the Solari Report

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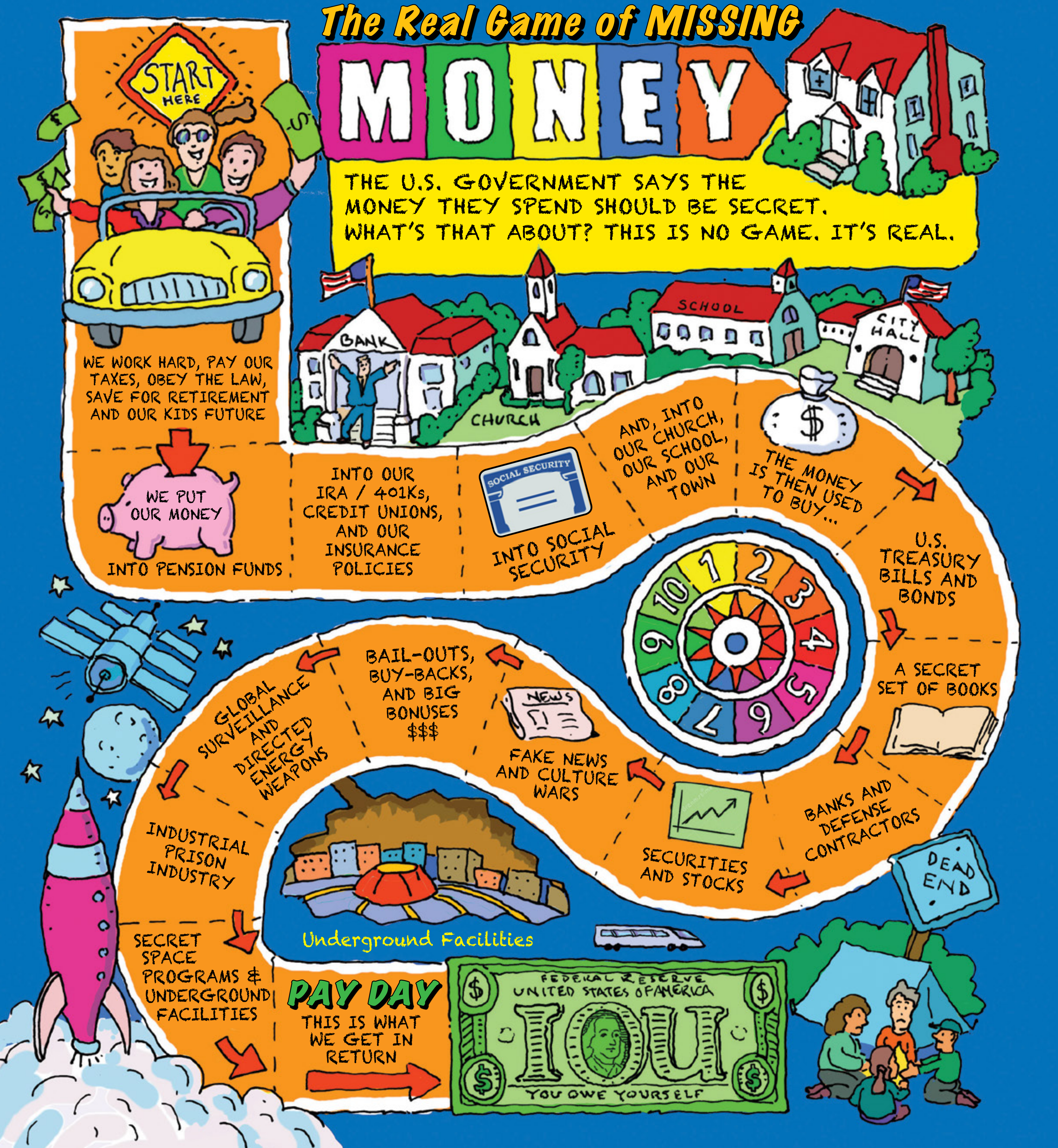

The Solari Report
2018 Annual Wrap Up

The Real Game of Missing Money

PART ONE / 2019 VOLUME ONE

by Catherine Austin Fitts

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2018 Annual Wrap Up
Part 1 – 2019 Volume 1

The Real Game of Missing Money

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The Real Game of Missing Money

"There is a tide in the affairs of men, which taken at the flood, leads on to fortune. Omitted, all the voyage of their life is bound in shallows and in miseries. On such a full sea are we now afloat. And we must take the current when it serves, or lose our ventures." ~ William Shakespeare, *Julius Caesar*

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NOTE: Part Two is available in a separate document

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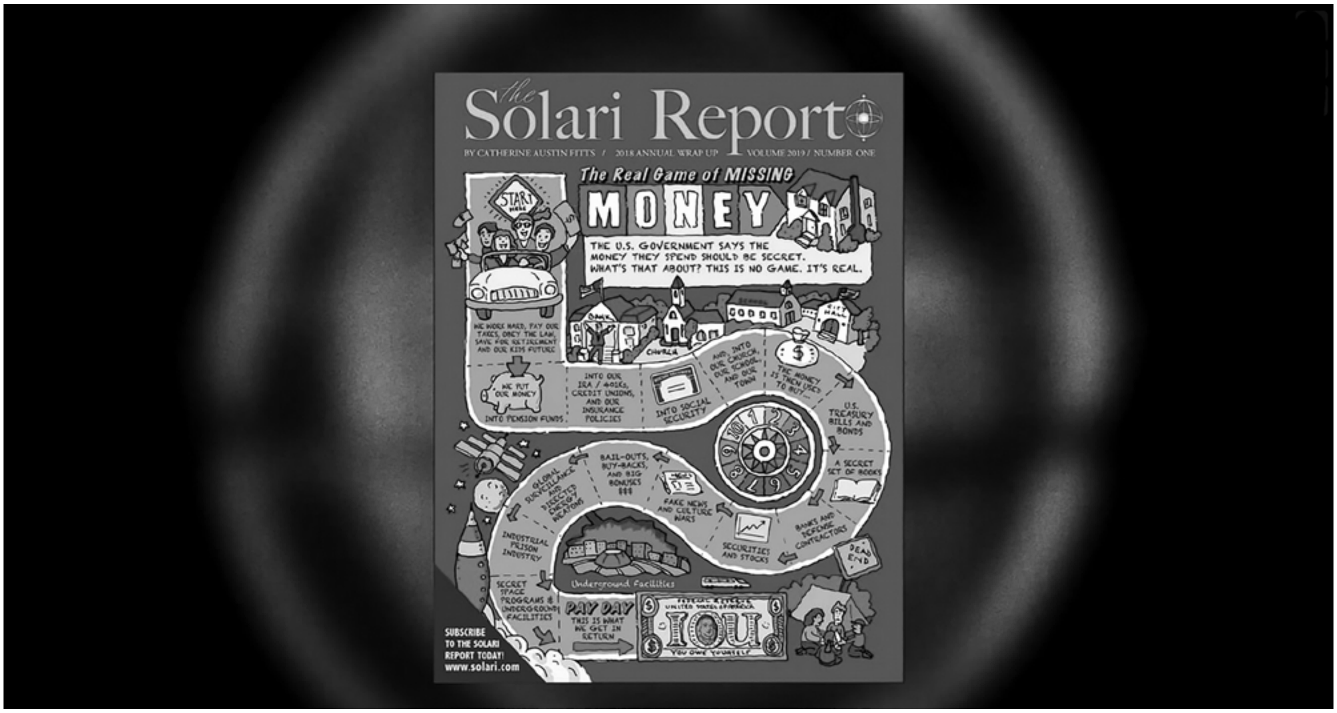
Chapter I. Introduction



"Perhaps the hardest thing to imagine about the secret life of the cryptocracy is that it isn't a subculture at all: it's a superculture. It's an underworld that rules over each and every one of us, and trying to see it is like trying to imagine a fifth dimension from the perspective of a fourth. Yet we also belong to this parallel world and it has always been there, acting on us in ways both invisible and oppressive—oppressive most of all because invisible. For what we fail to see continues indefinitely."

~ Jason Horsley

By Catherine Austin Fitts

The Goal of the *2018 Annual Wrap Up* Theme

The theme for our *2018 Annual Wrap Up* is *"The Real Game of Missing Money."*

My goal is to address the long-term refusal of the U.S. government and its central bank to obey the laws regarding federal financial accounts and operations as well as the recent adoption of accounting policies that will permit federal agencies and scores of related entities to keep secret books, thus rendering public financial reports meaningless.

These changes also render meaningless any pretense that the U.S. government and its finances operate according to the U.S. Constitution and its own financial laws. This dramatically increases the ability of whomever controls this mechanism to radically reengineer the federal government and budget and to use private armies to reengineer U.S. land use and enforcement and to start foreign wars.

In short, the U.S. government has implemented accounting policies that shift its governmental model from a Constitutional republic to something else. A small invisible group of people (we can't know who they are) can run the finances of the largest taxation and securities operation in the world by a secret process (we can't know by what process) and keep their decisions and the financial realities and the financial facts of ownership and control secret.

U.S. Senate Staff Describe a "Criminal Enterprise"

There are many words that could be used to describe such a governance model. The phrase I find most appropriate was used in 2001 by the chief of staff to the Chairman of the Senate Appropriations Subcommittee that oversees HUD and Treasury to describe the U.S. government mortgage insurance and housing subsidy operations. The mortgage bubble engineered by the U.S. government and central bank was in full bloom at the time. The term they chose to describe an operation run by a matrix of agencies and banks—FHA, HUD, the U.S. Treasury, the Department of Justice, the Office of Management and Budget, and the New York Fed and its member banks—was a "criminal enterprise."

What Do We Know?

The purpose of this report is to lay out the facts as we know them regarding the failure of the U.S. government to produce reliable financial reports. Two of the standout features of this failure include $21 trillion of undocumentable adjustments at DOD and HUD between federal fiscal years 1998-2015 and the recent publication of Federal Accounting Standards Advisory Board (FASAB) Statement 56, which authorizes secret books on a permanent basis. I also offer some history, analysis, and opinion in the hopes that these will inspire you—whether as a U.S. citizen, taxpayer, investor, or a global citizen affected by changes in the U.S. security umbrella—to do your own due diligence.

Whichever roles concern you, the adoption of FASAB Statement 56 and the events that led up to its issuance necessitate that you do serious due diligence on what this means to you and your unique circumstances. I hope that this aggregation of resources can make doing so easier for you.

What we fail to see "continues indefinitely." Or, as I often say, "crime that pays is crime that stays." Before we can address solutions, we must face and understand the problem. I have been working on the illegalities, fraud, and related harm done by the federal finances for 30 years, and I have put forward numerous proposals to convert a "negative return on investment" machinery to positive returns. I started in 1989, when I was asked as Assistant Secretary of Housing/Federal Housing Commissioner to clean up the finances of the U.S. mortgage insurance operations as they were rocked by the twin scandals of the savings and loan (S&L) crisis and Iran-Contra fraud. Given these experiences, I appreciate the depth of the issues involved—my estimates indicate that more than 50% of the income in every one of 3100 counties in America comes directly or indirectly from the federal budget and credit operations. At the same time, I know what we have all known all along. If you keep kicking the can, at some point, the economic squeeze will become unbearable, and you are likely to hit a wall.

That time is approaching.

U.S. Debt and Unfunded Liabilities: Rush Hour Cometh

Officially reported U.S. Treasury debt is starting to expand at a rapid pace. Outstanding debt disclosed in official reports is now greater than our annual GDP and is expanding at an increasing rate. Treasury debt grew by 6% in 2018 and is expected to grow by 8% in 2019, despite many years of "economic recovery." If the economy slows or goes into a recession, the debt growth will accelerate. Add unfunded liabilities, and the picture deteriorates even further.

The current U.S. administration is attempting to outgrow the debt—but these efforts are weighed down by the political divisions involved in changing a model that has made enormous profits from globalization and a military-industrial-congressional complex designed to create and profit from more centralization. The result is a series of factions that all produce more support for centralization at the expense of markets and democratic process—whether through technocracy or fascism.

If these factions are successful, the percentage of U.S. GDP that will flow through federal taxation, spending, and credit will continue to increase, while the federal accounts and reporting go dark.

Who Will Buy the U.S. Debt?

Who will buy this debt? Currently, foreign investors hold 29% of outstanding U.S. Treasury debt. However, foreign countries and central banks are grappling with their own high levels of debt. Some also fear economic sanctions and trade wars and wish to reduce their dollar dependency. A few, such as China, are looking to expand the global liquidity of their own currencies and bond markets. Given this combination of factors, it is unlikely that foreign sovereign wealth funds and central banks will provide a significant source of fresh funds. Along with a significant increase in corporate debt maturities over the next five years, the competition for private global investors and funds sitting in the offshore havens will be fierce.

That leaves three alternatives. The first is the Federal Reserve, which is reducing bond holdings ballooned during quantitative easing. The second is U.S. investors, including pension funds and retirement accounts. The third is the U.S. government, using funds such as the Social Security Trust Fund and the Exchange Stabilization Fund and its trading partners. Whatever combination is used, the demand to issue growing amounts of U.S. debt will involve significant "monetization" of the new debt. That means monetary inflation, if not hyperinflation. In addition, the risks of mandates forcing pensions and retirement accounts to allocate increasing assets to new debt are rising.

Don't be surprised if the primary dealers are now assuring large bond holders that FASAB Statement 56 provides sufficient behind-the-scenes control to ensure creditors' rights are represented in the potential face of an unruly population or fractious politics in Washington.

Annual Growth in the U.S. Cost of Living

While official statistics say that inflation is low, a trip to the grocery store will demonstrate an annual increase in the cost of living for U.S. households that is averaging 8%-14%, depending on where you live. That's not hyperinflation, but it signals a currency debasement that is contributing to the steady debasement of U.S. society and culture. I live in a county that created a place for people to have car trunk sales—selling their possessions from the back of their car because they did not own a home where they could have yard sales. That was in 2001. A lot of people have been squeezed, have failed, or have died since then. To a certain extent, the opioid epidemic in America is simply a way to feel good on the way out.

How Long Can This Last?

How much longer can the U.S. kick the can down the road? Is it one year? Five years? Ten years? I don't know, because this is a military question. How much longer can our military superiority and global operations permit us to maintain reserve currency status despite the breakdown of the Bretton Woods trading system? Much of the intelligence we need to assess the strategic issues and timing is secret. The fact of the matter is if the United States can maintain dominance in technology, science, and space, the U.S. dollar could remain the global reserve currency indefinitely. That does not mean, however, that many U.S. citizens will survive both the cost-of-living squeeze and the radical government reengineering and "piratization" underway.

This is a political question. In theory, we have three options. We can go to war, we can depopulate, or we can change. What happens if rather than behaving like crabs in a bucket, we surprise ourselves and rise to the occasion? Real change requires trust, however. It is difficult to trust a leadership that continues to get wealthier as $21 trillion goes missing from federal accounts—while the same leadership insists we have no money to fund pension funds or college educations.

The wealth creation potential of "positive return on investment" federal flows combined with new technology is theoretically explosive. However, realizing that potential means letting go of secrecy and privilege. Along with serious potential legal liabilities that pose practical problems, the privilege created by secrecy is the most serious addiction on the planet. Helping the U.S. aristocracy overcome their withdrawal pains is a political challenge we have failed to address. To date, we have chosen "fight to the death" rather than "truth and reconciliation."

Secret books such as are envisioned by FASAB Statement 56 are a signal of real trouble ahead. Secret books expand the power of a secret group of people to transfer what they can while the getting is good. They also make it easier to use U.S. special forces and covert operations or private mercenary armies to extend the life of the U.S. reserve currency and enhance corporate profits and related campaign contributions. Secret books increase the risk of more aggressive and violent kicks of the can. I believe this will include reengineering the U.S. government and U.S. resources and domestic land use in a manner significantly outside domestic and international law. The human and environmental damage that is occurring from secret U.S. operations and suppression of critical intelligence is already profound. U.S. life expectancy is falling. Inequality is rising.

The potential future scenarios have implications for all of us—whether citizen or investor—across the globe.

Caveat Emptor

The time has come to invoke the ancient rule of "Caveat Emptor"—Buyer Beware. The U.S. government will not provide you with adequate disclosure. Nor will the U.S. Congress, the media, the primary and secondary dealers, or the rating agencies.

If you are financing this machinery—as you pay taxes, buy Treasury securities, or work for the operations—you are responsible for understanding what you support. You are responsible for assessing and pricing the quality of the credit and the promises you are getting, as they really are, whether through a Treasury bond or a pension fund promise. You are responsible for the spiritual and moral implications of what you are supporting and what you pretend not to know despite your legal responsibilities. If you want the rule of law to apply to you, then you must take responsibility to withdraw from financing the absence of the rule of law or face the consequences. If you are a U.S. citizen, consider the words of Edward R. Murrow: "*We can deny our heritage and our history, but we cannot escape responsibility for the result. There is no way for a citizen of a republic to abdicate his responsibilities.*"

Please do your own due diligence and make your own decisions about what is happening and what you should do. I hope that the *2018 Annual Wrap Up* will assist you in this task.

Related Reading

The Solari Report's public collection on the missing money can be found at **https://missingmoney.solari.com**.

Chapter II. Caveat Emptor: Why Investors Need to Do Due Diligence on U.S. Treasury and Related Securities

By Catherine Austin Fitts and Carolyn A. Betts, Esq., February 18, 2019

"There can be no time, no state of things, in which Credit is not essential to a Nation…"
~Alexander Hamilton, "Report on a Plan for the Further Support of Public Credit," 1795

I. Introduction

Investors have experienced challenging times since the change in U.S. Presidential administrations in 2017 initiated a period of reverse globalization with continuous changes in tax, trade, and other U.S. federal policies. Unnoticed in the fray is the October 2018 adoption by the U.S. Congress and Administration of an obscure federal accounting policy that signifies the most important change in the balance of power between the public and private sectors, between overt and covert operations, and between the democratic and fascistic aspects of the American political system: Federal Accounting Standards Advisory Board Statement of Financial Standards 56 ("FASAB 56" or "Statement 56").

In simple terms, FASAB 56 claims to override the last 230 years of U.S. Constitution and financial management laws and accounting conventions established by the American Institute of Certified Public Accountants (AICPA). The policy allows approximately 170 federal reporting entities to shift amounts from line item to line item, and sometimes even omit spending entries altogether, in their financial statements if "national security" purposes make it necessary to avoid revealing classified information.

Essentially, the federal government has adopted an accounting and public reporting policy that allows a small group of unelected individuals with security clearances and "need to know" access to information to engage in secret processes to establish and maintain separate sets of classified secret books in most federal agencies and "component" entities. It also allows members of this group to purge from the publicly available financial statements anything the group deems to be worthy of national security protection. With the implementation of FASAB 56, when added to existing disclosure exemptions for national security and classified information that apply to the U.S. Treasury, federal agencies, banks, and companies doing business with the federal government and making a market in their securities, the greater part of the U.S. securities market has now effectively gone dark. This development, taken together with the growth of index funds, means that almost no one is "watching the store."

In our opinion, FASAB 56 is particularly sobering in light of the events of the thirteen months leading up to its issuance. The extent to which mandatory market disclosure has been reduced by Statement 56 and the events that inspired its issuance constitute "material facts" within the meaning of SEC's Rule 10b-5[1] to which investors surely are entitled. Consequently, these changes call for global and domestic investors—both individual and institutional—to exercise a new and greater level of due diligence in reaching an understanding of the U.S. Federal credit and its risks.

