sound and solvent condition;"* This language is not in dispute. However, it raises a question for the Court. Why would Treasury's attorneys draft agreements with this language unless the two GSEs were not solvent? Treasury does not need to make an entity solvent if it is solvent as of the date of the agreement.

Assuming that the Court has found the arguments above persuasive, this author believes that it needs to come to grips, from a legal perspective, that it is dealing with an unconstitutional accounting fraud that is much larger than the case at hand. See

Appendix A – Overview of the Size of the Problem of Unconstitutional Financial reporting by the Legislative and Executive Branches and Appendix B which contains a copy of my Barron's magazine article *"No Accounting for Government Cost!"*

II. Material Misrepresentations and Omissions

A. The GSEs Were Not Solvent

What was the truth about the GSEs financial condition at the time that they were placed into conservatorship on September 6, 2008? The Court needs to review a book *"On the Brink"*[10] written by Treasury Secretary Paulson and two relevant articles including the one written by Phillip Swagel. The other article is *"The Rescue of Fannie Mae and Freddie Mac,"* a Staff Report written by four individuals at the Federal Reserve Bank of New York and published in March 2015.

The following are excerpts from Treasury Secretary Paulson's book.

> *"With HERA in place, we launched an immediate analysis of the true financial condition of Fannie and Freddie. The Fed and the Office of Comptroller of the Currency sent in examiners, and Treasury set out to hire an adviser to conduct a full review of the GSEs' financial positions and capital strength, and to develop alternatives for addressing the situation...We selected Morgan Stanley, whose CEO, John Mack, offered to provide a team for free....He also offered us an extraordinary team that included two of his top people, Vice Chairman Bob Scully and financial institutions chief Ruth Porat....."*

> *"HERA failed to boost the market's faith in Fannie and Freddie. Their abysmal second-quarter earnings announcements made matters worse. On August 6, Freddie reported that it had lost $821 million in the period; two days later, Fannie followed with a $2.3 billion loss, forecasting "significant" credit-related expenses in 2009."*

> *"From the moment the GSEs' problems hit the news, Treasury had been getting nervous calls from officials of foreign countries that were invested heavily with Fannie and Freddie."*

> *"On August 11, Standard & Poor's had cut its preferred stock ratings for Freddie and Fannie, and the weekend I returned from China a piece titled "The Endgame Nears for Fannie and Freddie" appeared in Barron's. The lengthy article laid out the poor prospects for the two GSEs and predicted a government takeover that would wipe out holders of common shares...."*

[10] See chapters 1, 6 and 7.

"The story was pretty accurate. While I was away, Fannie's and Freddie's books had been analyzed by the Fed; the OCC; our adviser, Morgan Stanley; and BlackRock, the New York money manager that had a long-term relationship with Freddie. They agreed that the organizations were sorely undercapitalized. And the quality of the capital was suspect: some of it consisted of intangible items, such as deferred taxes, that would not have been counted to the same degree as capital by financial institutions overseen by the banking regulators. What's more, the GSEs had not adequately written down the value of guarantees provided by private mortgage insurers that had been downgraded by the rating agencies. Each of the companies looked to have true, economic capital holes amounting to tens of billions of dollars...."

"We'd been prepared for bad news, but the extent of the problems was startling."

"I concluded that the only solution was to get FHFA to put the GSEs into receivership."

"Two days later, on August 21, I had lunch in my private dining room with Jim Lockhart, who headed the new FHFA, created by HERA to oversee Fannie and Freddie.....I pressed him on the need for receivership, but he repeatedly told me that this would be difficult to do quickly because FHFA's most recent semiannual regulatory exams had not cited capital shortfalls....."

"With that, we needed outside advice to guide us through the intricacies of the law and the corporate governance issues involved. Anticipating this, Ken Wilson had already contacted Wachtell, Lipton, Rosen & Katz, a New York law firm, and Bob Hoyt [Treasury's General Counsel] signed them up on Friday, August 22......"

"By the next morning they had torn through the GSE's debt and preferred stock documents and concluded that going the receivership route would be perilous for a number of practical and technical reasons. That approach would be terribly disruptive to the GSEs' businesses and extremely difficult to implement successfully in a short time frame, especially without the active involvement and cooperation of the GSEs' management in the planning stages. It would have posed risks of court challenges and the early termination of the GSEs' valuable derivatives contracts. Receivership, which is used to liquidate companies, might trigger consequences every bit as bad as those we were trying to avoid, Wachtell said. By contrast, conservatorship was more like a Chapter 11 bankruptcy, where companies kept their current forms; it would provide a stable time-out for the GSEs to avoid defaulting on their debts and could be accomplished quickly....."

"Then on Monday, August 25, I received a disturbing report about FHFA. It turned out that the previous Friday, when Lockhart had told me he was on board for conservatorship, his people had sent the GSEs draft letters reviewing their second-quarter financial statements and concluding that the companies were at least adequately capitalized and in fact exceeded their regulatory capital requirements."

"The drafts had included a special reminder that the FHFA had discretionary authority to downgrade that assessment. Even so, for FHFA to reverse and say now Fannie and Freddie had capital holes big enough to justify conservatorship gave the agency pause. Jim had quite a challenge on his hands: his agency had been renamed with the HERA legislation, but it still had the same people and same approach as it had had a month earlier. Only FHFA had the legal power to put the GSEs under, and I was worried about its backsliding."

"We reviewed all of our alternatives in a thorough and systematic way. My staff wanted to be sure we had an airtight case for conservatorship, given the GSEs reputation as the toughest street fighters in town."

"It was crucial to win over FHFA's examiners because it would be next to impossible to put the GSEs into conservatorship without their support."

"Fed and OCC examiners scouring the portfolios had come up with estimates of embedded losses that were multiples of what the GSEs said they thought the losses were. The Fed and the OCC took FHFA through their models and assumptions, and finally persuaded Lockhart's people to change their minds...."

"On September 1, FHFA wrote the GSEs to suspend the August 22 letter that had said their capital was adequate and informed them that the agency was conducting a new review of the adequacy of their reserves...."

"It was Thursday morning, September 4, 2008, and we were in the Oval Office of the White House discussing the fate of Fannie Mae and Freddie Mac, the troubled housing finance giants. For the good of the country, I had proposed that we seize control of the companies, fire their bosses and prepare to provide up to $100 billion of capital support for each. If we did not act immediately, Fannie and Freddie would, I feared, take down the financial system, and the global economy, with them."

"I'm a straightforward person. I like to be direct with people. But I knew that we had to ambush Fannie and Freddie. We could give them no room to maneuver. We couldn't very well go to Daniel Mudd at Fannie Mae or Richard Syron at Freddie Mac and say: "Here's our idea for how to save you. Why don't we just take you over and throw you out of your jobs, and do it in a way that protects the taxpayer to the disadvantage of your shareholders?" The news

would leak, and they'd fight. They'd go to their many powerful friends on Capitol Hill or to the courts, and the resulting delays would cause panic in the markets. We'd trigger the very disaster we were trying to avoid......"

"The current model, where profits went to shareholders but losses had to be absorbed by the taxpayer, did not make sense...."

On Friday afternoon, September 5, we met with management of the companies; on Saturday, September 6, we met with their boards, which agreed to the takeover; and on Sunday, we announced that we had placed Fannie Mae and Freddie Mac into conservatorship. Asian markets rallied on the news."...

"...Common shareholders had lost nearly everything, but the government had protected debt holders and buttressed each entity with $100 billion in capital and generous credit lines...."

The following are excerpts from Mr. Swagel's article.