We believe the changes brought about by Statement 56 will materially affect the accuracy of current methodologies applied in both credit evaluation of issuers and valuations of their securities. Since current market pricing and credit evaluations do not reflect the new risks inherent in non-disclosure of key information to the investment decision, the prudent investor, with this new information in hand, may be embarking upon a lonely journey for some period of time.

In this article, we explain, with reference to other materials available on The Solari Report site, that it is no longer prudent for the investor to rely solely upon primary and secondary securities dealers, the U.S. rating agencies, and mandatory disclosure by issuers to accurately assess the risks and values of certain securities. While we encourage investors to do their own due diligence, we also recognize that FASAB 56 eliminates any hope that the investor will be able to obtain sufficient information to accurately assess the credit and value of his or her holdings of U.S. Treasury and other securities whose values are affected by Statement 56 (i.e., a meaningful percentage of U.S. public and private equity and debt securities).

The central-banking warfare model that has been the basis of the success of the Western world for 500 years is undergoing significant stress. The Bretton Woods system that has formed the structure for global trade since World War II is also unraveling. In this process, the secrecy and conflicts of interest that thread throughout the governance and management of the U.S. federal credit—whether by the government or the related financial institutions, market makers, investors, and contractors—have reached a point where the ancient rule of *caveat emptor* ("buyer beware") applies.

You are responsible for doing your own due diligence. We hope the materials that we have assembled in this article and in the *2018 Annual Wrap Up: The Real Game of Missing Money* will help you do so.

II. Which Securities and Financial Assets Are Affected by FASAB 56?

What securities and other financial assets are affected directly or indirectly by the credit of the U.S. government and market values of its securities? Here is a preliminary list to help investors determine which of their holdings may be affected by a material fact or change like FASAB 56.

U.S. Treasury Bills, Bonds, and Notes

Full faith and credit securities issued directly by the U.S. government that have been recorded on the official books and records, whether in terms of the payment of interest or to "roll over" or pay off at maturity. This category includes short-term T-bills and notes, medium- and long-term Treasury securities, savings bonds, and similar securities.

Official statistics indicate that the following are the holders of the officially outstanding $21.21 trillion of National Debt as of June 30, 2018:

- U.S. investors: $6.89 trillion—32.5%
- Federal Reserve: $2.38 trillion—11.2%
- U.S. government: $5.73 trillion—27%
- Foreign investors: $6.21 trillion—29.3%

See here: **https://hudmissingmoney.solari.com/us-debt-holders/** for more on U.S. debt holdings. Note that U.S. government securities (together with, in some cases, full faith and credit securities and Government-Sponsored Enterprise [GSE] securities) are the only securities that can be used for various purposes by certain other entities, e.g., to support bank and broker-dealer reserve requirements and for corporate and municipal bond sinking funds. If any downgrade of these reserve securities were to occur, there could be an automatic bond default or default by banks or broker-dealers in satisfying their statutory reserve requirements, resulting in a cascade of defaults and margin calls throughout the investment economy.

Other U.S. Full Faith and Credit Securities

Full faith and credit securities issued or guaranteed by a government agency and backed by the full faith and credit of the U.S. government. This category includes other securities, including securities guaranteed by Ginnie Mae, for which the U.S. government guarantees unconditional and timely payment of principal and interest. FHA issues debentures that carry the full faith and credit of the U.S.

Mortgage Securities Backed by Secured U.S Insured/Guaranteed Loans

Mortgage-backed securities comprising mortgages guaranteed or insured (usually not 100%) by FHA, VA, and the Rural Housing Administration. These securities are not "full faith and credit" because they are not unconditionally guaranteed (there being conditions to payment and delays in payment), and the guarantees and insurance do not cover 100% of outstanding principal and interest. Their collateral involves, however, direct insurance or guarantees by the U.S. government.

Pools of Unsecured U.S. Guaranteed Loans

Interests in pools of student loans and other similar unsecured federal government-guaranteed loans. These securities are subject to certain risks that are not guaranteed by the federal government, including a lack of collateral and administrator and similar risks (e.g., that the loans have not been serviced or originated properly), but the underlying loans are federally guaranteed if all conditions are satisfied.

Money Market Funds—U.S. Government Only

Units in money market mutual funds that hold Treasury securities, federally secured certificates of deposit, and other short-term securities that are dependent upon federal government credit. These securities have outside, issuer-related risks as well and, therefore, trade at greater discounts than do the underlying securities.

U.S. Government-Sponsored Enterprise (GSE) Securities

Securities issued by traditional government-sponsored entities:

- Freddie Mac and Fannie Mae securities
- Connie Lee securities (college loans)
- Federal Home Loan bank securities (backed by residential loans)
- Federal Agricultural Mortgage Corporation (Farmer Mac) (backed by farm loans)
- Securities issued by Federal Farm Credit Banks Funding Corporation (Farm Credit)

GSEs are private companies operating under government charters. Their securities (except to the extent risk has been transferred elsewhere) carry only an "implicit" guarantee of the U.S. government and have relatively high ratings because it is assumed (as was the case during the Financial Crisis for Fannie Mae and Freddie Mac securities and for Farm Credit Program securities during the 1988 bailout) that the U.S. government will make good on the agency guarantee if the agency is unable to do so. In case of a significant U.S. government credit downgrade, it is unlikely that investors in these securities could depend upon the government for payment.

U.S. Insured Deposits

Bank, savings and loan, and credit union deposits guaranteed by the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA). Both FDIC and NCUA have funding through user fees payable by the banks, savings and loans, and credit unions whose deposits they back, but the funding is not sufficient to cover all deposits and, therefore, there is a risk that the U.S. government will be called upon to fund any shortfall in claims by depositors.

Corporate Contractor Bonds and Stocks

Equity and debt securities issued by government contractors reliant for their business upon contracts with the federal government. The largest U.S. government contractors include the typical defense contractors like Lockheed Martin, General Dynamics, Boeing, Raytheon, BAE Systems, Bechtel, and Northrup Grumman; IT and service contractors like L3 Technologies, Hewlett-Packard, Leidos, Booz Allen

Hamilton, and CACI; and other companies that are not as associated with defense contracting but for which a large percentage of business involves government contracting, like UnitedHealth, Humana, Verizon, McKesson, General Electric, Accenture, Deloitte, Merck, Corrections Corporation of America, FedEx, AT&T, Berkshire Hathaway, and the State of California.[2]

Fed Member Bank Bonds, Stocks, and Derivatives

Equity and debt securities of Federal Reserve Bank members, whose capital positions and profits depend upon favorable borrowing rates from the Federal Reserve, which in turn borrows at favorable rates from the federal government. This includes members of the New York Fed and others of the twelve Federal Reserve banks that provide depository functions for the U.S. government and may be legally liable for any illegalities in the management of and transaction in federal funds and assets. This category also includes securities of banks and securities dealers whose capitalization depends upon their holdings of brokered deposits or repo agreements backed by Treasury securities.

U.S. Primary Dealer and Exchange Stabilization Fund Agent Bonds, Stocks, and Derivatives

Securities of banks that manage the sales of Treasury securities (primary dealers) and that assist in the New York Fed agent function for the Exchange Stabilization Fund for the Federal Reserve acting as agent for the U.S. Treasury (JPMorgan Chase, UBS, Goldman Sachs). Note that if illegal transactions were conducted over the years following World War II through the Exchange Stabilization Fund, or if there were questionable gold transactions by these same "bullion banks" on behalf of the Federal Reserve, the liabilities of the banks that implemented these transactions could be material. See here: **https://hudmissingmoney.solari.com/primary-dealers-of-u-s-government-securities/** for a list of the primary dealers in U.S. government securities and here **https://hudmissingmoney.solari.com/top-broker-dealers/** for a list of the top fifteen broker dealers based on their assets under management in 2018.

U.S. State and Local Government Municipal Bonds and Notes and Municipal Money Market Securities

State and local governments, particularly those with significant unfunded liabilities, that are highly dependent on funding from the federal budget in amounts in excess of the related federal taxes paid from their jurisdictions and municipal money markets using these notes and bonds.

Corporations and Financial Institutions with Fixed Income Investments—Stocks, Bonds, and Related Insurance Contracts

Any companies with large investment portfolios or pension funds with large holdings of any of the foregoing securities or financial assets.

Cash

Clearly, deterioration in the U.S. federal credit continues to debase the spending power of the U.S. dollar.

III. The Rating Agencies

There are three major U.S. nationally recognized statistical rating organizations (NRSROs) according to standards promulgated by the Securities and Exchange Commission:[3]

- Standard & Poor's (S&P)
- Moody's
- Fitch Group (which is dual-headquartered in New York and London and controlled by Hearst)

These three agencies are responsible for rating approximately 95% of rated securities globally.[4,5]

The SEC permits issuers of bonds with high NRSRO ratings to use short-form prospectuses and permits money-market mutual funds to purchase only securities with high NRSRO ratings. NRSRO ratings also are used in satisfying net capital requirements by banks; broker-dealers and insurance regulators use credit ratings from NRSROs to ascertain the strength of the reserves held by insurance companies.

Due to the reliance of regulators upon NRSRO ratings, such ratings have become a requirement for many private-sector transactions (e.g., for pension funds and banks) and are the basis for favorable analyst reports in the fixed-income market. Unfortunately, investors have a tendency to rely solely upon ratings rather than also doing their own due diligence in making purchase decisions.

The reputations of the ratings agencies suffered significantly as a result of their failure to do proper due diligence in rating mortgage-backed securities leading up to the 2008-2012 Financial Crisis. The rating agencies earn fees from the issuers. They had clearly bowed to the practices and wishes of the issuers and—no doubt—the wishes of the Fed, the U.S. Treasury, and other federal agencies that engineered the mortgage bubble.

One might rely on their failure to rate outliers whose securities present obviously unacceptable risks (and therefore have "junk" status), but if an entire sector faces the same risk (e.g., reliance on U.S. credit) that has been, traditionally, *de minimis*, the likelihood that the rating agencies will downgrade a whole class of securities is minimal.

In the words of the *Conclusions of the Financial Crisis Inquiry Commission*[6] (January 2011):

> *The three credit rating agencies were key enablers of the financial meltdown. The mortgage-related securities at the heart of the crisis could not have been marketed and sold without their seal of approval. Investors relied on them, often blindly. In some cases, they were obligated to use them, or regulatory capital standards were hinged on them. This crisis could not have happened without the rating agencies.*

To demonstrate the likelihood that rating agencies are no longer able to withstand political pressure, notwithstanding post-Financial Crisis attempts to become more independent, witness what happened when, in August 2011, for the first time in history, Standard & Poor's downgraded the U.S. credit from AAA to AA+. A furor ensued. In order to mend its relationship with the U.S. government, eighteen days after the U.S. debt was downgraded, S&P asked its then-CEO, Devin Sharma, to step down. Think about this for a minute. The CEO of a rating agency was fired for allowing his rating analysts to issue a perfectly reasonable rating change on the U.S. government's credit.

Subsequently, the Department of Justice (DOJ) initiated an investigation into S&P's role in the rating of several mortgage-backed securities that played a role in the 2008 Financial Crisis. In February 2013, DOJ and nineteen states' attorneys general and the DC U.S. Attorney filed a $5 billion lawsuit against S&P and its parent company, McGraw-Hill, based upon the findings in the investigation, which was settled two years later for $1.375 billion. Neither of the other major rating agencies, which had not downgraded the U.S. credit but had joined S&P in the Financial Crisis debacle, was subject to such a lawsuit. This was a clear warning shot fired to prevent any rating agency from considering any future such downgrades.

In our opinion, no U.S. rating agency can downgrade the U.S. government or issue a watch-list warning on the U.S. federal credit without jeopardizing its existence as well as that of its holding company. Such a rating action could also threaten the physical, financial, or legal security of its executives or board members.

In short, a "prudent man" in the U.S. should not rely solely on the U.S. rating agencies with respect to ratings of U.S. Treasury and related securities.

IV. Laws Related to U.S. Monetary and Fiscal Policy

To understand FASAB 56 and the immediate events leading to its issuance, it is essential to understand the U.S. laws related to U.S. monetary and fiscal policy.

Learning the law related to U.S. federal finances is challenging if you have not gone to law school. To ease the task, The Solari Report commissioned attorneys Michele Ferri and Jonathan Lurie to prepare briefing papers to summarize the legal infrastructure of the U.S. federal financial system.

These papers, including one on FASAB 56, are available in this volume (Chapter IV. U.S. Federal Finances: The Law) and at **https://hudmissingmoney.solari.com/us-federal-finances-the-law/**. They are available to the public at **https://constitution.solari.com**.

Monetary: Federal Reserve

1. The History and Organization of the Federal Reserve: The What and Why of the United States' Most Powerful Banking Organization

Fiscal: U.S. Treasury

2. The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause
3. The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them
4. The Black Budget: The Crossroads of (Un)Constitutional Appropriations and Reporting
5. Federal Accounting Standards Advisory Policy #56: Understanding New Government Financial Accounting Loopholes
6. National Security Exemptions and SEC Rule 10b-5
7. Classification for Investors 101

We hope these assist you in understanding the legal infrastructure created by the federal government budget, management, and reporting laws.

V. FASAB 56: Recent Events Leading Up to FASAB 56

Catherine Austin Fitts served as Assistant Secretary of Housing-Federal Housing Commissioner in the Bush I Administration from 1989-1990. At the time, the Federal Housing Administration (FHA) at the Department of Housing and Urban Development (HUD) had a $320 billion portfolio of mortgage insurance-in-force and was originating $50-$100 billion in mortgage insurance annually.

During that period, Catherine led the reform of the FHA financial and reporting operations, working closely with the Government Accountability Office (GAO) and the Office of Management and Budget (OMB). These efforts included designing the relevant titles in the HUD Reform Act of 1989. In creating a new financial model for FHA's and HUD's financial operations, the FHA was returned to a financially sound basis during that period. The Administration adopted the model on a government-wide basis under subsequent financial management laws. (See "The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them," page 109 and here: **https://hudmissingmoney.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**.) In implementing these changes, Catherine became knowledgeable regarding financial management and reporting practices in the U.S. mortgage programs, at HUD, and in federal agencies in general.

After leaving the Administration, Catherine started an investment bank and financial software developer, The Hamilton Securities Group. In 1993, Hamilton won a competitive-bid contract to serve as the lead financial advisor and portfolio strategist for the FHA and served in that capacity until 1997—leading $10 billion of highly successful sales of defaulted mortgage loans from the FHA-"held" mortgage portfolio (i.e., loans as to which FHA had paid off insurance claims by lenders and then taken title to the loans). Hamilton was able to more than double FHA's recovery rates on these loans and generate $2 billion of increased returns to the FHA Funds. Hamilton's assigned tasks involved developing significant software tools and databases to make FHA's portfolio, originations, and markets transparent to decision-makers. Hamilton also developed software that used geographic information system (GIS) applications to map federal resources in counties and Congressional districts.

The highly political termination of Hamilton's relationship with FHA in 1997 and the seizure, destruction, and ultimate theft of Hamilton's software tools and databases was followed by a decade of bill-collecting litigation, with Hamilton emerging as the winner and finally settling with the Department of Justice in 2006. Carolyn Betts had been an investment banker with Hamilton, served as general counsel to Hamilton, and continues to serve as general counsel to Hamilton's successor corporation, Solari, Inc. These events have been described in Catherine's online book *Dillon Read & Co. Inc. & the Aristocracy of Stock Profits* **https://dillonreadandco.com**, which includes, in the Resources section, an extensive litigation section and supporting documentation. This case study is one of the best documented examples of the extent to which the federal government and supporting media, financial institutions, and private interests will go, no matter the expense, to destroy efforts to bring transparency to the federal credit—in this instance in the mortgage and securities markets.

In 2000, during the litigation period, Carolyn was reviewing HUD-related documents posted on the GAO website and found the testimony of HUD Inspector General Susan Gaffney before the House Committee on Government Reform, Subcommittee on Government Management, Information and Technology on the "Status of Financial Management at HUD" in which Gaffney explained her refusal to certify HUD's financial statements for FY 1999 as required by law. She described unaccountable voucher adjustments in FY 1998 and FY 1999 of $17 billion and $59 billion, respectively, along with failure of the installation of new computer systems (HUDCAPS) and unsupervised access to accounting systems and information by HUD contractors. Given the financial controls and resources that Catherine had seen put in place, these discrepancies should not have been possible. Her conclusion: the only logical explanation was significant fraud and illegal transactions.

One of the reasons we picked up on this so dramatically was that we had been told in April 1997 by the President of CalPERS, the largest U.S. pension fund, that "we" were going to be moving all the money out of the country in the fall (which was the beginning of federal fiscal 1998). Originally, we assumed that this meant the pension funds and large institutional investors were increasing their allocations to offshore investments, particularly to Asia. After we learned about the $17B and $59B in undocumentable adjustments at HUD, Catherine's view of the CalPERS President's statement changed. See the full story here: **https://dillonreadandco.com/financial-coup-detat-1998/**

Thus began an effort spanning two decades in which Catherine and her companies have worked steadily to bring transparency regarding U.S. federal government financial statements and publicize the government's refusal, or inability, to comply with the laws that mandate responsible financial management and reporting. The total amounts uncovered and publicly available, yet infrequently reported, are now $21 trillion of undocumentable adjustments in the accounts in the Department of Defense (DOD) and HUD.[7] This "missing money," together with the financial bailouts, are what Catherine has referred to as the "financial coup d'état."

For a full description of the history of Catherine's efforts to reform the U.S. federal finances, see "Missing Money: A Personal History—1989 to 2019" in Part Two of the *2018 Annual Wrap Up: The Real Game of Missing Money* **https://hudmissingmoney.solari.com/2019/04/07/missing-money-a-personal-history-1989-to-2019/**.

In 2016, Catherine began writing and speaking about the latest and largest addition to annual undocumentable adjustments at DOD in fiscal 2015: $6.5 trillion. Dr. Mark Skidmore, Morris Chair of State and Local Government and Policy at Michigan State University, heard her and assumed that she was mistaken—no doubt she meant $6.5 billion, he thought. Dr. Skidmore accessed the DOD financial reports and discovered that Catherine was correct. The undocumentable adjustments at DOD for FY 2015 were, in fact, $6.5 trillion. Working with his graduate students, Dr. Skidmore offered to do a survey of financial reports at HUD and DOD for the fiscal years 1998-2015 to identify all reports of undocumentable adjustments. At the time, Catherine had identified $12.5 trillion of such adjustments.

After a thorough review, Dr. Skidmore and his students identified a total amount of undocumentable adjustments of $21 trillion, roughly equivalent to the official outstanding U.S. Treasury debt.

In September 2017, The Solari Report launched a dedicated website at **https://missingmoney.solari.com** to publish Dr. Skidmore's report on the survey results and all of the underlying documentation from DOD and HUD. The site also includes current and past media coverage of the "missing money" and ongoing report updates and radio and Internet interviews by Catherine and Dr. Skidmore. Dr. Skidmore's report is available in Chapter III of this volume (Reports on "Unsupported Journal Voucher Adjustments" for DOD and HUD) and here **https://hudmissingmoney.solari.com/the-real-game-of-missing-money-ii-summary-report-on-unsupported-journal-voucher-adjustments-in-the-financial-statements-of-the-office-of-the-inspector-general-for-the-department-of/**. It is available to the public at the Missing Money site here **https://missingmoney.solari.com/wp-content/uploads/2018/08/Unsupported_Adjustments_Report_Final_4.pdf**.