"GSE reform was finally enacted as part of the summer 2008 housing bill, by which time it was too late to avert insolvency at the two firms."

"Their regulator had said as recently as July that the two firms were adequately capitalized. (This statement referred to statutory definitions of capital, which included tax assets that could only be monetized in the future when the firms became profitable again, but it nonetheless carried weight.)"

"[On] Monday, July 28, [Secretary Paulson] instructed Treasury staff to analyze the capital situations of the GSEs. To protect taxpayers in the case that an actual investment was needed in the future, he wanted to know first if these firms were solvent. The Treasury's Office of Domestic Finance engaged a top-notch team from Morgan Stanley to dig into Fannie and Freddie's books and assess their financial condition."

"The Morgan Stanley team came back several weeks later in August with a bleak analysis: both Fannie and Freddie looked to be deeply insolvent with Freddie the worse of the two. In light of the firms' well-publicized accounting irregularities of previous years, Treasury staff were especially amazed that the GSEs appeared to have made accounting decisions that obscured their problems. With receivership still an undesirable outcome because it would imply prematurely winding down the retained portfolio, the Treasury worked with the GSEs' regulator (formerly OFHEO, the July legislation having merged it with the Federal Housing Finance Board to create the Federal Housing Finance Agency, or FHFA) to set out an air-tight case of insolvency that warranted putting the firms into conservatorship. The July legislation allowed FHFA to do this without consulting Congress."

> *"Even though the analysis from Morgan Stanley was clear, it took some time to bring the FHFA examiners on board – it seemed difficult for them to acknowledge that the firms that they had long overseen had gone so wrong, and it would have been awkward for the head of FHFA to decide on the conservatorship over the objection of his senior career staff. It was also necessary to convince the management of Fannie and Freddie to acquiesce without a legal fight."*

The Federal Reserve Bank of New York Staff Report no. 719 *"The Rescue of Fannie Mae and Freddie Mac,"* describes and evaluates *"the measures taken by the U.S. government to rescue Fannie Mae and Freddie Mac in September 2008."* It reviews *"the sources of financial distress that the firms experienced and the events that ultimately led the government to take action in an effort to stabilize housing and financial markets."* The report then describes *"the various resolution options available to policymakers at the time and evaluates the success of the choice of conservatorship, and other actions taken, in terms of five objectives that [the authors] argue an optimal intervention would have fulfilled."*

The following are selected excerpts from the Staff Report.

> *"Against this backdrop, and in an effort to calm markets, Treasury Secretary Henry Paulson proposed a plan in July 2008 to allow the Treasury to make unlimited debt and/or equity investments in Fannie Mae and Freddie Mac. (It was in a Senate Banking Committee hearing at this time when Paulson famously stated that "If you've got a bazooka [in your pocket] and people know you've got it, you may not have to take it out" (Paulson 2010).) This plan was incorporated as part of the Housing and Economic Recovery Act, which was signed into law later that month. The law also created the Federal Housing Finance Agency, and for the first time granted the new supervisor the authority to place a distressed government-sponsored enterprise into receivership. Immediately following the passage of the new housing legislation, the Treasury began a comprehensive financial review of Fannie Mae and Freddie Mac in conjunction with the FHFA, the Federal Reserve and Morgan Stanley (Paulson 2010). (HERA required that FHFA consult with the Treasury and Federal Reserve on any resolution of Fannie Mae or Freddie Mac.)"*

> *"Fannie Mae and Freddie Mac released their second quarter earnings in early August 2008...... [A]t this time the two firms were both technically solvent, in the sense that the book value of their equity capital was positive, and indeed exceeded statutory minimum requirements. However, there was a compelling case that, when viewed on an economic basis, both firms were actually insolvent. First, both firms were recognizing large "deferred tax assets" to offset future income taxes ($20.6 billion for Fannie Mae and $18.4 billion for Freddie Mac). Arguably these assets had little immediate value in light of the firms' extremely weak near-term earnings prospects. Excluding these assets, as would have been*

done for regulatory capital purposes if the two firms had been treated like banks, reduces their measured net worth to $20.6 billion (Fannie Mae) and -$5.5 billion (Freddie Mac). Second, the reported fair market value of their assets (net of liabilities) was significantly lower than book equity, and in Freddie Mac's case was actually negative. Even these fair values may have understated the firms' financial problems, since there is evidence that their accounting reserves against expected future credit losses were also insufficient (U.S. Financial Crisis Inquiry Commission, 2011, p. 317). These facts, together with continued deteriorating mortgage market conditions and potential near-term difficulties in rolling over the firms' significant short-term debt....., created a keen sense of urgency for the U.S. government to take action."

"Resolution: Issues, Options and Actions
Summing up, Fannie Mae and Freddie Mac were too large and interconnected to be allowed to fail, especially in September 2008 given the deteriorating conditions in U.S. housing and financial markets and the central role of these two firms in the mortgage finance infrastructure. Our view is that an optimal intervention would have involved the following elements:

(i) *Fannie Mae and Freddie Mac would be enabled to continue their core securitization and guarantee functions as going concerns, thereby maintaining conforming mortgage credit supply.*
(ii) *The two firms would continue to honor their agency debt and mortgage-backed securities obligations, given the amount and widely held nature of these securities, especially in leveraged financial institutions, and the potential for financial instability in case of default on these obligations.*
(iii) *The value of the common and preferred equity in the two firms would be extinguished, reflecting their insolvent financial position.*
(iv) *The two firms would be managed in a way that would provide flexibility to take into account macroeconomic objectives, rather than just maximizing the private value of their assets.*
(v) *The structure of the rescue would prompt long-term reform and set in motion the transition to a better system within a reasonable period of time."*

"What Action Was Taken?
"The senior preferred stock purchase agreements also required both Fannie Mae and Freddie Mac to provide the Treasury with:
1) $1 billion of senior preferred shares;
2) warrants that would allow the purchase of common stock representing 79.9 percent of each institution on a fully diluted basis;[11] *and*

[11] The 79.9 percent ownership stake was selected to avoid the necessity to consolidate the assets and liabilities of Fannie Mae and Freddie Mac onto the government's balance sheet. See Swagel (2009, p. 37).

3) a quarterly commitment fee to be determined by the Treasury and the Federal Housing Finance Agency (as conservator) in consultation with the Federal Reserve. (Citation omitted)"

"Why Conservatorship? What Were the Alternatives?
[A]s Paulson (2010) describes in his book, the Bush administration was opposed to nationalization or anything that looked like open-ended government involvement. Relative to conservatorship, nationalization would have given the administration more direct control over Fannie Mae and Freddie Mac, but would have required the firms to be put on the government's balance sheet. The 2012 "full income sweep" amendment discussed above effectively narrows the difference between conservatorship and nationalization, by transferring essentially all profits and losses from the firms to the Treasury."

B. Why Did Congress Re-structure the GSEs as Publicly Traded Companies?

In 1968, Congress made Fannie Mae a publicly traded, stockholder-owned corporation.[12] In 1989, Congress made Freddie Mac a publicly traded, stockholder-owned corporation.[13]

There are two critically important pieces of background information that has been omitted from the pleadings. First, Congress reorganized Fannie Mae as a private company in 1968 in order to remove it from the federal budget. Second, Fannie Mae and Freddie Mac were unique among privately-owned publicly-traded corporations. They were incredibly different than any other privately owned publicly traded company in the United States including having their own regulator. The GSEs equity was only a fraction of what other real publicly-owned financial services companies were required to have by their regulator. In addition, the GSEs had numerous legislative controls to ensure that Congress maintained maximum control over these enterprises within the limitation of having them operate as privately-owned publicly-traded companies with a very thin layer of equity. Most importantly, Congress put in place legislation that made it ambiguous to the world as to whether the GSE's borrowings were backed by the full faith and credit of the United States Government. This is a critical fact when you realize that it cuts against Congress' intent to have Fannie be accounted for off-budget. The implied guarantee was incredibly valuable and represented a significant expenditure every year of "public monies." Hence, the GSEs should have remained consolidated in the federal government's balance sheet in the "official" Statement and Account.