On October 5, 2017, Dr. Skidmore's team discovered that both the HUD and DOD Offices of Inspector General (OIG) had taken down their financial reports from the Internet. After this fact was highlighted in public interviews with Catherine and Dr. Skidmore, the financial reports were discovered in early December republished at different URLS. By way of explanation, the DOD OIG insisted that the reason for the new URLs was that DOD was reorganizing its website. Because The Solari Report had downloaded the reports before publishing its Missing Money website, readers had uninterrupted access.

Although OIG audit reports in previous years had always been made available online without formal restrictions or evident censorship, a DOD OIG report on a U.S. Navy financial statement for FY 2017 then appeared in heavily redacted form—not just the numbers it contained, but even its title! Only bureaucratic sloppiness enabled the readers to see that the report concerned Navy finances (because the censors had missed some of the references to the Navy in the body of the report). A request to the OIG for an uncensored copy was met with the response, "[i]t was the Navy's decision to censor it, and we can't do anything about that." Senator Chuck Grassley also requested that the OIG uncensor the report. Again, the OIG refused.

As explained in more detail in "FASAB Statement 56: Understanding New Government Financial Accounting Loopholes" (see page 138) **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**, FASAB 56 came about just as the Department of Defense was about to announce that after almost 28 years of failing to produce audited financial statements (notwithstanding legal requirements to do so) and the revelations of approximately $21B in unsupported journal voucher adjustments against Treasury, the 2018 fiscal- year clean audit under generally accepted accounting procedures (GAAP) DOD had been promising (again—this was one of a number of successive promises) was not to be. Ernst & Young and other independent public accounting firm auditors announced that the task was hopeless because DOD's financial records were "riddled with so many bookkeeping deficiencies, irregularities, and errors that a reliable audit was simply impossible."[8]

To help the investor better understand the events leading up to the issuance of FASAB 56, The Solari Report has provided a chronology available in flexible table form for the *2018 Annual Wrap Up: The Real Game of Missing Money*: (page 00) **https://hudmissingmoney.solari.com/missing-money-chronology/**.

The process of issuing FASAB 56 consisted of the following:

(1) FASAB issued the exposure draft of Statement 56 proposed language ("Exposure Draft") on December 14, 2017, with comments requested by March 16, 2018.

(2) Upon release of the Exposure Draft, FASAB provided notices and press release to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants (AGA) Topics, the *CPA Journal, Government Executive*, the *CPA Letter*, the Chief

Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

(3) FASAB followed up this broad announcement with direct mailings of the Exposure Draft to the following relevant congressional committees: House Homeland Security Committee: Full Committee; House Homeland Security Committee: Subcommittee on Oversight and Management Efficiency; House Homeland Security Committee: Subcommittee on Counterterrorism and Intelligence; Senate Select Committee on Intelligence; House Permanent Select Committee on Intelligence; Senate Armed Services Committee; House Armed Services Committee; House Oversight and Government Reform Committee; Senate Homeland Security and Governmental Affairs Committee; Senate Appropriations Committee; and House Appropriations Committee.

(4) FASAB issued a classified exposure draft of the first Statement 56 Interpretation: "Interpretation of Federal Financial Accounting Standards 56: Classified Activities, July 12, 2018, with comments due by August 13, 2018."

(5) FASAB held two "reading sessions" of the Interpretation exposure draft in a secure room for those it deemed had the appropriate "need to know" and security clearances for two hours on July 18, 2018 (Session One) and for two hours on August 1, 2018 (Session Two). Who attended these sessions? We do not know.

(6) The final version of FASAB 56 was made available to the public on October 4, 2018 (the day that the FBI report on its investigation of Justice Brett Kavanaugh took up the public's attention[9]) and is largely unchanged from the Exposure Draft upon which comments were received from various federal agencies and accounting firms.

In a piece on FASAB 56 for *Rolling Stone* ("Has the government legalized secret defense spending?"), Matt Taibbi captured the timing well in his subtitle: "While a noisy Supreme Court fight captivated America last fall, an obscure federal accounting body quietly approved a system of classified money-moving." Because the adoption of FASAB 56 required the approval of both sides of the aisle in Congress and the White House, the intimate bipartisan cooperation on the adoption of FASAB 56 contradicts the divisiveness portrayed during this period by the media.

While the initial distribution of the Exposure Draft was wide within the accounting community and Congress, and it appeared in the Federal Register, it garnered no attention from mainstream press that we have been able to identify. The final version of FASAB 56 does not differ greatly from the Exposure Draft.

VI. FASAB 56: The Final Statement

The adoption of the new permitted accounting treatment or "standard" by FASAB in FASAB 56 would alter the rules for auditing the books of federal agencies, without any approval of Congress, thereby effectively changing the mandates previously enacted by Congress in various statutes that required first 24 agencies—and then all components (or "reporting entities") of the federal government—to produce unqualified independent financial statement audits.

FASAB 56 could provide a back-door, secret remedy to eliminate the need for reporting unsupported journal voucher adjustments against Treasury in order to balance the books of government agencies: it could allow an agency, under the auspices of "national security," to make unexplained financial statement adjustments in order to achieve an unqualified audit under FASAB standards. And not only can the adjustments be "unaccountable" in terms of purpose, but they can be secret (i.e., classified) and unlimited in amount. By the time we know for sure what the problems with FASAB 56 might be (given the failure of the government to address the previous $21 trillion of undocumentable adjustments), it could be too late to do anything about them.

In reliance upon FASAB 56, in the future, an agency could not only make secret expenditures or liquidations of assets, but, for "national security" purposes, it could go without explaining (except within a small group of "properly cleared" individuals) why the expenditures or asset transfers were made; it also would not have to report to most of Congress or the public how much such expenditures cost taxpayers or the value of the transferred assets. Presumably, the agency could, in the future, achieve an unqualified audit in which only a selected few unelected officials with top security clearances would view the underlying (and classified) support. We concede that these actions might be illegal and not in accordance with the spirit of Statement 56, but in light of past efforts to hide the truth from taxpayers, is it any wonder we suspect a nefarious purpose?

FASAB 56 applies to otherwise-unclassified financial statements of federal agencies and their components—General Purpose Federal Financial Reports (GPFFR). It provides that, in order to protect classified information from disclosure:

(1) An entity may modify information required by other FASAB standards if the effect of the modification does not affect the net results of operations or net position.

(2) A component reporting entity may be excluded from one reporting entity and consolidated into another reporting entity. The effect of this modification may be to change the net results of operations and/or net position.

(3) An entity may apply Interpretations of FASAB 56 that allow other modifications to information required by other FASAB standards, and the effect may be to change the net results of operations and/or net position.

FASAB 56 also allows modifications to be made to unclassified disclosures, required supplementary information (RSI), and required supplementary stewardship information (RSSI) required by other FASAB statements to prevent the disclosure of classified information. This would include financial statement footnotes, for example.

In other words, any modification may be made if it does not change the net results of operations or net position (#1 above). However, a modification may affect the net results of operations or net position if it results from excluding a component from one reporting entity and consolidating it into another (#2 above) or if it results from applying an Interpretation allowing the modification (#3 above). For example, a modification can be a change in one line item (e.g., a subtraction from the amount of the line item) and a corresponding change in another line item (e.g., the addition of the same amount to another line item), resulting in no net change (#1 above); this would have the effect of mischaracterizing the subject of an expenditure, with no explanation or disclosure of the modification.

The second type of permitted modification is a consolidation modification, which results when a component of a reporting entity is moved out of that reporting entity and consolidated into a different reporting entity (#2 above). As an example, the finances of a division of the Navy (which is a reporting entity) could be deleted from the Navy's financial statements and moved (consolidated) into the Army's financial statements. Or, presumably, part of the Army's finances could be moved into (and consolidated with) the operations of HUD or NASA or any other reporting entity.

It appears that the only permitted modification that has the effect of changing the entire federal net results of operations (as opposed to moving money from one part of the government to another part) is when the modification is pursuant to an Interpretation issued by the FASAB that affects statements other than FASAB 56. Thus, an unlimited number of classified Interpretations not available to the public may be issued by FASAB that have the effect of permitting modifications to federal financial statements that misstate bottom-line numbers, and such misstatements may have a material effect on the reporting entities' financial statements. Already, one Interpretation applicable to Statement 56 was issued before Statement 56 became final. Was this to ensure a publicly acceptable level of undocumentable adjustments when the inability to complete the new audit was announced? There is no way to know.

Does this mean that FASAB 56 necessarily will result in no net change in federal government balance sheets (i.e., assets and liabilities) and income statements on a government-wide basis unless some future Interpretation expressly provides for an exception? What damage can be done even if there is no net change, government-wide?

In theory and at first blush, it may appear that, in the absence of an Interpretation to the contrary, there would be no net change and therefore no "harm." However, that would be the case only if no one cares whether a government asset is listed as, for example, gold or land or a claim against a foreign government—or whether an expenditure is listed as a loss on FHA insurance on an apartment complex or an expenditure for food stamps or a bribe to a foreign dictator. There are also fact patterns under which the net position can remain unchanged notwithstanding manipulation of accounts for purposes like the funding of secret mercenary armies.

But if there is no requirement that Congress or the public be informed of the number or amount of modifications or the nature of the expenditures or assets modified, how can anyone know whether even FASAB 56 requirements are being followed? And we wonder whether FASAB 56, in limiting modifications (except those pursuant to Interpretations) to those that do not have the effect of changing results of operations, would nevertheless permit modifications within the same reporting year that, if reported on a date other than the end of the fiscal year, would have the effect of changing net results of operations.

In other words, suppose that in October a reporting entity (e.g., the Department of the Army) were to transfer the title to a $10B satellite to a government contractor, creating an undocumentable journal voucher adjustment against Treasury in the form of a $10B debit against U.S. government assets. As long as, before September 30 of the following calendar year, there is a $10B undocumentable journal voucher adjustment against Treasury in the form of a credit to the balance sheet of the Army or any other reporting entity, there is no year-end net effect on the overall government's results of operations.

Will the government's independent accountants—who, in the future, are to issue unqualified audit letters as a result of permitted and undisclosed modifications pursuant to FASAB 56 and future, potentially classified, Interpretations—have access to classified information so that they can certify that the requirements of both FASAB 56 and future Interpretations and their professional obligations under SAS 122 have been satisfied? (See Kearney comments on the Exposure Draft in Appendix B.) It appears maybe not.[10] The only reference to this subject in the final Statement (other than disclosure of the six-step process for the issuance of Interpretations) is this:

> *"[D]uring the audit, the preparer [i.e., governmental reporting entity] would inform the properly cleared auditor whether and how this Statement and related Interpretations were applied. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles."*

The six-step process as outlined in the FASAB Memorandum of Understanding (MOU) provides for "proper clearance," including execution of a non-disclosure agreement and demonstration of a "need to know" regarding the classified information. Whether and how many independent public accountants providing audit opinions will be granted the "proper clearance" is left unstated, leaving the reader with only a reference to standard procedures for classified information.

Those who have not experienced the procedures for an independent audit of financial statements by an independent public accounting firm may not know that such a firm depends to a great extent upon various certifications by officers of the audited reporting entity, and the audit opinion is qualified to the extent of such assurances. Therefore, it may be that future auditors of government financial statements will place even greater reliance upon managerial certifications than they ordinarily would because support in the form of records is not made available to them. If auditors do not have access to all classified information taken out of the GPFFR unclassified statement, it seems a fair question how government agencies can be said to have satisfied statutory requirements that they produce audited financial statements. How will independent auditors of such financial statements issue "clean" audit opinions if they cannot follow the procedures required by the AICPA under SAS 122?

The various comments received by FASAB on the Exposure Draft of FASAB 56 are instructive. See Appendix B for a detailed description of the seventeen comment letters from accounting firms and organizations and federal agencies.

VII. FASAB 56: What Is the "National Security" Information that May Be the Subject of Modifications?

Executive Order 12356, "National security information," was issued by President Ronald Reagan, on April 2, 1982. According to Executive Order 12356, which set forth U.S. classification policy, information is considered classified if it concerns:

- Military plans, weapons, or operations
- The vulnerabilities or capabilities of systems, installations, projects, or plans relating to the national security
- Foreign government information

- Intelligence activities (including special activities), or intelligence sources or methods
- Foreign relations or foreign activities of the United States
- Scientific, technological, or economic matters relating to the national security
- United States government programs for safeguarding nuclear materials or facilities
- Cryptology
- A confidential source
- Or other categories of information that are related to the national security and that require protection against unauthorized disclosure as determined by the President or by agency heads or other officials who have been delegated original classification authority by the President.

Any determination made under this subsection must be reported promptly to the Director of the Information Security Oversight Office (ISOO). The ISOO is a component of the National Archives and Records Administration. It receives policy and program guidance from the National Security Council. ISOO is responsible to the President for policy and oversight of the government-wide security classification system and the National Industrial Security Program.

Those with original classification authority are the President, agency heads, and those to whom agency heads delegate this authority. Under Executive Order 13526, which was issued by President Barack Obama in 2009, government contractors and others may play a role in classifying information. Thus, the Order provides:

> *"[W]hen an employee, government contractor, licensee, certificate holder, or grantee of an agency who does not have original classification authority originates information believed by that person to require classification, the information shall be protected in a manner consistent with this order and its implementing directives. The information shall be transmitted promptly as provided under this order or its implementing directives to the agency that has appropriate subject matter interest and classification authority with respect to this information. That agency shall decide within 30 days whether to classify this information."*

Under Executive Order 13526, automatic declassification is the declassification of information based upon the occurrence of a specific date or event as determined by the original classification authority; or if the original classification authority was unable to specify a date, the expiration of a minimum of ten years from the classification date (unless the original classification authority determines the sensitivity of the information requires classification for a maximum time frame of 25 years).

Only 25-year-old or older records that have been determined to have "permanent historical value" in accordance with title 44, U.S. Code are subject to automatic declassification. Agency heads may exempt 25-year-old, permanently valuable classified records from automatic declassification only when the information contained in them has been determined to satisfy one or more of the exemption categories in section 3.3(b) of Executive Order 13526. Information exempted from automatic declassification under this section remains subject to the mandatory and systematic declassification review provisions of the Order; no information may be classified indefinitely.

Only information that reveals one of the following is exempt from automatic declassification:

- The identity of a confidential human source
- Information that would assist in the development, production, or use of weapons of mass destruction
- Information that would impair U.S. cryptologic systems or activities
- Information that would impair the application of state-of-the-art technology within a U.S. weapon system
- Formally named or numbered U.S. military war plans that remain in effect, or operational or tactical elements of prior plans that are contained in such active plans
- Information, including foreign government information, that would cause serious harm to relations between the United States and a foreign government, or to ongoing diplomatic activities of the United States
- Information that would impair the current ability of United States Government officials to protect the President, Vice President, and other protectees for whom protection services, in the interest of the national security, are authorized
- Information that would seriously impair current national security emergency preparedness plans or current vulnerabilities of systems, installations, or infrastructures relating to the national security
- Information that would violate a statute, treaty, or international agreement that does not permit the automatic or unilateral declassification of information at 25 years

In other words, classification, or the rendering as secret from the public, of information known to the U.S. government is largely within the control of the Executive Branch, with little oversight by the Judiciary or Congress, although we have no way of knowing what, if any, disclosure is voluntarily made to members of Congress (who, as we see below, are not required to obtain security clearances) and their staff members or to members of the Judiciary to the extent necessary for the Judiciary or Congress to carry out their respective Constitutionally-mandated responsibilities.

What about Congressional members? According to the CIA website, all members of Congress have access to intelligence by virtue of their elected positions. They do not receive security clearances per se. Congressional staffers who require access to intelligence in connection with their official duties receive security clearances based on background investigations conducted by the FBI. As a general rule, only committee staffers receive clearances; those in members' personal offices do not.

While it may be true that members of Congress theoretically have access to classified budget information, classified intelligence reports are routinely provided only to the committees that have responsibilities in the national security area. Members of these committees receive preference from the intelligence community in satisfying their requests on an individual basis. Among the national security committees, the intelligence committees and their members are accorded "preferential treatment." Committees that do not have national security responsibilities and individual members who do not serve on national security committees may request intelligence support but are typically given a "lower priority." As for legislation involving national security matters, the intelligence community usually is asked to provide briefings that are open to the entire body. These are ordinarily arranged at the request of the leadership in either house and are held in a secure briefing room on the fourth floor of the U.S. Capitol.

The National Security Act states that Congress must be kept "fully informed" of significant intelligence activities, but many presidents have interpreted this clause to mean they only need to notify the "Gang of Eight" rather than the full membership of the congressional intelligence committees. The Gang of Eight consists of the Senate and House majority and minority leaders, and the chairs and ranking members of the House and Senate intelligence committees.

The leadership in each chamber—the majority and minority leaders of the Senate and the speaker and minority leader of the House of Representatives—are ex officio members of their respective intelligence committees and have access to intelligence held by the committees. Typically, a member of each leader's staff serves as liaison to the intelligence committee, keeping up with the committee's activities and serving as a conduit for information to his or her boss. Each of these Congressional leaders also has staff responsible for national security issues who can make independent requests to the intelligence community for support —which may include briefings and/or written analysis.

The two intelligence committees (House Permanent Select Committee on Intelligence and Senate Select Committee on Intelligence) are the repositories of most intelligence shared with Congress. Their offices and hearing rooms are physically located in vaulted areas that meet the CIA standards for storage and discussion of information relating to intelligence sources and methods. They review the annual intelligence budget submitted by the President, oversee the operations of intelligence agencies, and prepare legislation for appropriations to them.

Rep. Adam Schiff (D-CA) is the Chairman of the House Permanent Select Committee on Intelligence, and Rep. Devin Nunes (R-CA) is its Ranking Member. There are twenty-four members on this House committee—fourteen Democrats and ten Republicans. Senator Richard Burr (R-NC) is the Chairman and Senator Mark Warner (D-VA) the Vice Chairman of the Senate Select Committee on Intelligence. Nineteen members serve on this committee—ten Republicans and nine Democrats. As of February 2019, members on one of these two committees and Steny Hoyer (D-MD), as House Minority Leader and member of the Gang of Eight, represented eighteen states and districts in an additional nine states.[11] Thus, more than half of the country and all of the largest states are represented by a Member of Congress with access to classified information (if they so choose).

Most national security appropriations appear as a single lump sum in the defense budget. Each appropriations committee (i.e., House and Senate) has a defense subcommittee that holds most of the control over the intelligence budget. Rep. Pete Visclosky (D-IN) in the House and Richard Shelby (R-AL) in the Senate are chairmen of these committees, which have a total of eleven members each.

What does the information in this section tell us?

First, a lot of members of Congress representing investors in many, if not most, states have access to and power to obtain information and exercise oversight or spending authority over intelligence matters and, presumably, classified financial information or financial information involving classified projects and programs. These representatives, particularly the relevant committee chairmen and House and Senate leadership, know the issues involved and the type of information that is behind the "national security" shield and have the wherewithal, if they wanted, to stop an a FASAB standard that would mislead the American people.