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[12] See Housing and Urban Development Act, Pub. L. No. 90-448, Sec 801, 82 Stat. 476, 536 (1968) (codified at 12 U.S.C. sec 1716b).
[13] See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, Sec 731, 103 Stat. 183, 429-436.

i. Congress Reorganized the GSEs to Get Them Off-Budget

The CBO study "Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises Long-Term Structures" was published on October 8, 2009 stated the following:

> *"In 1968 the Housing and Urban Development Act (the "1968 Act") reorganized Fannie Mae as a for-profit, shareholder-owned company with government sponsorship....According to some financial analysts, Congress largely reorganized Fannie Mae as a private company for budgetary purposes (that is, to remove its financial obligations from the federal budget). The 1968 act also gave the HUD Secretary general regulatory authority over Fannie Mae."*

The Senate Budget Committee released on July 14, 2016, its Budget Bulletin focused on "Budget Perspectives for Fannie and Freddie." It contains the following excerpt:

> *"The 1967 Presidential Concepts Commission established criteria for determining whether a GSE should be included in the federal budget, including assessing who owns the entity, supplies its capital, and selects its managers. The commission recommended that entirely privately owned GSEs should be omitted from the budget. Despite their government originations, both Fannie and Freddie had become entirely privately owned. Consequently, the two GSEs met the standard for exclusion from the budget, which remained the case in the budget until the housing-finance crisis of the latter-2000s."*

ii. Yet Congress Maintained Maximum Control

Congress put a very small fig leaf in place in the form of public ownership to justify its putting Fannie Mae and Freddie Mac off the government's budget. However, this should not have resolved the constitutional issue of how Fannie should be accounted for on the government's books post the 1968 Act. A recommendation of the President's Commission on Budget Concepts in 1967 followed by legislation based on that recommendation does not override a explicit directive in the United States Constitution that Congress publish a Statement and Account of the receipts and expenditures of all public Money. Furthermore, the improper accounting of putting Fannie, and after 1989, Freddie, off budget and off balance-sheet cannot be clearer in light of the tremendous controls that Congress put in place to effectively run Fannie and Freddie and the ambiguity that it created in various legislation as to the federal government's guarantee of the GSEs obligations. The fact that the GSEs were two of the largest publicly traded financial institutions in the world merely highlights why politicians did not want them to be consolidated into any financial statement to which they could be held accountable.

There are three articles that explain the incredible and extensive legislation that Congress put in place to create ambiguity in the marketplace regarding whether the

federal government had agreed to guarantee the GSEs obligations. These articles include: 1) a Republican Policy Committee memorandum *"Problems at Fannie Mae and Freddie Mac: Too Big to Fail?"* written by Economic Analyst Jason Thomas dated September 3, 2003 that was published under the letterhead of its Chairman Jon Kyl; 2) an article *"The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab,"* written by David Reiss, an Associate Professor at Brooklyn Law School and published in BrooklynWorks in July 2008; and 3) a CBO study *"Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-Term Structures,"* published on October 8, 2009.

The Republican Policy Committee memorandum "Problems at Fannie Mae and Freddie Mac included the following excerpts:

> *"Introduction*
> *Both Freddie Mac and its larger Government Sponsored Enterprise (GSE) cousin, the Federal National Mortgage Association (Fannie Mae), are treated in the law as "instrumentalities" of the federal government with some features of publicly listed corporations and others that are more similar to wholly owned federal agencies. (Citation omitted) In exchange for certain public policy responsibilities related to housing, (Citation omitted) the federal government provides both firms' securities with several explicit advantages (Citation omitted) that have convinced the financial markets that the Treasury (i.e., taxpayers) stands behind them. This is often referred to as the GSE's "implicit guarantee."*
>
> *"According to James A. Bianco, president of Bianco Research, "If you start viewing Fannie and Freddie like stand-alone corporations, what you see is some of the most leveraged [high debt relative to equity] financial institutions in the world."[14] In fact, most financial analysts generically consider a high debt-to-equity ratio to be anything more than 100 percent. Yet, as of December 31, Fannie Mae's debt was equal to an astonishing 6,252 percent of its equity.[15]"*
>
> *"As economists W. Scott Frame and Larry D. Wall explain in the Federal Reserve Bank of Atlanta's Economic Review, "Providing an implicit guarantee is like agreeing to co-sign a loan. A parent who co-signs a loan for an adult child is conveying a valuable benefit to the child in that the loan is made on terms that would not be available absent the parent's co-signing." While the co-signing requires no immediate financial contribution, if the borrower is unable to meet its commitments, "the guarantee may turn out to be very expensive."[16] The amount that taxpayers have "co-signed" for Fannie and Freddie over the past*

[14] Bianco quoted in Patrick Barta, "Fannie Mae, Freddie Mac Debt Falls on Reports of Bank Selling," The Wall Street Journal, July 29, 2003.
[15] John Dorfman, "Why Fannie Mae and Freddie Mac Look Vulnerable," Bloomberg News, August 26, 2003.
[16] W. Scott Frame and Larry D. Wall, "Financing Housing Through Government-Sponsored Enterprises," Economic Review - Federal Reserve Bank of Atlanta, Vol. 87, No. 1, First Quarter 2002.

> *10 years has grown by over 600 percent without Congressional consent, and it continues to grow each day as both firms add to their investment holdings."*

David Reiss stated clearly what he wanted to accomplish with his article *"The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab":*

> *"Undertaking the most comprehensive statutory analysis to date, this Article evaluates the contradictory, but deeply held, understandings of the federal government's guarantee of Fannie and Freddie's obligations. This Article contends that investors in Fannie and Freddie securities would likely not have any legally enforceable claim of a guarantee against the federal government should Fannie and Freddie default. Despite the absence of such a legally enforceable claim, this Article demonstrates that, as a practical matter, Fannie and Freddie are so deeply enmeshed in the regulatory regimes of other American financial institutions that the federal government has effectively signaled that it would support Fannie and Freddie if they were unable to make payments on their obligations. The federal government would provide the support in order to avoid financial contagion that could quickly spread throughout the global financial markets. The federal government's guarantee of Fannie and Freddie's obligations is, thus, implied in the American financial system's regulatory environment."*
>
> *".....One might also look to the legislative history of the Fannie and Freddie enabling statutes to determine whether Congress intended to guarantee their obligations. There are some interesting aspects to the legislative history, including the fact that it was "budget pressures from the Vietnam war" that led Congress to transform Fannie Mae from a government corporation to an off-budget GSE.[17]"*

The CBO study "Fannie and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-Term Structures" which was published on October 8, 2009 stated the following:

> *"In enacting the Federal Housing Enterprises Safety and Soundness Act of 1992 (the 1992 act), Congress fundamentally revised regulation of the enterprises and took steps to clarify Fannie Mae's and Freddie Mac's roles within the housing finance system and better define their public housing mission responsibilities."*

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[17] Robert Van Order, A Microeconomic Analysis of Fannie Mae and Freddie Mac, 23 REGULATION 27, 28 (2000); see Froomkin, supra note 163, at 559 ("[Federal Government Corporations] classified as either mixed-ownership or private tend to be given "off budget" status. Once excluded from the national accounts, their borrowing is not counted as part of the official measure of the federal deficit. When Congress operates under spending caps or deficit reduction targets, pursuant to the Gramm-Rudman-Hollings budget reduction process for example, off-budget items are usually excluded from the official total 'spent' by the government. As a result, a few GSEs were created as little more than accounting devices designed to allow the federal government to borrow funds without appearing to increase the deficit." (citations omitted)). (See footnote 233 in article).