Given the refusal of Congress to enforce the Constitution and financial management and reporting laws to date, we see no reason why they would start now, other than through the intercession of significant political or investor pressure. It should be noted that the primary source of campaign contributions is increases in capital gains from real estate and stock market value of major corporate and wealthy contributors. Consequently, the conflict of interest between the interests of Members of Congress in raising campaign contributions and any dedication they may have to transparency in the financial statements of major government agencies, contractors, and banks is clear. See the case study involving private prison stock profits in Catherine's *Dillon Read & Co. Inc. & the Aristocracy of Stock Profits* here: **https://dillonreadandco.com/** for a detailed description of how privatization can increase government costs in a manner that generates enormous amounts of stock profits and campaign contributions.

Catherine learned while serving as Assistant Secretary of Housing that through FHA's General Fund, HUD had what amounts to a put on the Treasury: at the end of each year, since the General Fund was not expected to be operated on a self-supporting basis (i.e., with mortgage insurance premiums covering claims and expenses), HUD merely sent a bill to Congress for the net deficit, with no obligation to account to Congress or provide a breakdown of the losses. Carolyn Betts learned while employed at Hamilton Securities, then FHA's lead financial adviser, that FHA's complete second mortgage portfolio was available only on a Lotus spreadsheet kept on a single HUD employee's hard drive. These observations form just the tip of the iceberg of financial management loopholes available, at least at that time, for hanky-panky by those having an interest in manipulating numbers for the benefit of third-party interests. For those who wish to learn more about HUD hanky-panky as an example of the numerous loopholes in the federal system, see "Missing Money: A Personal History—1989 to 2019" in Part Two of this *2018 Annual Wrap Up.*

Second, there are a lot of subject matter areas that could, arguably and with some stretch of the imagination, be lumped into "classified" or "national security" or "intelligence" information, particularly in the catch-all category of "other categories of information that are related to the national security and that require protection against unauthorized disclosure as determined by the President or by agency heads or other officials who have been delegated original classification authority by the President."[12] And even government contractors have a shot at seeing to it that information they generate may become classified. On the other hand, at least in theory, most classified information is automatically declassified within ten years; only a select few categories of classified information can remain classified for ten to twenty-five years, and virtually no classified information that a typical investor would consider important in everyday life may remain legally secret for more than twenty-five years.

Third, given the complexity of the workings and finances of the many intelligence agencies, House and Senate intelligence committee staffers, with their required security clearances, have a great deal of power to influence appropriations for intelligence programs and projects and to keep key intelligence committee members informed about relevant issues.

Fourth, the President of the United States, or those who control him or her and the information he or she is given, and the Director of National Intelligence[13] exercise virtually complete control over what the public can know or find out about anything the President determines in his or her sole and complete discretion, without any oversight, to be a matter of "national security."

Finally, with reference to the history of HUD's hundreds of billions in undocumentable adjustments since FY 1998 and its inability to produce audited financial statements, it is difficult to imagine what "national security interest" could be served by making modifications to HUD and FHA financial statements under FASAB 56. However, such authority has been provided.

Oliver North's statement alleged by one whistleblower that "HUD is the candy store of covert operations" and the statement by the chief of staff of Senator Kit Bond (chairman of the Senate HUD appropriations committee at the time of HUD's first undocumentable adjustments and audit failure) that "HUD is being run as a criminal enterprise" come to mind. In light of Catherine's experience while serving as HUD's Assistant Secretary-FHA Commissioner that the FHA portfolio included properties for which insurance claims had been paid after no debt service whatsoever had been received from day one (at least once capitalized interest had been used up), is there any reason to believe that HUD's books, with many billions of dollars of credit and other assets, could not have been used to launder secret and illegal government cash flows? After all, in order to hide a billion dollars in illegal expenditures or the transfer of billions of dollars of assets out of the government, one would have to find a government agency with billions of dollars on its books. HUD's FHA Fund is just such a potential hiding place.

VIII. Existing Securities Laws that Have the Effect of Reducing Transparency for National Security Purposes

The U.S. government agency responsible for integrity and full disclosure in the U.S. securities markets is the Securities and Exchange Commission (SEC). The four primary post-Depression laws enforced by the SEC are the Securities Act of 1933 ("Securities Act") governing the issuance of securities; the Securities Exchange Act of 1934 ("Exchange Act") governing secondary sales of securities and regulation of public companies; the Investment Company Act of 1940 ("Investment Company Act") regulating mutual funds; and the Investment Advisers Act of 1940 ("Advisers Act") regulating investment advisers. Historically, the emphasis of most SEC laws and the rules and regulations promulgated under these acts is one of complete disclosure of material information about securities, the securities markets, and the market participants (advisers, primary and secondary market dealers, and issuers). It is, therefore, a major development in the regulation of the issuance and sale of U.S. securities when the primary enforcer of transparency in the markets promulgates exemptions from disclosure requirements for the stated purpose of protecting U.S. government classified information.

The first SEC exemption for classified information occurred when, on May 24, 1968, SEC promulgated Rule 0-6 under the Exchange Act (17 CFR § 240.0-6), entitled "Disclosure detrimental to the national defense or foreign policy." Rule 0-6 provides in pertinent part:

> *(a) Any requirement to the contrary notwithstanding, no registration statement, report, proxy statement or other document filed with the [Securities Exchange] Commission or any securities exchange shall contain any document or information which, pursuant to Executive order, has been classified by an appropriate department or agency of the United States for protection in the interests of national defense or foreign policy.*
>
> *(b) Where a document or information is omitted pursuant to paragraph (a) of this section, there shall be filed, in lieu of such document or information, a statement from an appropriate department or agency of the United States to the effect that such document or information has been classified or that the status thereof is awaiting determination.… A registrant may rely upon any such statement in filing or omitting any document or information to which the statement relates.*

This rule operates as an exemption from SEC rules and regulations that would otherwise require the disclosure in a public filing of material classified information or documents in connection with the public offering of a security (by, for example, a government contractor working on a classified project) and reporting requirements under the Exchange Act applicable to public reporting companies, which require, among other things, the filing of annual financial statements certified by an independent accounting firm (i.e., so-called "audited" financial statements).

To date, the SEC has provided no publicly available guidance on whether this rule prohibiting the public disclosure of information might render a securities prospectus misleading for purposes of the antifraud provisions of Rule 10b-5 (17 C.F.R. 240.10b-5), which states in pertinent part:

> *It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,*
>
> * * * *
>
> *(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading*
>
> * * * *
>
> *in connection with the purchase or sale of any security.*

Rule 10b-5 and several similar rules permit potential recovery of losses by a purchaser or seller of any security (public or private) who later experiences a loss attributable to a misrepresentation of the counterparty (i.e., seller or purchaser, respectively) or failure of the counterparty to disclose information that—if disclosed or disclosed accurately—would have affected the aggrieved party's decision to purchase or sell the security. In other words, if the issuer of a security, say, a government contractor that builds weapons systems, fails to provide material information about a key project or provides misleading information about the project that might cause a potential investor in the security not to purchase or sell the security—and the potential investor purchases or sells the security on the basis of the false, misleading, or omitted information, the security value drops, and the holder of the security sells it at a loss—the aggrieved purchaser of the security may be able to recover his or her losses from the issuer under Rule 10b-5.

Query whether, if this government contractor had filed with the SEC under Rule 0-6 a statement from the Department of Defense that omitted materially important information from the contractor's prospectus, the contractor could use compliance with Rule 0-6 as a defense to the investor's Rule 10b-5 claim, in reliance on the Rule 0-6 statement that "[a] registrant may rely upon any such statement in filing or omitting any document or information to which the statement relates." We know of no reported cases on this issue and doubt that there are any, but we can imagine circumstances (e.g., the failure of a company due to the cancellation of a classified production contract involving a major secret military vehicle) under which certain risks are known by the contractor but are classified (whether properly or improperly) and, therefore, cannot be disclosed.

The next SEC rule that comes into play in connection with classified information in the context of private-sector securities is the Exchange Act § 13(b)(3) exemption from requirements that public companies (i.e., companies with securities registered under the Exchange Act that are required to satisfy public reporting requirements under Sections 13 and 15(d) of the Exchange Act)[14] keep detailed and accurate accounting records and systems. Specifically, such companies are required under 15 U.S.C. §78m(b)(2) (Section 13(b)(1) of the Exchange Act) to:

> *[M]ake and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;*
> *(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—*
> *(i) transactions are executed in accordance with management's general or specific authorization;*
> *(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;*
> *(iii) access to assets is permitted only in accordance with management's general or specific authorization; and*
> *(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.*

Included in the next paragraph of this statutory provision, however, is the following exemption § 13(b)(3):

> *With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance.*

This exemption (about which, we think, few securities analysts and attorneys outside the defense establishment are aware) appears to provide for a get-out-of-jail-free card to allow government contractors, in particular, to keep secret accounting records and file financial statements that fail to include all information that would otherwise be required in annual and quarterly reports, proxy statements, and other SEC filings. The only catch, it seems, is the administrative hassle of annually renewing the federal department or agency directive.

In February 2006, President George W. Bush delegated the exemption authority under Section 13(b)(3) of the Exchange Act to the Director of National Intelligence (then John Negroponte), thereby shrouding the government defense establishment in further secrecy. Now, in light of the issuance of FASAB 56, the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation seem far from reach.

It is not clear, however, how a public company could make material alterations of its financial records in accordance with Exchange Act § 13(b)(3) or Exchange Act Rule 0-6 and still (in the absence of a private-sector policy analogous to SFFAS 56 in the federal government sector) fulfill its Exchange Act obligations to file annual audited financial statements. It is possible that, as suggested in the Kearney & Company comment letter on the SFFAS 56 Exposure Draft (see Appendix B), the public accounting firm issuing a clean audit opinion on such a contractor's financial statements does so through the application of AICPA's AU-C Section 805, Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement with reference to Statement on Auditing Standards (SAS) No. 122, "Preface to Codification of Statements on Auditing Standards, Principles Underlying an Audit Conducted in Accordance With Generally Accepted Auditing Standards."

SAS 122 was issued in October 2011, effective for financial statements after December 15, 2012.[15] AU-C No. 240 is entitled "Considerations of Fraud in a Financial Statement Audit." The scope of this standard is stated as follows:

> *This section addresses the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, and section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained, are to be applied regarding risks of material misstatement due to fraud.*

IX. The Post-FASAB 56 World: Who Can Help Assess Credit, Risks, and Price?

As we stated in Section III, we do not believe a "prudent man" would rely solely on the U.S. rating agencies regarding the U.S. federal credit. We should also explain why a "prudent man" would not rely on the media, issuers, dealers, or financial institutions either.

We have seen that FASAB 56 was first proposed in the Federal Register in December 2017. Yet, with the exception of ongoing coverage by The Solari Report, a special report and update from Dr. Skidmore, an article by Steven Aftergood of the Union of Concerned Scientists, and Matt Taibbi's *Rolling Stone* article in December 2018, there has been nary a peep from those who should have an interest in an accounting standard that could have the effect of making material misstatements of the financial operations and position of every agency of the federal government. That fact, in itself, should be a warning that investors are on their own in doing due diligence on their investments where risks of financial solvency and stability of the federal government are concerned—that is, for many, if not most, of the equity and particularly debt securities and derivatives available in the market.

We have also seen that the traditional SEC-required disclosure, in public securities offerings as well as annual and quarterly reports and proxy statements of public companies, should be viewed with a degree of caution where securities issued by federal government contractors and banks are concerned, because classified information relevant to the investment decision may have been excluded with the blessing of the SEC under Exchange Act Section 13(b)(3) and Rule 0-6. Federal contractors, however, may include more than the obvious military-industrial complex contractors like Lockheed Martin and SAIC. This also includes the banks (like JPMorgan Chase, Goldman Sachs, and others) that, largely without wide disclosure of the fact, act as agents of the U.S. government in the gold markets, with respect to the Exchange Stabilization Fund, and otherwise in government financial market interventions.

From the 2008-2012 Financial Crisis, we learned that the investment banks (like Goldman Sachs) traded in mortgage-backed securities to benefit their own private interests, even to the detriment of their investor clients who were counterparties in the same transactions.[16]

With all the fanfare accompanying legislation purportedly addressing the "too big to fail" phenomenon witnessed during the Financial Crisis, since that time, the big banks have only gotten bigger. Several investment banks (Merrill Lynch and Goldman Sachs, in particular) have become banks, thereby being able to borrow at the Fed's window and take advantage of FDIC insurance while engaging in proprietary transactions for their own accounts. We see no sign of a "come to Jesus" moment in the financial sector that would lead us to believe that the major financial institutions are now generally dedicated to integrity and transparency, let alone when it is contradictory to their self-interest.

Threats to the dominance of the U.S. dollar as the world's reserve currency make it more likely that the U.S. making good on its guarantees will require the Federal Reserve to print more money, leading to a significant debasement of the U.S. dollar. U.S. military dominance is a major factor in holding up the value of the U.S. dollar, but this is not a politically correct factor for a primary or secondary dealer to incorporate in its analyses of credits of either direct U.S. obligations or obligations dependent on the U.S. credit, especially when such military dominance depends on secret weaponry and covert operations.

Consequently, the investor is advised to rely on his or her own due diligence as opposed to the assessments of third parties, be they media, dealers, rating agencies, or issuers.

X. The Post-FASAB 56 World: What Is the Federal Credit?

What Is Sovereign?

According to Wikipedia, the word "sovereign" is borrowed from the Old French *soverain*, which is ultimately derived from the Latin *superānus*, meaning "above."

> *"The roles of a sovereign vary from Monarch or Head of state to head of municipal government or head of a chivalric order. As a result, the word sovereign has more recently also come to mean independence or autonomy…. The sovereign is the autonomous head of the state."*
>
> *"Sovereignty is the full right and power of a governing body over itself, without any interference from outside sources or bodies. In political theory, sovereignty is a substantive term designating supreme authority over some polity."*

A government or sovereign bond is a bond issued by a national government. Government bonds are typically denominated in the issuing country's currency. Consequently, the government can never be forced to default, because it can simply create more currency to fund payment of principal and interest.

One of the important characteristics of state sovereignty has been Westphalian sovereignty—the principle that each state has exclusive sovereignty over its territory. Established by the Peace of Westphalia in 1648, this principle means that a sovereign government has a monopoly on the use and exercise of physical force within its jurisdiction.

There is an important question that investors must ask: What does it mean to the credit of U.S. Treasury securities that the U.S. has been privatizing parts of its military and intelligence function? It means that the U.S. military and enforcement authorities no longer maintain a monopoly on force within the U.S. jurisdiction. Rather, in our opinion, the number of parties that can and do kill with impunity on behalf of both governmental and non-governmental agencies and parties has been growing faster over recent decades than the U.S. GDP—and there is certainly a relationship between these two trends.[17] Economic performance is driven increasingly by force. With the development and implementation of drone and robotics weaponry, the potential impact will be far-reaching.

Who Hires and Fires the Deputy Assistant Secretary of Housing-Single Family at the U.S. Department of Housing and Urban Development?

As described earlier, the FHA, an agency within HUD, is a mortgage insurance operation, generally divided into two funds. The first is the Mutual Mortgage Insurance (MMI) Fund, which funds the single-family residential mortgage insurance originated by FHA. Officially outstanding mortgage insurance in force in the MMI Fund as of fiscal 2018 was approximately $1.1 trillion, with the fiscal 2018 budget requesting authority to issue $400 billion in new mortgage insurance.

The management of the single-family operations at FHA is traditionally undertaken by the Deputy Assistant Secretary of Housing-Single Family who reports to the Assistant Secretary of Housing-Federal Housing Commissioner who reports to the Secretary of HUD. Both the Secretary of HUD and the Assistant Secretary of Housing-Federal Housing Commissioner are Presidential appointees. They are nominated by the President and approved by Senate confirmation after an extensive FBI background check.

The Deputy Assistant Secretary (DAS) of Housing is traditionally recommended for appointment to the Secretary by the Assistant Secretary of Housing, reviewed and approved by the White House, and then appointed by the Secretary after a background check.

When Catherine became Assistant Secretary of Housing in 1989, one of her first jobs was to review and recommend the people for four main deputy positions, including the Deputy Assistant Secretary of Housing-Single Family. One of the resumes forwarded to her by the transition team was for Ronnie Rosenfeld.

Catherine knew Ronnie from her time serving on one of the boards at The Wharton School. After an initial interview, she invited Ronnie to lunch and asked him the most important question. Why was someone with such a successful career in real estate and finance interested in serving as Deputy Assistant Secretary to reform what was at the time a very troubled operation? Although required by law to be financially self-sustaining, the FHA single-family fund was instead losing $11 million a day—a significant amount at a time when the officially reported single-family mortgage insurance in force was approximately $300 billion.

To this day, Catherine remembers Ronnie's answer. He spoke about how his family had come to America—and thanks to the opportunities we enjoy here—had done very well. Now he wanted to give back. The next day, Catherine forwarded a recommendation to then HUD Secretary Jack Kemp for Ronnie Rosenfeld to be appointed the DAS-Single Family.

Shortly thereafter, Catherine received a call from the executive director of the National Association of Homebuilders (NAHB). The message said it was urgent. Could he and the president of NAHB meet with her as soon as possible? Soon enough, Catherine found herself in a small temporary office (she had not been sworn in yet, having just arrived at FHA) with the executive director and president of NAHB.

The NAHB president was quite upset. It seemed, she said, that Catherine had made a terrible error. She had nominated Ronnie Rosenfeld to be DAS for Single Family. That appointment, the president said, was in fact the NAHB president's to make—the DAS for Single Family essentially reported to her. She did not seem to be aware that the growing HUD scandals that were part of the savings and loan (S&L) crisis and the Iran-Contra scandal signaled a new day at HUD. In the meantime, Catherine was beginning to understand how the MMI Fund had arrived at the point of losing $11 million a day and not being in compliance with existing federal financial management laws.

Catherine explained that the new administration was planning on running things by the book and that the DAS for Single Family was going to be appointed by the HUD Secretary with approval of the White House. Catherine was only going to recommend to the Secretary candidates qualified to do an excellent job based on merit. Washington lobbyists needed to understand that the line management of a $320-plus billion government insurance program would report to government officials—not to the president of the National Association of Homebuilders.

The president stood up, pointed her finger closely at Catherine's face and, using the F-word liberally, explained, "I will have you fired." Catherine looked her in the eye and said, "You know you probably can, but it will take you a while. In the meantime, I am going to get this place on a sound financial footing." Catherine then picked up the phone, called security, and requested a security guard to physically evict the NAHB president from the building. Inspired by the call, the executive director quickly hustled the president, spitting and yelling, out of the office and down the hall to the elevators.

Before Ronnie arrived, Catherine bounced the fellow who was processing land development deals with the company owned by the president of NAHB from the Single Family office and, with the assistance of now-Deputy Assistant Secretary of Housing Ronnie Rosenfeld, shut down the program. Catherine was fired approximately eighteen months later, in part for a refusal to respect or implement illegal orders, but by that time FHA was on a sound financial footing—which was not to last.

Catherine had experienced some of the basic truths of sovereignty.