"By retaining the enterprises' off-budget status as GSEs, the 1992 Act permitted a continuation of the lack of transparency about the enterprises' risks and potential costs to taxpayers. Under the Federal Credit Reform Act of 1990, the potential costs associated with many direct federal loan and loan guarantee programs have to be disclosed in the federal budget.[18] Congress and the Executive Branch can use such disclosures to assess the potential costs and future risks of such programs and take steps on a timely basis to potentially mitigate such costs and risks (for example, tightening eligibility criteria)."

"Despite the implied federal guarantee of their obligations, the government's exposure in connection with the enterprises is not disclosed in the federal budget because GSE activities were excluded from the federal budget totals.[19] The 1992 Act did not change the status of the enterprises as off-budget entities."

iii. The $64,000 Question: Were the GSEs Spending Public Monies?

The Statement and Account is required to include the receipts and expenditures of all public monies. So, the only relevant question is: Were the GSEs spending public monies? This section is devoted to addressing that question. There are three important articles including 1) a CBO study "Federal Subsidies and the Housing GSEs" published in May 2001; 2) the October 23, 2003 testimony of CBO Director Douglas Holtz-Eakin before the Committee on Banking, Housing and Urban Affairs of the United States Senate regarding the "Regulation of the Housing Government-Sponsored Enterprises;" and 3) a relevant excerpt of David Reiss' article discussed previously "The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam will Pick Up the Tab."

The CBO study "Federal Subsidies and the Housing GSEs" includes the following excerpts:

"Preface - ...This study responds to a request from Congressman Richard H. Baker—in his capacity as Chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services—that the Congressional Budget Office (CBO) update its May 1996 study Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac. That study provided an estimate of the value of the federal subsidy to Fannie Mae and Freddie Mac."

[18] Pub. L. No. 101-508, title XIII (1990). Under the act, the credit subsidy cost of direct loans and loan guarantees is the net present value of the long-term cost to the government at the time the credit is provided to such programs, less administrative expenses. The act was intended to improve disclosures about the risks associated with government direct loans and guarantee programs and assist Congress in making budget decisions about such programs. (Footnote 29 in article)

[19] GAO, Budget Issues: Profiles of Government-Sponsored Enterprises, GAO/AFMD-91-17 (Washington, D.C.: February 1991). (Footnote 30 in article)

"Introduction and Summary
Fannie Mae, Freddie Mac, and the Federal Home Loan Bank (FHLB) System were established and chartered by the federal government, as privately-owned entities, primarily to facilitate the flow of credit to mortgage borrowers. Their special legal status as government-sponsored enterprises (GSEs), which includes tax and regulatory exemptions, enhances the perceived quality of the debt and mortgage-backed securities (MBSs) that they issue or guarantee and translates into a federal subsidy. By the Congressional Budget Office's (CBO's) estimates, the total subsidy grew steadily from $6.8 billion in 1995 to approximately $15.6 billion in 1999; it dropped slightly, to $13.6 billion, in 2000, reflecting a slowdown in the growth of the GSEs' activities...... Although the single largest source of the subsidy is the implicit guarantee on the GSEs' debt issues, in recent years the value of tax and regulatory exemptions has become significant, totaling an estimated $1.2 billion in 2000. The ultimate beneficiaries of that subsidy include conforming mortgage borrowers; the shareholders of (and other stakeholders in) Fannie Mae and Freddie Mac; and the stakeholders in the FHLBs and member institutions, including other borrowers at member banks.[20] *A little more than half ($7.0 billion) of that total subsidy in 2000 passed through to conforming mortgage borrowers, CBO estimates."*

On October 23, 2003 Congressional Budget Office ("CBO") Director Douglas Holtz-Eakin came before the Committee on Banking, Housing and Urban Affairs of the United States Senate to discuss the CBO's work on the economics, costs, and regulation of the government-sponsored enterprises (GSEs) for housing—namely, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Broadly speaking, that work leads to three main points:

"• *The federal government confers substantial benefits on GSEs through an implied guarantee of their debt and other financial obligations;*

• *In doing so, the government necessarily exposes taxpayers to risks; and*

• *Effective regulation can reduce but not eliminate the risks to taxpayers from the GSEs."*

Mr. Reiss's article "The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab" referenced research into the value of the subsidies to the GSEs.

[20] For Fannie Mae and Freddie Mac, conforming mortgage borrowers and shareholders are the primary beneficiaries of the subsidy. A portion of the subsidy also accrues to other "stakeholders," which include any other party that benefits from those GSEs' special status. CBO has estimated the total subsidy and the subsidy accruing to mortgage borrowers and therefore has not distinguished between shareholders and other stakeholders. FHLB stakeholders are defined as all beneficiaries of the subsidy that are not conforming mortgage borrowers.

"Wayne Passmore, a researcher at the Federal Reserve, has estimated that the present value of the federal government's subsidy of Fannie and Freddie is nearly $150 billion. (Citation omitted) One of the largest elements of this subsidy is the implied guarantee, the size of which is "only weakly controlled by policy makers because the GSEs control their own debt issuance and hence the size of the implicit subsidy." (Citation omitted)

iv. Is There an Ongoing Violation?

There are two relevant articles that discuss the ongoing violation in financial reporting. These include the CBO Background Paper *"CBO's Budgetary Treatment of Fannie Mae and Freddie Mac" published in January 2010* and a Senate Budget Committee Budget Bulletin *"Budget Perspectives for Fannie and Freddie"* published on July 14, 2016.

The Background Paper *"CBO's Budgetary Treatment of Fannie Mae and Freddie Mac"* contained the following excerpt in its Preface:

"After the U.S. government assumed control in 2008 of Fannie Mae and Freddie Mac—two federally chartered institutions that provide credit guarantees for almost half of the outstanding residential mortgages in the United States—the Congressional Budget Office (CBO) concluded that the institutions had effectively become government entities whose operations should be included in the federal budget." As a result, CBO incorporated estimates of the budgetary costs of the two entities in the baseline budget projections it published in 2009. This background paper describes CBO's budgetary treatment of Fannie Mae and Freddie Mac and the methods CBO used to estimate their costs."

The Summary and Introduction contained the following excerpts:

"The Administration has taken a different approach to recording the impact of Fannie Mae and Freddie Mac on the federal budget. In conjunction with the conservatorship, the Treasury signed agreements with the two entities intended to ensure that they could continue to support the mortgage market. In exchange for making direct cash infusions into the entities, the Treasury received shares of their preferred stock and warrants to purchase their common stock. The Administration's Office of Management and Budget (OMB) continues to treat Fannie Mae and Freddie Mac as outside the budget, and it records, and projects outlays equal to the amount of those cash infusions."