For a government to have sovereignty, it must have information sovereignty. The President of the United States must be able to call the Prime Minister of England and have a conversation without eighteen intelligence agencies and telecommunications companies recording and sharing it with numerous banks, private companies, and media outlets. A sovereign government's information and payments systems need to be controlled by loyal government officials rather than private corporations and banks that can profit from funds being moved illegally out of or laundered through the information systems or securities being issued without being recorded on the government books.[18]

For a government to have sovereignty, it also must have financial sovereignty. If no one accepts its currency or will buy its bonds, a government cannot provide the basic operational capacity it needs to run and maintain control within its borders. If a country practices deficit spending and becomes highly leveraged, it is ultimately controlled by the owners of its central bank, its creditors, and the dealers who manage its bond markets rather than by its citizens.

The president of the NAHB and Catherine disagreed in 1989 regarding whether FHA was part of sovereign government or simply a rich trough for the feeding of insiders. The reason the FHA Single-Family Fund was losing $11 million a day, although required to be run on a self-sustaining basis, was because it had lost its sovereignty.

Indeed, some of Catherine's greatest struggles involved getting basic financial data about the operations, including from the defense contractors[19] who ran HUD's IT and payments systems and would refuse requests for basic financial data. Certainly, FASAB 56 has great potential to allow such contractors even greater protection with respect to their control of agency resources and their financial relationship with both the government and shareholders.

In 2000, Catherine met with the chief of staff to the Chairman of the Senate Subcommittee that oversees HUD appropriations. The mortgage bubble was in full bubble mode. The staff member asked Catherine what she thought was going on at HUD. Catherine deferred and asked what the chief of staff thought was going on. The response was, "HUD is being run as a criminal enterprise." This was after billions of dollars started to disappear from HUD, with $17 billion and $59 billion of undocumentable adjustments in fiscal 1998 and 1999.

HUD is run on a matrix structure with the majority of operations handled by large defense contractors, New York Fed member banks, the U.S. Treasury, and the Department of Justice. HUD was indeed being run as a criminal enterprise—and those entities were intentionally running it as a criminal enterprise. Further outsourcing and privatization can only be expected to make things worse, not better.

The bailouts during the 2008-2012 Financial Crisis were in amounts that were several multiples of what would have been needed to pay off all the residential single-family mortgages in the country. How could that happen, you might ask? Among other things, it could happen because the federal agency responsible to lead policy and regulation for the United States was not run as a sovereign government agency and was handing out credit and booking undocumentable adjustments with abandon.

In 2003, Catherine challenged a retired senior civil servant who had held a senior position at HUD to find an existing member of the civil service at HUD who understood how the financial operations then worked. He accepted the challenge and had to buy Catherine dinner when he lost. It turned out that the banks and corporations were in complete control, he said. There was no government official or employee who understood the operations or finances, let alone was in a position to govern or manage the private banks and contractors at their tasks. He was stunned. HUD had achieved a full privatization operationally without anyone knowing it. Not surprisingly, the housing bubble continued to expand while HUD finances and financial systems remained—perhaps not so mysteriously—a complex, near-impossible-to-understand mess.

Indeed, as you read this, we are being regaled by media reminding us how government is inefficient and telling us that we should let corporations run more government operations.

As you read the *2018 Annual Wrap Up*, we encourage you to step back and see the big picture of where we are. The more power private banks and corporations get to run the U.S. government, the more money goes missing, and the larger and more secretive the National Security State grows.

In essence, the U.S. government is like a large double-decker bus. The friendly driver wears a hat and has a big steering wheel. That steering wheel, however, does not connect to the bus wheels. On the lower level, there is another driver with another steering wheel that does indeed connect. That wheel is controlled firmly by the private banks, corporations, and contractors who run the federal government and fund the campaign contributions for Congressional and presidential campaigns.

The passengers get angry at the friendly driver every four or eight years and vote in a new friendly driver. And nothing changes. The situation could change—but that would require cutting off the funding to the real driver, which, of course, threatens the real system and the existing cash flows that generate "fees for your friends" and levitate the corporate profits on U.S. equity markets.

FASAB 56

The collapse of U.S. sovereignty that was under way when Catherine threw the president of the NAHB out of FHA is now complete with the issuance of FASAB 56. This is a material event in the context of investor and citizen risk.

The U.S. government is maintaining secret books through a secret process without any independent verification that those with proper clearances are following the rules that supposedly authorize this secrecy. The people making these decisions are, for the most part, secret. An obscure accounting policy overrides the U.S. Constitution and federal financial management and securities laws. Since the banks and corporations that have run the U.S. government outside those laws for twenty years now have even more power, it is not clear on what basis we would presume they will follow the new set of rules issued to institutionalize their refusal to follow the old set of rules.

There is a simple way to cut through the complexity of what is happening. The U.S. government is not a sovereign government. It does not have information sovereignty. It does not have financial sovereignty. It does not have operational sovereignty. And it has accumulated undocumentable transactions from fiscal 1998 to 2015 at two of its 24 agencies equal to the amount of its officially reported outstanding debt: $21 trillion.

Sovereign Bonds

This brings us to the question of the outstanding U.S. debt. The official amount of outstanding U.S. Treasury debt is now $22 trillion and rising quickly.

U.S. Treasury debt grew by 6% in 2018. It is expected to grow by 8% in 2019. That is despite many years of what is being called an "economic recovery." If the economy slows or goes into recession, as it inevitably will, the debt growth will accelerate. If unfunded liabilities are added, the picture deteriorates further.

One important question is, who will buy this debt? As described in Section II and in our tables (page 193) at "Contractors, Investors, and Dealers" in the *2018 Annual Wrap Up*, U.S. investors own 33% of the debt, the Federal Reserve Bank owns 11%, and the U.S. government owns 27%—for a total of 71% that is owned domestically. That leaves 29% owned by foreign investors, who are currently net sellers. In addition, the next two years will also see a significant volume of corporate bond maturities, significantly increasing corporate refinancings. Given high global government debt levels, the competition for capital is fierce.

Another question facing investors is, what exactly are they buying? If the U.S. government is no longer a sovereign government (and indeed, aggressive plans for further privatization underscore the fact that there is no possibility of that changing in the near and intermediate future—quite the contrary), what does it mean?

It means that a U.S. Treasury bond is not a sovereign bond. It is something else. The term "sovereign" no longer applies.

So, what is it? It is a bond issued by a governmental shell that is secret and whose operations are run by private corporations and banks that fund—or whose investors, lawyers, and lobbyists fund—the campaign contributions that elect the politicians who serve in Congress and the White House.

We have no way of knowing for sure whether the assets financed by bonds issued by this government continue to be owned by the government, thus providing some form of collateral as a credit matter. We cannot say whether the assets financed by government bonds are being laundered out to private corporations in a manner that supports a high U.S. domestic stock market and the resulting campaign contributions. That possibility would certainly help to explain the dramatic outperformance of the U.S. stock market relative to world markets, however.

Is the U.S. government a government, or rather a tax collection operation that is also a marketing shell for the U.S. Treasury financing operation?

In New York State, when Catherine was on Wall Street, they used to call a certain class of bonds "moral obligations." That was because it was considered essentially a political *fait accompli* that the New York State legislature would vote appropriations to pay debt service. But the State did not have a legally binding obligation to do so—the debt was a "moral obligation," subject to the future will of the legislature. Presumably, the legislature could be expected to appropriate the necessary funds because members did not want the State's bond market access to come to an end.

For twenty years, Catherine has steadily referred to unaccountable adjustments by HUD and DOD and bailouts—$21 trillion in missing money combined with $24-plus trillion in bailouts—as "the financial coup d'état." Now, the financial coup d'état period is coming to a close.

With the squeeze in the bond market upon us, as the amount of outstanding debt grows at an accelerating rate, the U.S. and global investors are entering a new phase. Think of this as a leveraged buyout. The investors who can afford the biggest positions in Treasury bonds and can afford to buy new ones are likely the very groups that engineered the financial coup.

This means governmental control is likely being purchased with the money stolen from and through the government. As Catherine always says, "crime that pays is crime that stays." So now, investors have a "moral obligation" bond secured by a secret government being run as a criminal enterprise.

There are two reasons most investors assume that such a Treasury bond has financial value. The first is that the U.S. military is considered the strongest in the world. Consequently, a nuclear arsenal should count for something on the global chessboard, despite the unraveling of the global trade system. Second, U.S. Treasury and related debt is denominated in dollars, and the Federal Reserve and, if necessary, the U.S. Treasury can simply create as many dollars as they want—there is no need to default.

The problem is that nowhere in this system are there internal controls that would require economic optimization or fundamental productivity. It has been cheaper to buy people's political loyalties on a pay-as-you-go basis, using, among other tools, control files made economic by digital technology and media control. The price of secrecy and privilege, however, is that, over long periods of time, they subject the system to ever greater rates of entropy. The more uneconomic and entitled the system becomes, the more it depends on force rather than trust. The result is the downward spiral in performance that is now happening concurrently with an upward spiral in debt.

Secret Funding for Secret Armies

This brings us back to our last condition of sovereignty—Westphalian sovereignty. With very little fanfare, over the last three decades, the United States of America has made a significant investment through its intelligence and defense budgets in building private mercenary armies. Those private armies have been lobbying aggressively to be allowed to replace the U.S. Army in the Middle East and in hot spots around the globe.

Private armies are now a financial constituency that lobbies for profitable opportunities to use force that generate U.S. corporate and bank profits and capital gains and the resulting campaign contributions.

If you look at the covert operations happening around the United States—including shootings, assassinations, false flag events, and likely weather warfare—it is clear that United States military and federal enforcement and state and local governmental subdivisions no longer maintain a monopoly on the use of force within U.S. borders.

Here is what Catherine wrote to one reporter after FASAB 56 was adopted quietly while the country was in an uproar over the Kavanaugh Supreme Court confirmation hearings:

> *"The story is simple and obvious. What is it about secret financing for secret armies that you do not understand? The U.S. government just officially changed its governance model from a constitutional republic to fascism through an obscure accounting policy. No need to bother with a Constitutional convention.*
>
> *The U.S. Treasury is free to tax and then borrow from our pension funds and global and domestic investors and then transfer the money and assets financed and technology found or created without limit, compensation, or oversight to private corporations and investors. This is privatization by the 'just do it' method. Think of this as the extension of the bailouts to a permanent open bailout structure.*
>
> *The White House and Congress just opened a pipeline into the back of the U.S. Treasury and announced to every private army, mercenary, and thug in the world that we are open for business.*

> *Every mercenary on the planet is now generating proposed schemes to create business for themselves that pumps up U.S. corporate profits and campaign contributions. Why do you think Mattis is suddenly out, and ads are suddenly running that 'Blackwater is Coming'?*
>
> *My advice? Ask now-former DOD Secretary Mattis—who opposed mercenary armies—how he feels about using his credibility to arrange significant increases in DOD appropriations and then getting the boot as soon as the mechanism to finance secret private armies goes into place."*

Catherine should have added General Kelly as well. With large appropriations achieved, he was replaced as White House Chief of Staff by the head of OMB, who himself had led the Administration approvals for FASAB 56.

So, not only are the U.S. sovereign bonds no longer sovereign, but the U.S. military that has heretofore served as the backbone of the U.S. financial strength is no longer a sovereign military—it is increasingly being privatized or replaced by private armies, free to roam in U.S. territory as well.

This state of affairs is not unrelated to the fact that an increasing number of the senior officials and legislators in the U.S. government are reported to have dual citizenship. Unfortunately, an accurate account of the number of dual citizenships is also secret.[20] Where do these officials' and legislators' loyalties lie?

Where does that leave us? If we have a "moral obligation" bond in a governmental financial mechanism operating under the cloak of secrecy in a jurisdiction with multiple secret intelligence agencies, and private armies are operating on behalf of private investment syndicates, who is really in charge, where are they going, and what does it mean to investors?

Honestly, we don't know. If there is no law, and there is no coherent understanding of how resource management works and who is in control and how that control operates, then we are approaching a system where fiat currency has little or no meaning. We suppose that if you are a member of the secret societies that now run everything, and you trust your secret decoder ring, then you have a way of understanding this.

Essentially, to continue to finance such an operation, we have to trust the "moral obligation"; we have to trust a secret group of people, and we have to trust that assets are not being transferred out the door—although $21 trillion in undocumentable adjustments clearly would suggest otherwise. And, given the rate of entropy in the economics and the many indications that it is accelerating, we have to depend on the military mechanism and, increasingly, private armies to keep the harvesting machinery fed.

Even from the point of view of one who is a member of the committee that runs the secret government, how is anything this big and this secret supposed to work?

Given where we are, U.S. Treasury bonds are not just "moral obligation" bonds. Rather, they may represent a new mechanism for financing disaster capitalism—how about "Benghazi bonds"?

Our challenge is, as we look around the world, that there is a planet full of warlords, oligarchs, and bullies who clearly offer no practical alternative for our capital. This is a powerful argument for challenging the United States to rebuild a sovereign government, rather than accelerating the growth of corporate and bank control. Some investors believe that diversifying their capital into the banks and corporations that have been successful at engineering these rolling coups and "piratization" is the way to go. Given the underlying economics and lawlessness, we are not as confident in that as a strategy. Whatever happens, creditors will be better protected if we reduce operational and political dependency on privileged secrecy and a bloated National Security State.

XI. Conclusion

The U.S. is reversing two decades of globalization by "reshoring" significant operations and capital. The decision to do this is logical, given the unraveling of the Bretton Woods system and new developments in manufacturing technology and material science. As part of this process, the U.S. Congress and Administration have now taken a series of steps in federal accounting policies that render a significant portion of the U.S. government and U.S. fixed-income, derivatives, and equities markets "dark."

With FASAB 56, the U.S. has created significant new capacity to continue to operate outside the law with impunity. This enhances its ability to field and fund private armies domestically and internationally, engage in securities fraud, launder the assets and profits of war out of and through the United States government and transfer them to private corporations and investors, and complete the corporate and banking control of U.S. government operations.

Ask yourself how you feel about private corporations owning and controlling nuclear weapons. President Eisenhower was furious when Stephen Bechtel, Sr. first suggested that Bechtel should be permitted to own nuclear weapons. Eisenhower would have none of it.

During the George W. Bush Administration, Bechtel assumed control of the U.S. nuclear laboratories, calling this takeover a "privatization." Another description would be "coup d'état"—turning over the nation's nuclear energy and weapons complex to a private company financially vested in starting a new Cold War. Do you want the private investors who profited so richly from the Iraq War—and who have a vested interest in starting a new Cold War with the Soviet Union—to be in charge of the nation's nuclear arsenal?

Sally Denton, in her book *The Profiteers: Bechtel and the Men Who Built the World*, quotes a senior employee at Lawrence Livermore National Laboratory who referred to this new style of private management of our nuclear energy and weapons infrastructure as a combination of "the worst aspects of the Department of Motor Vehicles and Goldman Sachs."

Given the level of uncertainty and secrecy, only you, the investor, can decide if this is something that you wish to finance. If you do wish to finance it, you must determine the nature of what your financial asset is and your investment risk and how to price it.

For many years, most investors have purchased U.S. Treasury bills and bonds or related securities secure in the knowledge that this was one credit they did not have to worry or think about. That time has come to an end. A sure thing has been replaced by something that is no longer sure. And, the investor cannot be sure exactly what that thing is or who controls it—just that it's secret.

As a U.S. or global citizen and as a fiduciary responsible for family or institutional assets, you must also determine your responsibility and risk if the enterprise you are financing continues to aggressively reorganize its global and domestic operations at your expense and the expense of those you love.

Caveat emptor is the ancient rule. It certainly applies.

There is another ancient rule that applies as well: "Do unto others as you would have them do unto you."

It's your money. You are responsible for where it goes and what it does in your name.

XII. Links

"FASAB Statement 56: Understanding New Government Financial Accounting Loopholes," The Solari Report, December 29, 2018. **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**

FASAB Statement 56, "Classified Activities," from *FASAB Handbook*. **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**

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"The Missing Money: $21 trillion dollars is missing from the U.S. government. That is $65,000 per person —as much as the national debt!" The Solari Report, *2018 Annual Wrap-Up*. **https://missingmoney.solari.com/**

"Enforce the Constitution." The Solari Report. **https://constitution.solari.com/**

2018 Annual Wrap Up: The Real Game of Missing Money, Catherine Austin Fitts, The Solari Report. **https://hudmissingmoney.solari.com/**

"Summary Report on 'Unsupported Journal Voucher Adjustments' in the Financial Statements of the Office of the Inspector General for the Department of Defense and the Department of Housing and Urban Development," Catherine Austin Fitts and Dr. Mark Skidmore, The Solari Report, September 23, 2017. **https://hudmissingmoney.solari.com/the-real-game-of-missing-money-ii-summary-report-on-unsupported-journal-voucher-adjustments-in-the-financial-statements-of-the-office-of-the-inspector-general-for-the-department-of/**

"The History and Organization of the Federal Reserve: The What and Why of the United States' Most Powerful Banking Organization," Michele Ferri and Jonathan Lurie, The Solari Report. **https://hudmissingmoney.solari.com/the-history-and-organization-of-the-federal-reserve-the-what-and-why-of-the-united-states-most-powerful-banking-organization/**

"The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause," Michele Ferri and Jonathan Lurie, The Solari Report. **https://hudmissingmoney.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**

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Matt Taibbi, "Has the Government Legalized Secret Defense Spending?" *Rolling Stone*, January 16, 2019. **https://www.rollingstone.com/politics/politics-features/secret-government-spending-779959/**

Steven Aftergood of the Federation of American Scientists' Project on Government Secrecy, "Financial Accounts May Be 'Modified' to Shield Classified Programs," *Secrecy News*, August 15, 2018. **https://fas.org/blogs/secrecy/2018/08/fasab-modified/**

SAS No. 122, "Clarified Statements on Auditing Standards," clarifies previously issued statements; links to the redrafted standards and related interpretations are included in a table at this link: **https://www.aicpa.org/research/standards/auditattest/clarifiedsas.html**

AU-C Section 240 (SAS No. 128), "Consideration of Fraud in a Financial Statement Audit." **https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00240.pdf**

AU-C Section 250, "Consideration of Laws and Regulations in an Audit of Financial Statements." **https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00250.pdf**

AU-C Section 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement, American Institute of Certified Public Accountants SAS No. 122, effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2012. **https://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00805.pdf**

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FINANCIAL STATEMENTS FY 2001 Results Highlight the Continuing Need to Accelerate Federal Financial Management Reform, April 9, 2002. **https://www.gao.gov/new.items/d02599t.pdf**

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Conclusions of the Financial Crisis Inquiry Commission Report, January 2011. **http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf**

Kai Ryssdal, "Negroponte given power to waive SEC rules," Marketplace, May 24, 2006.
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Executive Order 12356, "National Security Information."
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XIII. Appendices

Appendix A: Explanation of the Interpretation Process under FASAB 56

Under the FASAB MOU, there was a six-step procedure for the issuance of future (presumably classified) Interpretations pursuant to which Standard 56 permits modifications that may have the effect of altering the government's net results of operations and net position. This process is disclosed in the Appendix of Statement 56 as follows:

a. Identification of accounting issues and agenda decisions

i. The Board will carry out this step by consulting with cleared stakeholders in secure facilities. Stakeholders —including preparers, auditors, and users of classified information—will be informed regarding the process for raising issues for Board consideration.

b. Preliminary deliberations

i. Preliminary deliberations will engage all members of the Board. Deliberations will occur during closed meetings. Closed meetings will be approved and announced in the Federal Register consistent with the process established in the Federal Advisory Committee Act.

c. Preparation of initial documents (issues papers and/or discussion memoranda)

i. We expect that all initial documents will contain classified information and will therefore be subject to federal requirements pertaining to classified information. Initial documents will be prepared by cleared individuals of FASAB staff and representatives of affected organizations who have original or derived classification authority. Such documents will be shared with members in a setting appropriate to the classification level of the documents. Members will be afforded adequate time to review the materials, ask questions, and deliberate over the materials before making decisions regarding the issues raised.

d. Release of documents to the public, public hearings, and consideration of comments

i. Members of the public will have an opportunity to comment on the proposed Statement. The public will be able to comment on the general subject matter discussed in the proposed Statement and the existence of classified Interpretations. The Board will consider all comments provided.

ii. Also, because we expect that all documents related to Interpretations will contain classified information, release will be limited to cleared individuals and organizations that have signed a non-disclosure agreement and have a need-to-know, in accordance with federal requirements pertaining to classified information. The Board will ensure a representative group of stakeholders with varied perspectives and appropriate clearances are engaged. The Board expects to seek input from elected representatives of the public and appointed government officials to ensure the needs of citizens are balanced against national security interests. The Board will consider all comments and input received from the representative group of stakeholders.

e. Further deliberations, exposure draft, and consideration of comments

i. This step will occur in closed sessions as noted above. The Board will seek input from cleared individuals, including elected and appointed officials, and organizations to the greatest extent possible given the classified nature of the materials and deliberations. The Board will consider all comments and input received from the representative group of stakeholders.

f. Vote to approve proposed Interpretations

i. Consistent with the Board's established procedures for consideration of proposed Interpretations, final classified Interpretations will be those approved by a majority of the members and not objected to by a member representing the Comptroller General, the Secretary of the Treasury, or the Director of OMB during a 45-day review period. Final classified Interpretations will be maintained by FASAB. Component reporting entities should contact FASAB to arrange access to the classified Interpretations as needed. FASAB will provide access to any relevant Interpretations following appropriate security procedures.