"CBO's Budget Projections for Fannie Mae and Freddie Mac
Consistent with the principles expressed by the 1967 President's Commission on Budget Concepts, CBO has concluded that Fannie Mae and Freddie Mac should now be included in the federal budget. The commission's landmark report

asserted that "The federal budget should, as a general rule, be comprehensive of the full range of federal activities. Borderline entities and transactions should be included in the budget unless there are exceptionally persuasive reasons for exclusion."[21] *The commission identified several key questions to use in determining whether to include programs in the budget: "Who owns the agency? Who supplies its capital? Who selects its managers? Do the Congress and the President have control over the agency's program and budget, or are the agency's policies the responsibility of the Congress or the President only in some broad ultimate sense?" The report recommended that "Government-sponsored enterprises be omitted from the budget when such enterprises are completely privately owned." CBO believes that the federal government's current financial and operational relationship with Fannie Mae and Freddie Mac warrants their inclusion in the budget."*

"Comparison with Cash Budgetary Treatment
The Office of Management and Budget considers Fannie Mae and Freddie Mac to be nongovernmental entities for federal budgeting purposes."

The Senate Budget Committee released on July 14, 2016, its Budget Bulletin focused on Budget Perspectives for Fannie and Freddie. "The Budget Bulletin provides regular expert articles by Senate Budget Committee analysts on the issues before Congress relating to the budget, deficits, debt and the economy." It contains the following excerpts:

"Differing Budgetary Treatment
The Office of Management and Budget (OMB) and Congressional Budget Office (CBO) take differing approaches to the costs associated with the two GSEs in the federal budget. OMB focuses on money flowing in and out of the government; CBO, on the risks the government assumes in backing the two GSEs. This stems from differing views about the relationship of the government to the two GSEs."

"The history, operations, and current legal structure of the two GSEs generally lead observers to take one of two views on the relationship of Fannie and Freddie to the government. The first is that the entities are an arm of the government that guarantees mortgages on behalf of the government. Proponents argue that the government owns, controls, and funds the entities. The government uses its control of the two GSEs to fulfill the public policy goal of supporting the housing-finance market. In this view, the two GSEs are de facto government agencies, not private financial institutions."

"The second view is that the two GSEs legally remain private entities under a temporary conservatorship. Proponents argue that the entities are statutorily

[21] President's Commission on Budget Concepts, Report of the President's Commission on Budget Concepts (October 1967), pp. 25, 30.

created to be shareholder-owned for-profit companies. Under this view, these private entities have agreed to a temporary conservatorship under the FHFA. This conservator entered into a contract with Treasury on behalf of the two GSEs to exchange funding for ownership interests."

"CBO takes the first view that the two GSEs are government agencies, while OMB holds the second view that the two GSEs legally remain private entities. This leads to different methods of accounting for the costs and benefits of the two GSEs."

C. Why Did Treasury Structure the PSPAs as They Did? In a Word "Politics!"

The most important question that was never asked or answered at the District Court is why did the Agencies structure the initial Preferred Stock Purchase Agreements ("PSPAs") with the GSEs as they did? The answer to this question completely undermines the Agencies "high ground" position that they were "the good guys" saving the nation from financial ruin. It appears that the defendants-appellees were "bad guys" executing transactions that were politically motivated. The true reason why the takeovers of Fannie and Freddie were executed as they were could not be revealed to the Court because that the transactions may have been declared unconstitutional.

The Treasury structured the transactions as it did to achieve the critical objectives of adhering to the directive of the President of the United States to Treasury Secretary Paulson not to have the GSEs be nationalized as well as not having to consolidate the GSEs assets and liabilities into the federal government's balance sheet. It wanted the GSEs to remain off its balance sheet for an entirely practical economic reason; if it had to consolidate the GSEs onto its balance sheet the ratings agencies might downgrade the debt of the United States of America. A downgrade of U.S. debt in the midst of a financial crisis is an outcome that Treasury wanted to avoid at all costs.

So, Treasury simultaneously used and ignored the Morgan Stanley analysis as well as its own analysis. The Morgan Stanley analysis indicated that Fannie and Freddie "looked to be deeply insolvent with Freddie the worse of the two." In order to maintain the public's equity stake the federal government had to take the position that the public's common and preferred equity in the GSEs still had value at the time of the conservatorship, despite the federal government having conclusive evidence in its possession that the public's common and preferred equity stakes were worthless. Furthermore, it had to invent an accounting rule that essentially stated that consolidation into the federal government's balance sheet was not required if the federal government owned less than eighty percent (80%) of a GSEs common stock. There is no basis for this accounting rule anywhere in any accounting literature prior

to its invention by the Treasury Department. As the saying goes: "Necessity is the mother of invention!"

The following quotes are also taken from the article written by Phillip Swagel *"The Financial Crisis – An Inside View."*

> *"[E]ven putting the GSEs into conservatorship raised questions about whether their $5 trillion in liabilities would be added to the public balance sheet. This did not seem to Treasury economists to be a meaningful issue, since the liabilities had always been implicitly on the balance sheet – and in any case were matched by about the same amount of assets. But the prospect that ratings agencies might respond by downgrading U.S. sovereign debt was unappealing."*

> *"The U.S. Government ended up as a 79.9 percent owner of the GSEs, receiving preferred stock on terms that essentially crushed the existing shareholders. (The precise level of ownership was chosen in light of accounting rules that would have brought GSE assets and liabilities onto the government balance sheet at 80 percent ownership.)"*

> *"The Treasury could not by law make GSE debts full-faith-and-credit obligations of the U.S. government – this could only happen through an act of Congress that changed the GSE charters."*

The following quotes are taken from an article written by Steven M. Davidoff Solomon *"Regulation by Deal: The Government's Response to the Financial Crisis":*

> *"Treasury also received a warrant to purchase 79.9% of the outstanding common stock of each of Fannie and Freddie. The warrant was exercisable for a twenty-year period and had a nominal exercise price of $0.00001 per share. (Citation omitted) Through this mechanism, the government effected a transaction to significantly, but not completely, dilute the holders of these securities and significantly reduce their value. But the government did not place its ownership interest higher into the capital structures of each GSE in order to penalize or otherwise wipe out the secured or subordinated debt of these entities."*

> *"This was likely done for both political and economic reasons-again the government's actions were constrained by the outer boundaries of the law. The secured debt was issued by Fannie and Freddie to finance mortgage lending and had historically been viewed as having an implicit (now effectively explicit) government guarantee. The amount outstanding was over $5.14 trillion in mortgage-backed securities and guarantees, and Treasury could not eliminate or otherwise impair this debt without risking significant, if not catastrophic, disruption to the mortgage market. (Citation omitted) The subordinated debt*

was generally perceived by the market as riskier and was not viewed as having a government guarantee. (Citation omitted) Fannie and Freddie utilized this debt to finance their riskier, nonconforming loans and for trading capital. (Citation omitted) However, a substantial portion of the subordinated debt, like much of the secured debt, was held by foreign financial institutions and sovereigns. It was privately viewed that if this debt was impaired, it would drive away foreign lenders from U.S. debt at a time when the United States required this money to service its federal obligations. (Citation omitted) Thus, the government limited its actions to impairing the value of the GSEs' preferred and common stock. Here, the government particularly impacted the many depositary institutions that were permitted to invest in the GSEs' preferred stock and had done so in search of a higher return."