Appendix B: FASAB 56 Comment Letters

Comments on Standard 56 Exposure Draft

On December 14, 2017, FASAB issued the Exposure Draft for Classified Activities for comment. Comments were due March 16, 2018. On July 5, 2018, the "Sponsor Review" draft of proposed Standard 56 was released **https://fas.org/sgp/news/2018/07/fasab-review.pdf**. On July 12, 2018, FASAB issued the Exposure Draft Interpretation of Federal Financial Accounting Standards 56: Classified Activities. On July 17, 2018 the FASAB issued a Notice of Request for Comment on the Exposure Draft of a Classified Interpretation of Federal Financial Accounting Standards (SFFAS) 56: Classified Activities. The Standard was issued in final form in the Federal Register on October 15, 2018.

Seventeen comment letters were received on the FASAB 56 Exposure Draft, two from independent public accounting firms (Kearny & Company and KPMG), three from associations of CPAs (the AICPA, the Association of Government Accountants/FMSB and the Greater Washington Society of CPAs) and twelve from various federal government reporting entities.[21] The accounting firm comments are most instructive in providing us guidance as to what ought to have been incorporated in the Statement, as opposed to what was actually adopted, and what risks are involved in the application of Standard 56 by the government's independent public accounting firm auditors (if, in fact, such auditors are able to perform successful government audits within the restrictions imposed under Standard 56).

Kearney & Company

Kearney & Company's Jamie Cox, an administrative assistant at the firm (instead of its CEO or government services executive) submitted Kearney's comments to FASAB on Statement 56, presumably with the authority to speak for the firm.[22]

In answer to the question "Do you agree or disagree with the Board's overall proposed approach for protecting, classified information? Please provide the rationale for your answer." Kearney responded:

> *Disagree.*
> *Generally Accepted Accounting Principles (GAAP) should not be modified to limit reporting of classified activities. Rather, GAAP reporting should remain the same as other Federal entities and redacted for public release or remain classified. This approach retains the benefits of GPFFR and audited financial statements in terms of improving underlying processes, systems, and controls, as well as the usefulness of GPFFR to users, even if those users are limited.*
>
> *The FASAB's proposed approach could result in material omissions in [General Purpose Federal Financial Reports]. By FASAB's own definition, "The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement." If GPFFR can be modified so material activity is no longer accurately presented to the reader of financial statements,* ***its usefulness to public users is limited and subject to misinterpretation.*** [Emphasis added]

In other words, users cannot rely upon financial statements modified in accordance with the Exposure Draft, which was adopted without significant change as the final Statement 56.

Kearney's comments go on to point out that allowing modifications based upon classified interpretations would "limit due process and transparency," elements that are crucial to the process of developing GAAP. Kearney "disagrees" with allowing modifications of disclosures and required supplementary information (i.e., financial statement footnotes, which are key to an understanding of audited financial statements). Assuming that Statement 56 is adopted (an eventuality Kearney clearly opposes in anything like the Exposure Draft form), Kearney proposes that two sets of books be produced: modified and unmodified, with "[f]ormalized crosswalks of the unmodified financial statements to modified/condensed financial statements" as well as further parameters for classification of line item or disclosure. In response to the proposal that no disclosure be made to users as to the existence of financial statement modifications, Kearney politely but firmly states that it disagrees, because "GAAP serves the purpose of providing complete, consistent and reliable information to users of financial statements. Permitting these omissions would seem to go against these purposes.

Kearney proposes two alternative methods of protecting classified information from disclosure in audited federal financial statements: either (1) the preferred approach, where all required activity is included in the face of the financial statements and, at the line-item level, classified activity is concealed within line item balances or (2) the less preferred method, where classified information is excluded from the financial statements, a disclosure is made that the exclusion has occurred and the audit report relates only to the scaled down financial statements that exclude classified information.

Kearney proposes that financial statements of classified entities should remain classified or redacted like other classified documents before release to the public. Under its preferred approach, Kearney would require reporting entities to reporting entities to first attempt to comply with existing standards and not use the classified activities standard. In coordination with the independent public accountants, the reporting entity should attempt to broadly describe financial information in a manner that classified data is protected. If the disclosure modification cannot be avoided, Kearney believes the disclosure modification should be disclosed to make users aware that relying on the information within the footnotes should be done so understanding that certain disclosures have been modified for the protection of classified information. The problem with this "fix," however, may be that the whole point of Statement 56 is to enable the government reporting entities not to disclose sufficient information to users (i.e., the public) to enable it to understand the extent to which the financial statements have been modified and the inherent risks in allowing only those with top secret clearances to understand the real expenditures and asset transfer line items underlying the modifications.

Kearney's second (less preferred) approach would be to rely upon AU-C Section 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement" to remove the classified information from the publicly accessible federal financial statements. It appears, although Kearney's comments do not go into detail on this point, that, using AU-C Section 805, the independent public accountants would produce two separate sets of audited financial statements, one "scaled down" version released to the public and another one that is classified and is available only to those with proper security clearances and a "need to know." The classified portion would be for the "single financial statements and specific elements, accounts or items" covered by AU-C Section 805.

The unaddressed problems with this approach are at least twofold: (1) even under AU-C Section 805, the independent public accountants issuing the audit opinions are required to conduct the audit of both sets of statements in a manner that satisfies the professional standards under SAS 122, the goals of which are to render financial statements fully transparent to the user, and it would appear impossible for the modifications permitted under Standard 56, particularly those made in accordance with classified "interpretations," which may have the effect of modifying the net results of operations, to "pass the smell test," so to speak, under SAS 122 and (2) in order for independent public accountants to form an audit opinion on the classified portion of the government's financial statements, the accountants would have to review the "real" books and, presumably, have proper security clearances. Noting in the professional standards outlined in SAS 122 addresses classified information and the prospect that the issuer of the audit opinion is under regulatory constraints, with specter criminal liability, for disclosing information. Can independent public accountants, even with security clearances, be counted upon to safeguard the secrecy of the classified audited statements if they suspect that fraud or illegitimate motives may be involved?[23] If the independent auditors cannot render a clean audit opinion on the classified financial statements, under AU-C Section 805 they may be forced to disclose in the public portion of the financial statements the fact that they could not render a clean opinion on the classified statements. Under AU-C Section 805, it appears that a separate independent public accounting firm could issue the audit opinion on the classified statements, thereby reducing the number of accountants involved in viewing the classified supporting records and modifications, but even those accountants would be required to be independent public accountants (as opposed to employees of the U.S. government). If the classified statements (presuming classified information could be segregated into separate financial statements, which may not be the case) could not be audited, it may take an amendment to the [CFO Act] by Congress to exempt the classified portions of government financial statements from audit requirements. Presumably, if members of the deep state believed that Congressional approval could be obtained for such an exemption, there would have been no need for Statement 56.

KPMG

KPMG's comments on the exposure draft begin with the self-serving statement that "We support the Board's efforts to address the challenges posed by the financial statement presentation of classified activities" and then immediately points out the obvious elephant in the room of FASAB 56, "[w]e believe there are certain aspects of the [Exposure Draft] that are unclear, which will make implementation difficult." The authors suggest that the paucity of detail in the Exposure Draft (and final) FASAB 56 make it not only difficult, but impossible, for independent public accountants to implement FASAB 56 while conforming to GAAP and GAAS.

Among the key issues addressed in the KPMG comment letter are:

> *(1) Inconsistency of Standard 56 with underlying concepts applicable to the presentation of federal financial statements under 16b of SFFAC 8, which provides:*
>
> > *"Operating Performance. Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities."*
>
> *(2) Complexity – "The brevity of the standard implies a simplicity in its application. As we considered several possible scenarios under this proposal, we realized that each masking decision leads to other decisions that take the preparer further away from the stated objectives in SFFAC 8." For this reason, KPMG suggests an example be given to users.*
>
> *(3) Disclosure – KPMG states that it believes that there should be disclosure that modifications of presentations and omissions of disclosure have been made because, in the absence of such an alert to users, their ability to assess how much weight to place on reported results in evaluating an entity's operating performance will be impaired.*
>
> *(4) Future Interpretations – Since Statement 56 apparently allows for the issuance of "interpretations" that would, arguably, override existing statements instead of merely clarifying existing statements (as the FASAB Handbook indicates interpretations are intended to do), KPMG suggests, instead, the issuance of new standards to deal with what the Statement 56 Exposure Draft envisions being contained in "interpretations." The problem with this fix, as noted by KPMG, is that it does not deal with the fact that Statement 56, Appendix A, provides for classified interpretations. The comment letter rightly questions how management of a reporting entity can contend that its financial statements have been prepared under GAAP when management [not to mention the independent accountants], do not have access to all of GAAP.*

KPMP's other comments include a concern that the inclusion of the statement that "unclassified reports should be presented in a manner that protects the classified information" as a GAAP requirement leads to the conclusion that the audit opinion provides assurance that the entity has protected its classified information, and that would not be the case. KPMG also recommends including a statement that a modification does not change the character of rhe underlying asset. For example, "if Asset X is presented as Asset Y in the financial statements, Asset X retains the accounting for the type of asset it is." Aside from other technical, largely insubstantial, comments, KPMG's only remaining issue is whether OMB is required before the exclusion of a classified reporting entity.

Securities and Exchange Commission

Given that the main goal of SEC regulations is transparency in disclosure to investors and the general public, it is worth noting that the SEC's only comment on the Exposure Draft of Standard 56 is in response to the question whether every component reporting entity of the federal government should be required to disclose that certain presentations may have been modified. SEC's comment was:

> *We believe that this would be misleading and likely to cause confusion for financial statement readers, by implying that SEC is involved in classified activities. It's likely that SEC, as well as other agencies, would receive numerous inquiries from the public and from the media by including such an unexpected disclaimer in its financial statements.*

In other words, the agency whose mandate it is to protect investors from undue risk from the absence of disclosure, or existence of misleading or incomplete disclosure, about the financial and other risks of investing in U.S. securities is mainly interested in preventing nuisance questions from investors as to why SEC-sanctioned financial statements of government reporting entities have an overbroad statement that indicates, incorrectly, that all government financial statements may have been modified when, in fact, the particular statements that are the subject of investor focus may not have been modified. In other words, the SEC does not believe that a given reporting agency's financial statements should include the boilerplate "modification legend" set forth in the Exposure Draft if that reporting agency's statements were not modified because that would lead to many inquiries of the SEC that would not otherwise be necessary. The SEC indicated no concern that massive modifications to government financial statements for alleged national security purposes (without any support as to the legitimacy of such national security interests) may result in the issuance of meaningless disclosure, or that U.S. investors will be unable to assess the risk of investing in securities whose values may be affected by the economic stability of the U.S. government.

The SEC's apparent lack of concern (or concession that it is powerless to change what the deep state has decreed must happen) about potentially-misleading financial disclosure must be put in context. The SEC is the U.S. government agency that sets the standards for what disclosure is required for public companies and companies issuing registered and exempt securities in offerings to investors. It is the SEC that issues guidance and regulations on the accounting methods to be used in financial statements that are filed with it by publicly traded companies pursuant to the federal securities laws and it is the SEC that oversees the Public Company Accounting Oversight Board[24] created under Sarbanes-Oxley in 2002 to oversee audits of public companies. Anyone who has been through an internal or external audit of a registered securities broker-dealer or investment adviser or an SEC/PCAOB audit or the audit of a public company by an independent public accounting firm knows that moving one line item in a financial statement to another line item, filing financial statements without explanatory footnotes, making unaccountable voucher adjustments and keeping key support information from auditors is strictly verboten and would be cause for shutting down the company immediately. Yet the SEC is in support of these very practices by the U.S. government, without any requirement that the validity of the need for obfuscation for "national security" purposes be verified by any independent auditor or the SEC itself.

Association of Government Accountants on behalf of the Financial Management Standards Board

Not surprisingly, the AGA/FMSB [agrees] with the conclusion and FASAB's overall rationale as presented in the Basis for Conclusions in the Exposure Draft, believes that the overall approach is reasonable, since "[o]ne element of national security is the ability to restrict the viewing of sensitive information," and agrees that reporting entities should be permitted to modify their presentation when it does not change net results and net position. However, AGA/FMSB believes even those modifications should not change the meaning of the information or be misleading. It takes issue with the lack of disclosure to explain modifications resulting in amounts associated with one financial statement line item being presented in another financial statement line item.

AGA/FMSB agrees with the proposed process for the adoption of classified interpretations as stated in the Exposure Draft whereby there is a development of classified proposals, comment on the proposals from individuals and organizations holding appropriate clearances, consideration of comments, and issuance of Interpretations to individuals and organizations holding appropriate clearances. As regards the omission of required disclosures, this commenter recommended that the FASAB should clarify that omitted disclosures should not negatively affect other financial information. This latter comment is not entirely clear, it appears that AGA/FMSB would propose omission of only disclosures for which omission would not negatively affect (i.e., mislead as to) other financial information.

AICPA

AICPA's comments on the Exposure Draft were made from the perspective of the AICPA's role in the designation of FASAB as the body to establish generally accepted accounting principles (GAAP) for federal government entities and not to comment specifically on the proposed accounting and related questions posed in the Exposure Draft. One focus was the limited due process accompanying the adoption of Interpretations when necessary to provide detailed guidance not included in the Statement 56 itself. AICPA believes that the six-step process described in the Exposure Draft, which includes cleared preparers, auditors, and users of classified information is adequate under the circumstances and consistent with the Board's normal due process procedures as outlined in FASAB's MOU. AICPA emphasizes, however, the importance of including a representative group of stakeholders with varied perspectives and appropriate clearances be engaged in the due process of Interpretations and the fact that the determination who has a "need to know" will be critical to the process. AICPA believes as broad an interpretation as possible the realm of federal requirements for classified information is advisable.

The AICPA comment letter concludes with this cautionary statement:

> *Finally, we recommend that FASAB closely monitor the implementation of this standard and the development of any future classified Interpretations from a Rule 203 perspective through the Board's annual self-review process. Following the standard protocol established between the FASAB and AICPA, we would expect that any issues or concerns that arise relating to any of the Rule 203 criteria (e.g., reportable events) would be reported to the AICPA on a timely basis.*

Greater Washington Society of CPAs

The Greater Washington Society of CPAs Federal Issues and Standards Committee (FISC) states that its 3,300 members include thirty who are active in financial management, accounting, and auditing in the

Federal sector. While generally supporting FASAB's approach to protecting classified information, FISC recommended the following:

> *a. [T]he FISC suggests that the Board consider the impact of classified information on total budgetary resources. If the Board's intent is to purposefully include or exclude total budgetary resources for this Standard, then the FISC suggests that the Board address this matter in the final Standard.*
> *b. The FISC suggests that the Board include in the final Standard whether a modification could be so material that the overall financial statement presentation no longer represents a fair presentation of the financial position and operations of the entity.*
> *c. The FISC suggests that the Board consider additional guidance or action on ensuring the consistent classification and presentation of transaction cycles or end items among component reporting entities. Such discussions could occur through a Board-appointed or Board-sponsored working group, which would include a representative group of stakeholders, to evaluate the consistent application of this Standard among reporting entities.*

Other Federal Agency Comments

Other federal agencies that submitted comments on the Exposure Draft largely approved of and agreed to the proposed terms of Statement 56 with one notable exception – some (Treasury, HUD, DoD, Energy, and Interior but not Homeland Security) expressly approved only modifications that would not affect net results of operations and net position. However, it is not clear that all commenters "got" the loophole that unclassified financials statements could include modifications that affect net results of operations and net position if supported by a classified Interpretation.

HUD's only substantive comment was:

> *HUD does not believe that every component reporting entity of the federal government should be required to disclose that certain presentations may have been modified. Revealing the mere presence of such information, in a particular reporting component, may compromise the classified information or the underlying reporting component entity that generated the classified information.*

This comment is particularly interesting in light of HUD's history of reporting large unsupported journal voucher adjustments against Treasury and the fact that HUD's mission would appear to not involve any need for withholding of classified information from its financial statements.

The DOD strongly supports the issuance of classified Interpretations and generally approves of Statement 56 as proposed but disagrees that every component within the federal government should disclose that its financial statements may contain modifications in order to protect classified information. DOD's primary concern appears to be that FASAB's due process requirements adequately protect sensitive information and that the mechanisms for that include strict enforcement of validation of any stakeholder's need to know and obtaining a signed non-disclosure agreement.

The Department of Veterans Affairs is in agreement with the whole approach of Standard 56 except that it strongly disagrees that component reporting entities should not have to disclose certain presentations may have been modified, unless there are actual modifications. Its reasoning is that such a policy would lead to questions from external parties if an agency with no expected classified activities adds a disclosure that presentations have been modified. Adding the disclosure to only entities with classified activities should not present a security concern to the United States or its citizens.

Treasury strongly believes that, in order to protect classified information, every component reporting entity in the U.S. Government should disclose that its financial statements may have been modified.

Homeland Security's comments included two unsolicited proposals not covered by other comment letters. First, it noted that one of its component reporting entities favored having classified activities audited by properly-cleared members of its Office of Inspector General. Second, Homeland Security suggests that the Board may wish to consider adding an accounting category that covers secret spending and secret projects (without revealing the details of how much applies to any specific project.