"Moreover, the government did not completely wipe out the preferred and common shareholders of the GSEs. Rather, the government limited its interest to the 79.9% figure. The exact reasons for this limitation have yet to be disclosed, but it does not appear that this issuance was structured to maintain value for the security holders. Rather, it was likely done for one or more of the following reasons: (1) to support a position that the GSEs did not have to be consolidated onto the books of the federal government for accounting purposes (something the Congressional Budget Office disputed); (2) to build a case that each GSE was not now a government-controlled entity so that the government's unique accounting rules did not have to be adopted by these entities; (3) to ensure that these GSEs could still deduct interest paid on their loans from the government, something they would be unable to do under § 163 of the Internal Revenue Code if they were deemed "controlled" by the government; (Citation omitted) and (4) to ensure for Employee Retirement Income Security Act (ERISA) purposes that the GSEs were not deemed "controlled" by the government, making the government joint and severally liable for these entities' ERISA plan liabilities.(Citation omitted)"

"A former Treasury official would later assert that this was indeed done for accounting purposes in order to keep Fannie Mae's and Freddie Mac's liabilities off the government's balance sheet.[22] But for whatever reason, the government felt that it could not completely eliminate these security holders' interests."[23]

[22] See Swagel, Philip, The Financial Crisis: An Inside View, Brookings Papers on Economic Activity, (Spring 2009), available at http://www.brookings.edu/economics/bpea/-/media/Fies/Programs/ES/BPEA/2009-spring _bpea-papers/2009_springbpea-swagel.pdf ("The 79.9 percent ownership was chosen in light of accounting rules that would have brought GSE assets and liabilities onto the government balance sheet at 80 percent ownership."). Footnotes 6, 112 in article)

[23] Davidoff Solomon, Steven M., "Regulation by Deal: The Government's Response to the Financial Crisis, 61 Admin L. Rev. 463, 488-489 (2009).

D. The Political Branches Hijacked the Combined Statement in 1953

The best way to understand the history of the Combined Statement is to review excerpts from selected Combined Statements since the report's first appearance in 1872.

i. 1872 to 1928 Focus is on All Receipts and Expenditures

1872 - The cover letter from the Secretary of the Treasury to the Chairman of the Committee on Appropriations transmitting a statement of the receipts and expenditures of the Government, by appropriations for the fiscal year ended June 30, 1872 stated:

> *"I have the honor to transmit a combined statement of the receipts and disbursements of the Government, by appropriations, exclusive of the principal of the public debt....., exhibiting the various sources of the revenues; the apparent expenses of each branch of service under the several Departments,...."*

1927 – The Combined Statement contained the following description of the report:

> *"In accordance with the requirements of the act of July 31, 1894, the receipts are classified, whenever practicable, by ports, districts, and States, and the expenditures by each separate head of appropriations."*

Selected excerpts of the Foreword to the 1927 report "Inauguration of the Statement of Expenditures on the Basis of Checks Issued"....appear below.

> *"It has been realized for some time that a more accurate method should be devised for exhibiting the detailed expenditures of the Government in the annual reports than the one heretofore observed. Except in the case of the daily Treasury statements the detailed expenditures have been exhibited on the basis of warrants issued against appropriations provided by Congress in accordance with section 305 of the Revised Statutes. Accountable warrants, so called because the disbursing officers must regularly account for expenditures therefrom, are issued to place funds to the credit of disbursing officers upon the books of the Treasurer of the United States, subject to their official check for the payment of Government obligations. Settlement warrants authorize the Treasurer to make direct payments to claimants upon settlements of the accounting officers."*

> *"Funds placed to the credit of disbursing officers by means of accountable warrants have been exhibited heretofore as expenditures during the period in which such advances were made. As a matter of fact, some of the money in many instances is not actually spent until the period following the one in which the advance is made, and, to some extent, not at all, the unexpended portion being returned to the appropriation accounts on the books of the Secretary of the Treasury in a subsequent period, which operates to reduce expenditures on a*

warrant basis for that year. The expenditures on a warrant basis, therefore, do not accurately reflect the trend of governmental expenditures since they include unexpended balances remaining to the credit of disbursing officers at the end of the year but not expenditures from unexpended balances at the beginning of the year. It may be stated, however, that the differences between the expenditures on a warrant and check-issue basis are not so material in cases where the unexpended balances to the credit of disbursing officers remain more or less constant from year to year."

"In the early history of the Government when payments to public creditors were made by direct Treasury warrant, the warrants issued during a given fiscal year represented the actual expenditures of the Government. Subsequently, however, as the expenditures increased with the growth of governmental activities and it was found impractical to make all payments by direct warrants, advances or credits in round amounts were authorized to be established in favor of disbursing officers, so that, at the present time the major part of the general expenditures of the Government are made by means of disbursing officers' checks from funds advanced to them upon accountable warrants as stated above. The funds thus advanced are placed to the credit of disbursing officers practically as a bookkeeping expedient, and, to the extent that the unexpended balances of the funds so advanced vary between the beginning and close of the fiscal year, the warrant expenditures differ from the actual expenditures for that year...."

"In order to correct the situation described above and exhibit the expenditures on the best practicable basis, the several departments and establishments have cooperated with the Treasury in furnishing the unexpended balances to the credit of disbursing officers under their respective jurisdictions at the beginning and end of the fiscal year 1927, classified by appropriations. These figures, when used in conjunction with the warrants issued during this year, make it possible to include checks drawn during 1927 against unexpended balances of disbursing officers at the beginning of the fiscal year, and to. exclude from expenditures all unexpended balances remaining in their hands or to their credit at the close of the year."

1928 - The bases of the figures included in this report are explained in the Foreword which appears below:

"FOREWORD: BASIS OF FIGURES INCLUDED IN THIS REPORT

RECEIPTS Section 305 of the Revised Statutes provides that receipts for all moneys received by the Treasurer of the United States shall be indorsed upon warrants signed by the Secretary of the Treasury, without which warrants, so signed, no acknowledgment for money received into the Public Treasury shall be valid. The receipts of the United States Government as published in this report are based upon warrants issued by the Secretary of the Treasury and represent the formal covering into the Treasury of the public moneys deposited

in Treasury offices and Government depositaries during the fiscal year ended June 30, 1928."

ii. 1954 to 1960 The Political Branches Hijack the Report

Key passages from several Combined Statements describe the transitioning of the Statement and Account from a statement depicting the receipts and expenditures of all public money to another financial report supporting the President's Budget.

1954 – The Foreword for the 1954 Combined Statement contained the following:

"Legislative Requirement for the Report

...The exercise and performance of this duty was broadened by Section 114 of the Budget and Accounting Procedures Act of 1950 (64 Stat. 832),... In accordance with this provision of law and under the objectives of the Joint Accounting Improvement Program a proposal for improved reporting was approved on October 5, 1953 by the Secretary of the Treasury, Director of the Bureau of the Budget, and the Comptroller General of the United States. Treasury Department Circular No. 940, dated February 17, 1954, provided for reporting of cash transactions and the instructions issued thereunder set the pattern of uniform reports which serve as the basis for the Monthly Statement of Receipts and Expenditures of the United States Government as well as this report."

"BASES OF FIGURES
Receipts - Section 305 of the Revised Statutes (31 U.S.C. 147) provides that receipts for all moneys received by the Treasurer of the United States shall be endorsed upon warrants signed by the Secretary of the Treasury, without which warrants, so signed, no acknowledgment of money received into the Public Treasury shall be valid. Pursuant to Section 115 of the Budget and Accounting Procedures Act of 1950, the procedure was modified to permit certain receipts to be deposited direct to disbursing officers' checking accounts without the issuance of covering warrants."

"Expenditures (net) - Check-issued basis. - ....Where appropriations are credited with reimbursements or refunds of moneys previously expended, as authorized by law, the expenditures reflected in this report are reduced by such amounts."

"Appropriations when made by Congress and established upon the books of the Treasury Department do not represent so much income or cash actually set aside in the Treasury for the purposes specified in the appropriation acts. Appropriations are established upon the books of the Treasury simply as record accounts and merely represent the limit to which administrative offices may obligate Government funds during the fiscal years specified in the appropriation acts, and as a general rule are based upon anticipated future tax collections and other receipts."

1955 – The Foreword of this report contains the following:

"REQUIREMENTS OF LAW
This report has been compiled in accordance with the following requirements of law:

Section 15 of the Act of July 31, 1894 (5 U. S. C. 264) which provides, "It shall be the duty of the Secretary of the Treasury annually to lay before Congress, on the first day of the regular session thereof, an accurate combined statement of the receipts and expenditures during the last preceding fiscal year of all public moneys, including those of the Post Office Department, designating the amount of the receipts, whenever practicable, by ports, districts, and States, and the expenditures by each separate head of appropriation, and

Section 114 of the Act of September 12, 1950, 31 U. S. C. 66b(a), which provides: "The Secretary of the Treasury shall prepare such reports for the information of the President, the Congress, and the public as will present the results of the financial operations of the Government: Provided, That there shall be included such financial data as the Director of the Bureau of the Budget may require in connection with the preparation of the Budget or for other purposes of the Bureau. Each executive agency shall furnish the Secretary of the Treasury such reports and information relating to its financial condition and operations as the Secretary, by rules and regulations, may require for the effective performance of his responsibilities under this section.

The Department also publishes under authority of Section 114 of the Act of September 12, 1950, monthly statements of receipts and expenditures of the United States Government which currently reflect the budget surplus or deficit. There is prepared after the close of the fiscal year a final statement of Receipts and Expenditures which includes receipt and expenditure data for the fiscal year which is in agreement with corresponding data for the fiscal year included in this report and in the Budget of the United States Government."

"BASES OF FIGURES
....Section 115 of Public Law 784, 81st Congress, approved September 12, 1950, modified Section 305 of the Revised Statutes by authorizing the Secretary of the Treasury and the Comptroller General of the United States, under certain conditions, to issue joint regulations waiving the requirements for the issuance and countersignature of warrants for the receipt and disbursement of public money. Pursuant to this authority, joint regulations were issued during the fiscal year 1951 under which all collections representing repayments to appropriations are covered into the Treasury and credited directly to the accounts of disbursing officers without issuing covering warrants."

"Expenditures (net) - Check-issued basis. - The expenditures exhibited in this report in the fourth money column, include checks drawn upon the Treasurer of

the United States in payment of Government obligations, with the exception of interest on the public debt (which is shown on an accrual basis"

1959 – The Foreword contained the following excerpts:

"EXPLANATION OF TERMS AND BASES OF FIGURES
....Section 115 of Public Law 784, 81st Congress, approved September 12, 1950, modified Section 305 of the Revised Statutes by authorizing the Secretary of the Treasury and the Comptroller General of the United States, under certain conditions, to issue joint regulations, waiving the requirements for the issuance and countersignature of warrants for the receipt and disbursement of public money. Pursuant to this authority, joint regulation No. I, effective November 1, 1950, was issued and provided for all collections representing repayments to appropriations to be covered into the Treasury and credited directly to the accounts of disbursing officers without issuing covering warrants; also joint regulation No.3, effective July I, 1951, was issued and provided that certain special fund and trust fund receipts be credited directly to the accounts and made immediately available to the collecting agency."

1960 – The Foreword contained the following excerpts:

"This report is recognized as the official publication containing the details of receipts and expenditure data, as well as the budget surplus or deficit for the fiscal year, with which all other reports containing similar data will be in agreement."

"NONBUDGET ACCOUNTS
Trust Fund Accounts - ....Some of the major trust accounts are the Federal old-age and survivors insurance trust fund, unemployment trust fund, civil service retirement fund, highway trust fund, and the national service life insurance fund."

iii. 1968 Impact of the President's Commission on Budget Concepts

The 1968 Combined Statement describes the importance of the President's Budget to the Combined Statement

1968 – The Foreword contains the following excerpts:

"MAJOR CHANGES IN REPORTING CONCEPTS
This combined statement of receipts and expenditures incorporates for the first time the changes in the President's Budget for 1969, in consonance with those recommendations of the President's Commission on Budget Concepts which were adopted and implemented during fiscal year 1968."

"....Certain accounts formerly in the trust and deposit fund category remain outside the budget, coordinate with the Commission's recommendations. These are primarily the Federal Land Banks and Federal Home Loan Banks, which are entirely under private ownership..."

"BUDGET RECEIPT AND EXPENDITURE ACCOUNTS

ii. Authorizations to expend from public and agency debt receipts - ..... A few agencies of the Government are authorized by law to issue their own securities to the public. Before issuing these securities, the agencies are required to secure approval from, or consult with, the Secretary of the Treasury with respect to terms of the borrowing and the timing thereof. Such borrowings and repayment of borrowings from the Treasury or the public represent financing transactions and therefore do not affect the budget surplus or deficit."

v. 1976 to 2018 Treasury and OMB Dictate Financial Reporting

1976 is included because it lays out the legal requirements for reporting. By 2001 the legislation governing reporting for the Combined Statement had changed dramatically.

1976 – The Foreword contains the following excerpts:

"INTRODUCTION
The requirement for the preparation of a report on receipts and outlays of the Government originated with Article I, Section 9 of the Constitution of the United States, which provides in part that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of all public money shall be published from time to time." (Underlining provided) This requirement was followed by a standing order of the House of Representatives, dated December 31, 1791, which required an annual report on receipts and outlays of the Government. This requirement was superseded by the following:

Section 15 of the Act of July 31, 1894 (U. S. C. 1029) which provides, "It shall be the duty of the Secretary of the Treasury annually to lay before Congress, on the first day of the regular session thereof, an accurate combined statement of the receipts and expenditures during the last preceding fiscal year of all public moneys, including those of the Post Office Department, designating the amount of the receipts, whenever practicable, by ports, districts, and States, and the expenditures, by each separate head of appropriation."

Section 114 of the Act of September 12, 1950 (31 U. S. C. 66 b (a)) which provides, "The Secretary of the Treasury shall prepare such reports for the information of the President, the Congress, and the public as will present the results of the financial operations of the Government. . . " Section 114 also provides that the duties imposed upon the Department of the Treasury by Section 15 of the Act of July 31, 1894, may be exercised and performed by the Secretary as a part of his broader authority and duties outlined in this section."

2001 – The Preface contains the following excerpts:

"Legislative Requirement

31 U.S.C. 3513(a) provides in part, "The Secretary of the Treasury shall prepare reports that will inform the President, Congress, and the public on the financial operations of the United States Government."

"This statement is recognized as the official publication of receipts and outlays. Several major Government bodies rely on data found in this report."

III. Appendices

A. Appendix A – Overview of the Size of the Unconstitutional Financial Reporting Problem

The four major items that are fraudulently and unconstitutionally reported by the federal government in the Combined Statement, the President's Budget and the Financial Report include:

-- The Federal Reserve System, Fannie Mae and Freddie Mac, with total assets of $3.9 trillion (as of May 29, 2019),[24] $3.4 trillion (as of March 31, 2019)[25] and $2.1 trillion (as of March 31, 2019),[26] respectively, are not consolidated into the federal government's financial statements.

-- The federal government's $24.2 trillion net present value obligation for Medicaid was reported for the first time in the 2010 Financial Report.[27] Omitting the disclosure of material information, as was done from the creation of Medicaid through 2009, violated the laws against fraud. The amount reported in the 2018 Financial Report was $34.1 trillion.[28]

-- The total adjusted net present value obligation for Medicare and Social Security that is fully funded with appropriations reported in the Statements of Social Insurance ("SOSI") and in related footnotes in the 2018 Financial Report is $68.6 trillion.[29] But the SOSI does not interrelate with the other financial

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[24] See Federal Reserve Statistical Release May 30, 2019, https://www.federalreserve.gov/releases/h41/current/h41.htm.