The comments from the Office of Personnel Management stressed the importance of applying GAAP standards but were in favor of disclosure that modifications may have been made to financial statements to protect classified information only in the first year of implementation of Standard 56.

The Department of Labor favors at least annual review by the Board of Standard 56 so that "FASAB may act proactively as opposed to reactively in response to changes that may occur in the Federal security environment."

Finally, an "Other Governmental Agency" comments stated in answer to most questions posed that protecting classification information should take precedence over [the issuance of audited] financial statements. An additional comment is that

> *". . . there definitely needs to be a limited audience/participative base to protect the discussion of need to know information. . . The current lack of guidance leaves accounting practices open for interpretation, creating an environment where financial reporting preparers, reviewers and independent auditors may arrive at different conclusions that impact the financial statements"*

The "current lack of guidance" comment may be an indication of past problems on the government accounting front. From its designation and comments, we might speculate that these comments came from the CIA, NSA or similar intelligence agency or component.

Endnotes

1. Securities Exchange Act Rule 10b-5 (codified at 17 C.F.R. 240) is the major antifraud provision in U.S. securities law. It enables an investor to recover damages from the counterparty in the purchase or sale of a security if the investor suffered a loss as the result of the counterparty's untrue statement of a material fact or omission to state a material fact in connection with the purchase or sale.

2. See **https://hudmissingmoney.solari.com/top-100-u-s-government-contractors/** for Solari's list of the top 100 government contractors.

3. The Credit Rating Agency Reform Act of 2006 (Pub.L. 109–291, 120 Stat. 1327) was enacted on September 29, 2006. This law required the SEC to establish clear guidelines for determining which credit rating agencies qualify as NRSROs. It also gives the SEC the power to regulate NRSRO internal processes regarding record-keeping and how they guard against conflicts of interest and makes the NRSRO determination subject to a Commission vote (rather than an SEC staff determination). Notably, however, the law specifically prohibits the SEC from regulating an NRSRO's rating methodologies. In June 2007, the SEC promulgated new regulations that implemented the provisions of the Credit Rating Agency Reform Act. In February 2009, the

SEC promulgated amended regulations designed to address concerns about the integrity of the process by which NRSROs rate structured finance products, particularly mortgage-related securities. [Source: Wikipedia]

4. Source: Wikipedia, "Credit Rating Agency" fn. 3, citing Christopher Alessi, "The Credit Rating Controversy. Campaign 2012," *Council on Foreign Relations*, **https://www.cfr.org/backgrounder/credit-rating-controversy**.

5. Other credit rating agencies include DBRS (owned by Carlyle and Warburg Pincus), Kroll Bond Rating Agency, A.M. Best (for insurance companies), Egan-Jones, and Morningstar (for mutual funds).

6. Page 118. Get the report here:
http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf. The Commission was established as part of the Fraud Enforcement and Recovery Act passed by Congress and signed by the President in May 2009. This independent, 10-member panel was composed of private citizens with experience in areas such as housing, economics, finance, market regulation, banking, and consumer protection. Six members of the Commission were appointed by the Democratic leadership of Congress and four members by the Republican leadership. The Report was issued in January 2011 and is often referred to as the "Angelides Report" after its chairman, Phil Angelides.

7. An unsupported (or "undocumentable") journal voucher adjustment against Treasury by DOD or HUD is a debit or credit on the books of the federal reporting entity that has to be made in order to reconcile the agency's version of its assets, liabilities, income, and expenditures with what the U.S. Treasury's books reflect. In order to pass an audit, however, an explanation has to be made by the agency's independent public accountants as to what caused the discrepancies. When DOD says that it has made $21B in undocumentable journal voucher adjustments against Treasury, without more information, we do not know whether the net of the adjustments is positive or negative: if all of the adjustments are debits, then the agency has "lost" $21B, whereas if the credit balance and the debit balance of adjustments is equal, the net balance is zero and the agency is just unable to explain its mistakes, but there is no gain or loss. In the unlikely event that all of the adjustments are credits, then the agency has just "found" $21B it did not know it had.

Complicating this analysis is the fact that when one adjustment is made, it may require an adjustment in sub-accounts. Assuming the adjustments of the sub-accounts are included in the total of "unsupported journal adjustments," the total of all adjustments may tend to overstate the problem through duplications. On the other hand, multiple debit and credit adjustments over a single reporting period (a government fiscal year, from October 1 until September 30 of the following year, in the case of an audit), may net out to zero, making it appear that no adjustment has been made but enabling the agency to mask secret or unauthorized expenditures (debits) with accounting entries that zero out the results of operations over the year (i.e., credits). In any case, even one trillion dollars is a big number—once explained as approximately one dollar for each second going back to Jesus Christ.

8. See: "Exclusive: The Pentagon's Massive Accounting Fraud Exposed," *The Nation* (January 7, 2019).

9. Credit for this observation goes to Matt Taibbi. See "Has the Government Legalized Secret Defense Spending?" *Rolling Stone*, January 16, 2019. **https://www.rollingstone.com/politics/politics-features/secret-government-spending-779959/**

10. In a February 13, 2019 conversation with a member of the staff of the FASAB, we were told that independent auditors would have access to classified supporting information, but we cannot verify this from publicly available materials, and we do not know whether there are limits on access to classified documents.

11. Senate: Arkansas, California, Colorado, Florida, Idaho, Kentucky, Maine, Virginia, Kentucky, Missouri, Arkansas, Texas, Nebraska, New Mexico, New York, North Carolina, Oklahoma, Oregon, New Mexico, Maine, Florida, New York, Rhode Island, Texas, and Virginia Colorado. House: Districts in the additional states of Alabama, Connecticut, Illinois, Indiana, Ohio, Utah, Vermont, and Illinois, Washington, Vermont, Ohio and Utah.

12. Note that in Barack Obama's executive order on classified information (Executive Order 13526), the list of classified items includes only nine categories, eliminating the "catch-all" tenth category. We do not know whether, as has been suggested elsewhere, Obama's restatement of existing directives from the original Reagan executive order (Executive Order 12356) has the effect of rescinding or replacing matters that are dealt with in both executive orders. If so, the Obama executive order may have the effect, in this regard, of narrowing the amount of information that may be legally subject to classified treatment. In other ways, however, the Obama executive order is expansive, specifically, in providing for a process for government contractors to request that information over which they have control is classified.

13. In 1981, President Ronald Reagan delegated authority over the SEC classified information exemption from the requirements that public companies keep accurate books and records to the Director of National Intelligence.

14. A public company is a company with securities (equity and debt) owned and traded by the general public through the public capital markets, generally through a securities exchange like the New York Stock Exchange, or over the counter on the NASDAQ. Shares of a public company are openly traded and widely distributed. Under the Exchange Act, any company with more than $10 million in assets and 500 shareholders of record is required to register with the SEC under the Exchange Act and is subject to reporting standards and regulations under Sections 13 and 15(d) under the Exchange Act. Registration under the Exchange Act is separate and distinct from registration of securities in an initial public offering under the Securities Act of 1933 ("Securities Act"), although Exchange Act registration often follows a company's initial public offering.

15. The title and a synopsis of each section in the professional standards covered by SAS 122 can be found at **https://www.aicpa.org/research/standards/auditattest/clarifiedsas.html**

16. C.f., Portia Crowe, "We have new details on Goldman Sachs' $5 billion legal settlement," *Business Insider*, April 11, 2016, **https://www.businessinsider.com/goldman-sachs-mortgage-backed-securities-settlement-2016-4** and "Senate subcommittee investigating Financial Crisis releases documents on role of investment banks," *New York Times*, April 14, 2010, **https://www.nytimes.com/interactive/projects/documents/goldman-sachs-internal-emails**

17. For those interested in learning how commonplace these techniques have become, covert harassment and violence for political ends are covered regularly on The Solari Report. We also recommend Richard Dolan's documentary series "False Flags," the litigation section in the Resources section at **https://dillonreadandco.com** and a general search on "banker deaths" and "natural doctor deaths."

18. A review of spying and leaks by the U.S. intelligence agencies and enforcement services during the 2016 Presidential Election and the incoming administration offer an excellent example of this sovereignty "collapse." For a reader interested in knowing more, see the excellent coverage at The Last Refuge **https://theconservativetreehouse.com** and video interviews available at YouTube on this subject with William (Bill) Binney, retired technical director of NSA.

19. It is noteworthy that the lead contractor on DOD IT and payment systems from fiscal 1998 to fiscal 2015 (and lead on HUD IT and payment systems for a portion of the time as well) spun their government contracting division out to Leidos (to which SAIC had spun a portion out to the previous year) after the close of fiscal 2015, but before the announcement that $6.5 trillion was missing at DOD. See "Lockheed Cuts and Runs" at The Solari Report: **https://home.solari.com/lockheed-cuts-runs/**

20. See "Dual Citizens in Congress? We Need to Know" by L. Michael Hager, from *Foreign Policy Journal*, December 10, 2018. **https://www.foreignpolicyjournal.com/2018/12/10/dual-citizens-in-congress-we-need-to-know/**

21. These included the Department of Veterans Affairs–OFP, Department of Energy–OCPO, the Department of Housing and Urban Development, the Department of Labor–OCPO, the Department of Interior, the Office of Personnel Management, the Department of Defense OIG, the Department of Homeland Security–OCPO, the Department of Treasury–OCPO, and an "Other Governmental Agency."

22. The firm's website makes the following statement about its government auditing practice:

> *Kearney experience includes financial audits at the department and agency levels, major components, and Government corporations. Kearney's approach for providing financial audit services is consistent with the GAO/CIGIE FAM, which defines a methodology for conducting financial statement audits of Federal entities. Kearney reaches beyond FAM guidance to tailor our audit approach to the unique needs of each client. Our financial audits are designed to add value and insight, to improve financial management, operations, and accountability.*

23. AU-C 240.05 states that:

> *An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Due to the*

inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS.

24. Among other things, the SEC approves the PCAOB's rules, standards, and budget.

Chapter III. Reports on "Unsupported Journal Voucher Adjustments" for DOD and HUD

"No money shall be drawn from the treasury, but in consequence of appropriations made by law; and a regular statement and account of receipts and expenditures of all public money shall be published from time to time."
~ Article I, Section 9, Clause 7, U.S. Constitution

Solari Report—September 2017

Interview with Dr. Mark Skidmore, Thursday, September 28, 2017
https://library.solari.com/the-missing-money-19-trillion-in-undocumentable-adjustments-and-counting-with-dr-mark-skidmore/

Summary Report on "Unsupported Journal Voucher Adjustments" in the Financial Statements of the Office of the Inspector General for the Department of Defense and the Department of Housing and Urban Development*—September 2017

*Since we first published this report, it appears that some of the links to original sources at the Office of the Inspector General have been changed or taken off line. However, all of the original government documents can be found on the Solari missing money website: **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**.

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Catherine Austin Fitts
Catherine is the president of Solari, Inc., publisher of The Solari Report, and managing member of Solari Investment Advisory Services, LLC. She served as managing director and member of the board of directors of the Wall Street investment bank Dillon, Read & Co., Inc., as Assistant Secretary of Housing and Federal Housing Commissioner at the U.S. Department of Housing and Urban Development in the first Bush Administration, and was the president of Hamilton Securities Group, Inc. Her experience on Wall Street and Washington is described in her book *Dillon Read & Co. Inc. & the Aristocracy of Stock Profits* **https://dillonreadandco.com/**. Catherine graduated from the University of Pennsylvania (BA) and the Wharton School (MBA).

On September 10, 2001, Secretary of Defense Donald Rumsfeld stated in a Congressional hearing that the Department of Defense had lost track of $2.3 trillion in transactions. Mr. Rumsfeld made the following statement:

> *According to some estimates, we cannot track $2.3 trillion in transactions. We cannot share information from floor to floor in this building because it's stored on dozens of technological systems that are inaccessible or incompatible*.[1]
> ~ Remarks as delivered by Secretary of Defense Donald H. Rumsfeld, The Pentagon, Monday, September 10, 2001

Since that time, numerous documents produced by the Office of the Inspector General have reported trillions of dollars as "unsupported journal voucher adjustments." According to the Office of the Comptroller **http://comptroller.defense.gov/Portals/45/documents/fiar/FIAR_Plan_May_2015.pdf**, the definition of journal vouchers is as follows:

> *Journal vouchers are summary-level accounting adjustments made when balances between systems cannot be reconciled. Often these journal vouchers are unsupported, meaning they lack supporting documentation to justify the adjustment or are not tied to specific accounting transactions. While many adjustments are valid, having too many journal vouchers may be an indicator of underlying problems, such as weak internal controls. For an auditor, journal vouchers are a red-flag for transactions not being captured, reported, or summarized correctly. Auditors must judge whether the errors that triggered the journal voucher are isolated or systemic, leading them to select more transactions to test. If the auditors cannot estimate the magnitude of the errors, they may not be able to complete the audit or issue an opinion on the financial statements.*

Any journal voucher or entry requires appropriate documentation such as receipts with accompanying explanations. Journal voucher entries without such documentation are referred to as "unsupported journal voucher entries," and "unsupported journal voucher adjustments" are sometimes used to reconcile accounts. According to DeVries and Kiger (2004), when auditing private entities unsubstantiated journal entries and other adjustments represent significant exposure to potential fraud. Thus, in both the private and public sectors, unsupported journal voucher entries and adjustments are considered red flags for potential fraud.

The Inspector General's report for the Army in fiscal year 2015 is also notable: this document reported $6.5 trillion in unsupported journal voucher adjustments (**https://media.defense.gov/2016/Jul/26/2001714261/-1/-1/1/DODIG-2016-113.pdf**, see page 4). The report indicates that unsupported journal voucher adjustments are the result of agencies' failure to correct system deficiencies. Also, there was a lack of guidance on system-generated adjustments. The result, according to the report, is that data used to prepare the year-end financial statements were unreliable and lacked an adequate audit trail. For context, consider the fact that the entire budget of the Department of Defense (DOD) in 2015 was $565 billion. Therefore, the unsupported journal voucher adjustments for the Army were more than 10 times the entire DOD budget.

These two reports (the Rumsfeld announcement in 2001 regarding the "lost" $2.3 trillion and the $6.5 trillion in unsupported adjustments in 2015) prompted us to conduct a search at the website of the Office of the Inspector General and the Government Accountability Office to compile documents between the years 1998 and 2015 for the DOD and the Department of Housing and Urban Development (HUD) that indicate the amounts of unsupported journal voucher adjustments.[2] To make these documents more easily accessible to the general public, they have been made available at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**. While we were unable to recover data for a number of years, we were successful in identifying $21 trillion in unsupported adjustments for DOD and $350 billion for HUD. For those unaccustomed to dealing with large figures, $21 trillion is equal to about $166,000 per household in the United States. For further context, the entire sum of authorized DOD and HUD spending for years 1998-2015 in nominal terms was $8.6 trillion and $781 billion, respectively.[3] Thus, the unsupported journal voucher adjustments we identified for DOD, which are incomplete, were more than twice the size of authorized spending over the period. The sums are smaller for HUD in relation to its total budget, in part because we were only able to identify four years for which the amounts of unsupported adjustments or errors were reported. However, in fiscal year 2015, HUD "material errors" in reporting were $270 billion, nearly eight times the size of its $36 billion budget. The explanation given in the report was as follows (see **https://www.hudoig.gov/sites/default/files/3-16-2017-HouseHearing-Written-TestimonyPDF.pdf**, page 4):

> *Of the $278.5 billion in errors, $159.4 billion was due primarily to (1) incorrect data entry, (2) omission of restated balances, or (3) incorrect data provided by HUD's component entities (FHA and Ginnie Mae). The remaining $119.1 billion were due to inappropriate rounding adjustments. We found several instances in which rounding was performed to the nearest billion and hundred billion instead of the nearest million as required.*

The Inspector General reports that are available to the public only provide summary information; thus it is impossible for us to conduct a detailed assessment of the nature of these unsupported adjustments and errors. However, the report for fiscal year 2015 "Army General Fund Adjustments Not Adequately Documented or Supported" **https://media.defense.gov/2017/Apr/18/2001734010/-1/-1/1/00-167.PDF** offers some additional information in the appendices. Consider Appendix C Table 4 on page 27 of the report, which provides a summary of net changes in the Army General Fund balance sheet that are due to unsupported journal voucher adjustments. On the asset side, there is the following increase:

> $794 billion in Fund Balance with Treasury

For liabilities, there is the following increase:

$929 billion in Accounts Payable.

These two items are the largest entries. Summing all the changes in Appendix C Table 4, there is a net increase of $1 trillion in assets resulting from unsupported journal voucher adjustments, and a $1 trillion increase in net liabilities due to unsupported journal voucher adjustments. While the appendices do not provide a full accounting of the $6.5 trillion in unsupported adjustments articulated in the report, this additional information offers some guidance with regard to questions one might ask:

1) On the asset side of the ledger, from where did the additional $794 billion in Fund Balance with Treasury come? These adjustments appear to represent a flow of funds to the Army through Treasury above and beyond the known resources authorized by Congress. Were these additional funds authorized and if so when and by whom? From where did the funds come?

2) For liabilities, if our interpretation is correct the $929 billion in Accounts Payable represents the amount owed for items or services purchased on credit. What entities are expected to receive payment, which appear to be in excess of authorized spending? While the DOD systems do not provide adequate documentation to answer this question, it seems possible to learn more about such transactions via other means. For example, numerous DOD contractors are publically traded companies that regularly produce SEC filings and audited financial statements. Also, the Federal Reserve Bank acts as the fiscal agent for the government and therefore has a record of transactions.[4] Would not prudent fiscal management compel one [to] inquire further?

The report offers a footnote in Appendix C Table 4 stating that: "DFAS Indianapolis personnel stated that the majority of the increase is related to budget execution adjustments from prior years that must be applied to establish the correct beginning balances for the general ledger accounts reported on this line." Again, it seems possible, with further inquiry, to learn more about the nature of these adjustments and when the original transactions occurred. In principle, it could be that these adjustments represent a one-time event to reconcile the budget. However, as can be seen from the compiled documents available at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**, these types of substantial adjustments have occurred on a regular basis.

Turning to the 2001 Rumsfeld comment, consider the document "Statement of Robert J. Lieberman Assistant Inspector General Department of Defense Before the Task Force on Defense and International Relations House Budget Committee on Department of Defense Financial Management" which was delivered in July 2000 **https://media.defense.gov/2017/Apr/18/2001734010/-1/-1/1/00-167.PDF**. This may have been the document Mr. Rumsfeld was referring to when he indicated that the DOD could not account for $2.3 trillion. On page 9 of this report, we see that $2.3 trillion in transactions were "unsupported by reliable explanatory information." There is little explanation of the nature of these adjustments except that they are evidence of "how poor the existing systems are." The explanation in the document is that existing systems are inadequate given the complexity of DOD operations and contracts.