[25] See Federal National Mortgage Association Form 10-Q for the Quarterly Period Ended March 31, 2019, http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2019/q12019.pdf.

[26] See Federal Home Loan Mortgage Corporation Form 10-Q for the Quarterly Period Ended March 31, 2019, http://www.freddiemac.com/investors/financials/pdf/10q_1q19.pdf.

[27] See 2010 Financial Report of the United States Government, page 140, http://www.gao.gov/financial_pdfs/fy2010/10frusg.pdf

[28] See 2018 Financial Report of the United States Government, Statements of Long-Term Projections on page 60, https://fiscal.treasury.gov/reports-statements/financial-report/current-report.html.

[29] See 2018 Financial Report of the United States Government, pages 10, 61-65, 196-197, https://fiscal.treasury.gov/files/reports-statements/financial-report/2018/03282019-FR(Final).pdf. Please note that the obligation reported by the government for Social Security (OASDI) under the Infinite Horizon reported on page 197 is $37.2 trillion. However, this figure must be reduced to be equal to the amount of the government's legal obligation which is the amount of the existing appropriations for Social Security. (Reporting figures in excess of appropriated amounts appears to violate the Anti-deficiency statute discussed later in this article.) This is equal to the amount in

statements and no current expenses are recorded for required future payments.

-- The net present value obligation for Other Mandatory spending, assuming only a 75-year time horizon, that appears to be fully funded with permanent appropriations is reported in the Statements of Long-Term Fiscal Projections in the 2018 Financial Report. The amount reported as of September 30, 2018 is $41.0 trillion.[30] This statement does not interrelate with the other financial statements and no current expenses are recorded for required future payments.

B. Appendix B – No Accounting for Government Cost

the trust fund which is $2.9 trillion. Meanwhile, the Medicare program (HI and SMI Part B and Part D) has permanent appropriations so the full amount reported on page 197 of $65.7 trillion represents the government's total legal obligation. Combining the two figures yields $68.6 trillion.

[30] ID. See page 60.

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OTHER VOICES | SATURDAY, JANUARY 4, 2014

No Accounting for Government Cost

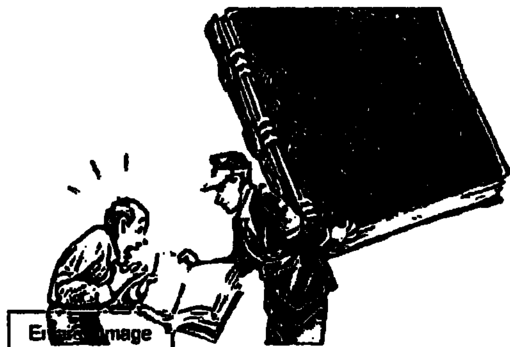
By JOSEPH H. MARREN

The financial position of the U.S. is not just troubled; it is artificially created to fool the people.

The nation's budget deficit and debt are exponentially higher than what our politicians say they are. None of the headline figures used as the basis of public discourse have any relevance to the true state of U.S. finances.

The government's financial reporting is misleading because our political leaders have subverted the democratic process to advance their personal interests. They have spent enormous sums of taxed and borrowed money to endear themselves to the electorate, but they do not want to be held accountable for the full extent of this spending. Hence, the legislative and executive branches collude to underreport expenditures.

In reality, the federal government's existing legal obligations exceed $90 trillion, which is far above the carefully defined debt-ceiling limit of $16.7 trillion and is almost six times the size of the gross domestic product. The reported budget deficit for fiscal 2012 was $1.1 trillion, when a more realistic accounting would show a $5.8 trillion deficit. Recently, the Treasury Department reported that the budget deficit for fiscal 2013 was $680 billion, but the true deficit cannot be calculated without the 2013 Financial Report of the United States Government, scheduled for publication on Feb. 26.



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A true accounting is necessary.

The Constitution's statement and account clause requires that "a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." Congress' false reporting has resulted in the violation of several rights, including the right to vote, freedom of speech, due process, equal protection, the right to financial information, and the right to political accountability.

As Supreme Court Justice William O. Douglas said in a dissent in 1974, "The Framers of our Constitution deemed fiscal information essential if the electorate was to exercise any control over its representatives and meet their new responsibilities as citizens of the Republic." The failure to publish a complete and truthful statement and account of the nation's finances has made our republic dysfunctional, plagued by successive budget-deficit and debt-ceiling crises.

The official statement and account, which is called the "Combined Statement of Receipts, Outlays and Balances," is not much known or used by the public, including the media; is not central to any discussion of the nation's finances; and is not viewed as a major publication by any recent Congress or administration. The government's two primary financial reports are the President's Budget and the Financial Report of the U.S. Government. But their accounting principles violate the Constitution.

The government's accounting rules cannot be reconciled with the statement-and-account clause's "all public Money" requirement. The clause has no exceptions for entities or programs that our politicians want to put off-budget, off-balance sheet, and out of mind. If the important information is described at all, it's only in footnotes.

Congress goes wrong whenever it commits the country to future expenditures and creates permanent appropriations to make that spending automatic. Such actions have to be reflected in the financial statements, and if they are not, the government is committing fraud on its citizens.

THE THREE MAJOR VIOLATIONS ARE:

1) The Federal Reserve System, Fannie Mae, and Freddie Mac, with total assets of $4 trillion, $3.3 trillion, and $2 trillion, respectively, are not consolidated into the federal government's balance sheet.

2) The federal government's $24.2 trillion net-present-value obligation for Medicaid was reported for the first time in the 2010 Financial Report and buried in supplementary information in that report. Omitting the disclosure of material information, as was done from the creation of Medicaid through 2009, violates the laws against fraud, and the Supreme Court's "buried facts" doctrine suggests that even current reporting is unlawful.

3) The total adjusted obligation for Medicare and Social Security reported on the Statement of Social Insurance and in related footnotes is $48.5 trillion. But the statement does not interrelate with the other financial statements, and no current expenses are recorded for required future payments.

The government's accounting rules are designed to mislead voters about the consequences of their votes. The rules make a mockery of the idea of political accountability. Financial reporting leaves voters with no idea how large federal government expenditures are. They cannot send the responsible representatives packing because they retired from Congress years ago. Their current representatives say that their hands are tied on mandatory spending and they cannot be held accountable.

Adding all of the costs associated with the nation's social-insurance programs to the amounts reflected in the Financial Report shows that over the past decade the federal government effectively spent more than $88 trillion, while its revenues totaled a little over $22 trillion. The government pretends that obligated money is not spent until the future arrives: a legally correct accounting must accrue for those future payments.

Without an improbable change of heart in the people and their self-serving representatives, the nation has only one place to turn. The Supreme Court should take up a case requiring an interpretation of the statement-and-account clause and decide that reporting must adhere to the Constitution.

A fresh case would take years to be resolved, but the court could consider the matter sooner. In June 2012, the Supreme Court ruled that the Medicaid expansion in the Affordable Care Act was unconstitutional. But each of the opinions issued contained economic and political analysis based on the government's false financial information. The court should reopen the case to apply the rule of law and restore needed accountability.

JOSEPH H. MARREN is a lawyer and accountant, and president and CEO of KStone Partners, an alternative asset manager based in Briarcliff Manor, N.Y. The views in this essay are his and do not represent the views of KStone Partners or its other members.

Other Voices essays should be about 1,000 words, and e-mailed to **tg.donlan@barrons.com**.

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