In our opinion, the DOD is no more complicated than large multi-national corporations, which by and large have effective systems of financial management. As a general rule DOD personnel are well-trained, skilled, and competent. Further, DOD has had more than two decades to correct any inadequacies in their systems of financial management. The ongoing and repeated nature of the unsupported journal voucher adjustments coupled with the seemingly enormous size of the adjustments warrants the attention of both citizens and elected officials.[5] By making these government documents more readily accessible at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**, we hope others will take note, inquire, and demand access to the necessary information for independent and Congressional inquiries. How is it that such large sums of unsupported journal voucher adjustments could be possible given the size of the appropriated DOD and HUD budgets? It is important to recognize that federal agencies maintain credit, loan, guarantee, insurance and, in the case of HUD, securities operations. Without reliable accounts and records of financial assets and liabilities, such operations theoretically have the potential to leverage the resources managed.[6]

If we can draw themes regarding the stated explanations for the unsupported adjustments from all of the government reports we were able to collect for years 1998 through 2015, they are: 1) inadequate systems financial management, 2) complexity of DOD operations, and 3) deficiencies in feeder systems and management. Regardless, the reports we have collected point to a failure to comply with basic Constitutional and legislative requirements for spending and disclosure. The reports also reveal a willingness on part of Congress to approve new spending and various governmental and third parties to process transactions despite that failure.

While budgets can be complex, in principle accounting relies primarily on basic math. It should be feasible to track revenues flowing in and expenditures flowing out, and share this information in a format that can be understood by literate people. The federal government is once again facing a potential budget crisis. Without formally expanding the debt limit beyond the existing $20 trillion ceiling, the federal budget and the economy will experience a significant shock. These issues will come to a head in December 2017. It seems now, more than ever, a transparent and publically available accounting of the $21 trillion in unsupported adjustments would be especially timely and valuable.

References

DeVries, D.D., & Kiger, J.E. (2004). Journal entries and adjustments? Your biggest fraud danger. *Journal of Corporate Accounting & Finance*, 15(4), 57–62. https://doi.org/10.1002/JCAF.20023

Endnotes

1. You may also view a C-SPAN recording of Representative Cynthia McKinney (D-GA) questioning Donald Rumsfeld about DOD financials in March 2005 at **https://www.youtube.com/watch?v=9RvLL--vSsA&mode=related&search=**

2. We anticipate conducting searches for other federal agencies in the future.

3. These data were obtained from historical tables available at **https://www.whitehouse.gov/omb/budget/Historicals**.

4. See **https://www.newyorkfed.org/aboutthefed/whatwedo.html**.

5. It should be noted that there have been reports of large amounts of money going missing in Iraq in connection with US operations in the Middle East. How those reports relate to the undocumented adjustments is unknown. See: **https://www.vanityfair.com/news/2007/10/iraq-billions200710?currentPage=all&printable=true**.

6. The appropriations budget is not the only source and use of funds for government agencies. With programs involving guarantees, credits, and loans (as with both HUD and DOD) and securities operations the amount of transactions can be much larger than the appropriations budget.

Update—October 5, 2017

On October 5, 2017, we discovered that the link to the report "Army General Fund Adjustments Not Adequately Documented or Supported" had been disabled. Within several days, the links to other Office of Inspector General (OIG) documents we had identified in our search were also disabled. The sequential and non-random nature of this disabling process suggests a purposeful decision on the part of OIG to make key documents unavailable to the public via the website (as opposed to website reorganization or some other explanation). We revisited the website intermittently to see whether the documents had been reposted under different URLs; until very recently, they had not been reposted.

Update—December 11, 2017

On December 11, 2017, we learned that key documents had been reposted on the OIG website, but with different URLs. Documents now appear to be reposted on new URLs. As we find the new URLs, we are adding them in the footnotes entitled "new link" next to the original link.

Update—December 12, 2017

Subsequent to the publication of Dr. Skidmore's report, the OIG at the Department of Defense (DOD) and the Department of Housing and Urban Development (HUD) took reports offline; consequently, our primary links in the table below are to the same documents posted on our website. We have preserved the original DOD and HUD links in the footnotes—if they result in a 404 error or "not found" message, this indicates they were taken down or moved subsequent to publication.

Update on the $21 Trillion in Unsupported Adjustments at the Department of Housing and Urban Development and the Department of Defense—June 6, 2018

By Mark Skidmore

It has now been about nine months since Catherine Austin Fitts and I released a report demonstrating how official government records indicate that the Department of Housing and Urban Development (HUD) and the Department of Defense (DOD) had $21 trillion in undocumentable adjustments over the 1998-2015 period. Over the past several months, I have repeatedly tried to contact the Office of the Inspector General (OIG) in an effort to obtain additional information regarding the nature of the unsupported adjustments. However, no information has been provided and the OIG is no longer responding to inquiries.

In late May 2018, a graduate student at Michigan State University found on the OIG website the most recent report for the DOD, which summarizes unsupported adjustments for fiscal year 2017. However, this document differs from all previous reports in that all the numbers relating to the unsupported adjustments were redacted. That is, all the relevant information was blacked out. The report can be accessed here: **https://home.solari.com/wp-content/uploads/2018/06/Financial-Statement-Compilation-of-Adjustments-and-Information-Technolog....pdf** .

Recently, a C-Span video recording came to my attention in which David Norquist, Comptroller of the DOD, offers an explanation to Congressman Walter Jones regarding the nature of the $6.5 trillion in unsupported adjustments for the Army in fiscal year 2015. You can view his testimony here: **https://www.youtube.com/watch?v=NoOFhjDjGqU&feature=youtu.be**. To summarize, Norquist says that unsupported adjustments are the result of changes in the "property book" that can amount to hundreds of billions of dollars. According to Norquist, since the system that tracks the property book is not integrated with the system that tracks the general fund ledger, large unsupported adjustments are required for reconciliation. Though it is not entirely clear from his testimony, it seems Mr. Norquist is suggesting that changes in the valuation of property and equipment due to depreciation, base closures, equipment becoming obsolete, etc. are leading to large undocumentable adjustments.

If I were present at the hearing, I might have asked Mr. Norquist follow-up questions. The report highlighting unsupported adjustments of $6.5 trillion does indeed indicate that $164 billion in unsupported adjustments were needed to address issues related to "property" (see page 27 of the report). The $164 billion in unsupported adjustments is substantial; what properties, equipment, etc. required changes in valuation? Further, $164 billion accounts for less than two percent of the $6.5 trillion. Why were an additional $6.3 trillion in unsupported adjustments needed? Because the reports that are available to the public do not offer detailed explanations and additional data are unavailable, we are left to "trust" that the authorities are offering an accurate assessment...it is not possible to verify using data or other documentation.

While Norquist's description of the unsupported adjustments is not the only one that has been offered, some evaluation to assess the veracity of this explanation is possible. Consider the case of the Army for which we found $11.5 trillion in unsupported adjustments over the 1998-2015 period. During this time period, authorized general fund Army spending was about $2 trillion. We know from other sources that about 40 percent of the Army's budget is allocated to personnel costs, and thus was not used for purchasing property, equipment, and the like. For purposes of this exercise, let's assume that the remaining amount (60 percent of the $2 trillion, or $1.2 trillion) is used to purchase property, equipment, etc., and suppose all of this spending is fully written off at 100 percent. For how many years could the Army write off all non-personnel spending and then call it an unsupported adjustment? Between 1998 and 2015, the Army's average annual budget was about $118 billion, of which about $71 billion annually was for non-personnel spending. If we divide $11.5 trillion by $71 billion, we see that the Army could have fully written off all non-personnel spending for the past 163 years (assuming a stable budget allocation in real terms), and then called it an unsupported adjustment. From this evaluation, it seems that Mr. Norquist's explanation does not hold up to a modest level of scrutiny.

Here is a summary of three notable developments since the fall of 2017:

1) The OIG has not provided any additional information and has not responded to the questions we posed in our report, despite having offered to provide more information following an interview I gave on Michigan Radio in January 2018.

2) The latest OIG report regarding DOD unsupported adjustments in fiscal year 2017 is now available, but all numbers and figures referring to unsupported adjustments have been redacted. Thus, it is not possible to ask questions about unsupported adjustments for fiscal year 2017. If undocumentable adjustments simply reflect computer communication problems, why has the DOD OIG redacted the numbers in their report regarding undocumentable adjustments in fiscal year 2017?

3) The explanation offered by Mr. Norquist regarding the $6.5 trillion in unsupported adjustments for the Army in fiscal year 2015 appears to be insufficient and does not appear to hold up to scrutiny.

We continue our efforts to increase transparency and provide information regarding the degree to which the US government is complying with financial reporting laws and the US Constitution.

Update—September 18, 2018

Early this year, the Pentagon announced that it was conducting its first-ever independent audit. However, several months after beginning the audit, the government accepted the recommendations of the Federal Accounting Standards Board: **https://fas.org/sgp/news/2018/07/fasab-review.pdf** (see page 3 for a summary). The statement allows government officials to misstate and move funds around to hide expenditures if it is deemed necessary for national security purposes, and the rule applies to all agencies, not just the black budget. Here is an excerpt from the report:

> *This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.*

From this statement, it seems that only a few people with high-level security clearances have the authority to determine what is a national security issue, and these same people will now be allowed to restate financial reports to hide activity. No one but those few people would ever know that expenditures on "activity A" are hidden in a completely different area of government. What good is an independent audit if authorities are allowed to move expenditures around with no transparency? How can one conduct an evaluation of any portion of the federal budget under such an arrangement? How is this policy in compliance with financial reporting laws or Constitutional requirements for reporting on government spending to the citizens of the United States?

Update—December 12, 2018

On October 4, 2018, federal government officials accepted the recommendation of the Federal Accounting Standards Advisory Board (FASAB) **https://fasab.gov/about-fasab/mission-objectives/** that the government be allowed to misstate and move funds in order to hide expenditures if it is deemed necessary for national security purposes. The new guidelines apply to all agencies, not just the black budget. See page 3 of the July 2018 FASAB report **https://fas.org/sgp/news/2018/07/fasab-review.pdf** for a summary of the proposed recommendations and see here **https://fas.org/sgp/news/secrecy/2018/10/100918.html#1** for more detail. See here **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf** for the final statement: *Statement of Federal Financial Accounting Standards 56.*

With the change in accounting guidelines, which is a full departure from Generally Accepted Accounting Principles (GAAP), only a few people with high-level security clearances have the authority to determine what is deemed a national security issue, and these same people will now be allowed to restate financial reports in order to conceal actual expenditures without any disclosure. No one but those few people would know that such modifications were made, thus making evaluation of government financial statements impossible. From this point forward, the federal government will keep two sets of books—one modified book for the public and one true book that is hidden.

The FASAB recommendation effectively institutionalizes non-transparency in federal financial reporting. While many aspects of federal finances are already non-transparent because government has failed to comply with existing financial reporting laws, at least citizens had the laws working in their favor. Now, citizens have no recourse; non-transparency is going to proceed as a matter of executive branch authority and policy.

Accounting rules are often thought of as boring and of secondary importance. However, this particular change has enormous implications, and yet few citizens are aware of it. People should know about these changes so that they have an opportunity to voice their concerns and reverse the decision.

Update—February 8, 2019

Dr. Skidmore prepared a chapter ("Should Economists Care about Secrecy in Financial Reporting?") for a book on the U.S. Federal debt with Catherine's input—it includes updates and new information subsequent to the 2018 updates to the original report and so is provided here.

Should Economists Care about Secrecy in Financial Reporting?—February 8, 2019

[CAF Note: This is a chapter that Dr. Skidmore prepared for a book on the U.S. Federal debt with Catherine's input–it includes updates from the last updates to the original report. It was submitted for publication on February 8, 2019 and is a forthcoming book chapter in *Perspectives on the U.S. Federal Debt Crisis* https://vetfiscalrules.net/.]

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Introduction

On October 7, 2016 Reuters published an article by Scot Paltrow (2016), which reported that in fiscal year 2015 the Army made $6.5 trillion in unsupported accounting adjustments "to create an illusion that its books were balanced." Given that the Army general fund budget in that year was $122 billion, this was an astounding revelation. Though the article highlighted ongoing accounting problems within the Department of Defense (DOD), Paltrow tried to alleviate public concerns about the enormous unsupported adjustments with the following statement:

> *At first glance the adjustments totaling trillions may seem impossible. The amounts dwarf the Defense Department's entire budget. Making changes to one account also requires making changes to multiple levels of sub-accounts, however. That created a domino effect where, essentially, falsifications kept falling down the line. In many instances this daisy chain was repeated multiple times for the same accounting item.*

Though the massive $6.5 trillion figure raised eyebrows, the story quickly faded from public view. The original government report upon which Paltrow based his article comes from the Office of the Inspector General (OIG). The document "Army General Fund Adjustments Not Adequately Documented or Supported" (2016) concluded that the problems were attributed to "control deficiencies." While the report did not receive much additional attention from the media, it did catch the eye of former Assistant Secretary of Housing and Urban Development, Catherine Austin Fitts. Ms. Fitts had been tracking similar unsupported adjustments in the Departments of Housing and Urban Development (HUD) and the Department of Defense (DOD) for nearly twenty years. Fitts became interested in the issue because she had become aware of financial impropriety within HUD many years prior.

The DOD made major media headlines many years earlier for its accounting problems on September 10, 2001 when Secretary of Defense Donald Rumsfeld stated in a Congressional hearing (C-SPAN, 2014) that the DOD had lost track of $2.3 trillion in transactions. At the time, Mr. Rumsfeld said:

> *According to some estimates, we cannot track $2.3 trillion in transactions. We cannot share information from floor to floor in this building because it's stored on dozens of technological systems that are inaccessible or incompatible.*
> ~ Remarks as delivered by Secretary of Defense Donald H. Rumsfeld, The Pentagon, Monday, September 10, 2001

This acknowledgement made news headlines on that day, but was forgotten a day later when the tragedy of 9/11 captured the attention of the entire world. DOD accounting problems also found their way into the media during the Iraq War, but have largely remained out of public view for more than a decade.

When Professor Mark Skidmore learned of the $6.5 trillion in unverifiable Army transactions, he contacted Ms. Fitts and they agreed in the spring of 2017 to work together to identify other similar government reports that indicated unusually large unverifiable transactions within HUD and DOD. Over the course of the next six months, Skidmore, Fitts and a small team of graduate students collected official government documents wherein a total of $21 trillion in undocumentable transactions were identified during the 1998-2016 period.[1]

The remainder of this chapter provides an assessment of the nature of the huge unsupported transactions, placing the issue within the context of changing financial reporting rules that enable ever-growing secrecy within both the public and private sectors. In the next section, we provide a formal definition of an "unsupported journal voucher adjustment," discussing examples with some interpretation. This section is followed by an evaluation of an important change in federal financial reporting rules, which is known as Standard 56. Adopted by the federal government in October 2018, Standard 56 effectively enables a small group of high level government authorities with security clearances to create financial reports for the public, which have been altered in order to hide expenditures that may be related to issues of national security. From this point forward, the United States will produce two sets of financial reports, one altered set for the public and another real set of undisclosed financial reports. The discussion of Standard 56 is followed by a brief section describing two major changes in private sector financial reporting rules that create greater opacity. Here, we discuss a little known law that enables the National Security Agency (NSA) to exempt some corporations from Security Exchange Commission (SEC) financial reporting requirements as well as the suspension of "market to market" valuation of assets for financial institutions that was implemented 2009 during the financial crisis. The chapter concludes by discussing implications of ever growing secrecy for economists, investors and all U.S. citizens.

What Is an Unsupported Journal Voucher Adjustment?

The Office of the Undersecretary of Defense (2016) defines an unsupported journal voucher adjustment as:

> *Journal vouchers are summary-level accounting adjustments made when balances between systems cannot be reconciled. Often these journal vouchers are unsupported, meaning they lack supporting documentation to justify the adjustment or are not tied to specific accounting transactions. While many adjustments are valid, having too many journal vouchers may be an indicator of underlying problems, such as weak internal controls. For an auditor, journal vouchers are a red-flag for transactions not being captured, reported, or summarized correctly. Auditors must judge whether the errors that triggered the journal voucher are isolated or systemic, leading them to select more transactions to test. If the auditors cannot estimate the magnitude of the errors, they may not be able to complete the audit or issue an opinion on the financial statements.*

A journal voucher or journal entry requires appropriate accompanying documentation such as receipts with accompanying explanations. Journal voucher entries without such documentation are referred to as "unsupported journal voucher entries," or "unsupported journal voucher adjustments" and are sometimes used to reconcile accounts.[2] According to DeVries and Kiger (2004), unsubstantiated journal entries and other adjustments represent significant exposure to potential fraud. Thus, unsupported journal voucher entries are considered red flags for potential fraud.

In the case of Army in fiscal year 2015, the OIG report (2016) identified $6.5 trillion in unsupported journal voucher entries. The report indicates that unsupported transactions are the result of the agency's failure to correct system deficiencies. According to the report, the data used to prepare the year-end financial statements were unreliable and did not have an adequate audit trail. For context, keep in mind that the entire budget of the DOD in 2015 was $565 billion. Therefore, the Army unsupported journal voucher entries were more than 10 times the entire DOD budget.

The anomalous size of the unsupported adjustments for the Army in fiscal year 2015 coupled with Rumsfeld's $2.3 trillion figure prompted us to conduct a search at the websites of the OIG, Government Accountability Office (GAO), and to the Office of the Under Secretary of Defense to compile documents between the years 1998 and 2016 for DOD and HUD that indicate the amounts of unsupported journal voucher entries. To make these original federal government source documents more easily accessible to the public, they have been made available at **https://solari.com/blog/dod-and-hud-missing-money-supporting-documentation/**. While we were unable to find reports for many years, we were able to identify more than $20 trillion in unsupported adjustments for DOD and nearly $600 billion for HUD. For reference, the entire sum of authorized DOD and HUD spending for years 1998-2016 in nominal terms was $9.2 trillion and $806 billion, respectively.[3] Thus, the unsupported journal voucher adjustments we identified for DOD, which are incomplete, were more than twice the size of authorized spending over the period. In the case of HUD, we were only able to identify five years for which the amounts of unsupported adjustments and/or errors were reported. Notable is the fact that in fiscal years 2015 and 2016 HUD "errors" in reporting were $516 billion, roughly 10 times the size of the sum of authorized spending in those two years.

The OIG reports that are available to the public only provide summary information, and thus it is impossible for us to conduct a full assessment of the nature of these unsupported adjustments/errors. However, the report for fiscal year 2015 "Army General Fund Adjustments Not Adequately Documented or Supported" (2016) offers some additional information in the appendices. We discuss some of the unsupported adjustment in Skidmore and Fitts (2016), and we highlight them again here. Appendix C Table 4 on page 27 of the report provides a summary of net changes in the Army General Fund balance sheet that are due to unsupported journal voucher adjustments. On the asset side, there is an increase of $794 billion in Fund Balance with Treasury. In addition, liabilities increased by $929 for accounts payable. On page 6 Table 2, there are 170 unsupported adjustments tallying to $2.3 trillion.
While the report does not provide a detailed accounting of the $6.5 trillion in unsupported adjustments, the information provided in the appendix offers guidance in terms of questions to ask:

1. On the asset side of the ledger, from where did the additional $794 billion in Fund Balance with Treasury come? Do these unsupported adjustments represent a flow of funds to the Army through Treasury beyond the known resources authorized by Congress? If the undocumented transactions merely represent a "domino" effect of falsification as described by Paltrow (2016), why is it that the Army fund balance with Treasury must be increased by nearly $1 trillion? If these represent funds

flowing to the Army, were they authorized and if so when and by whom? From where did the funds come?

2. With regard to liabilities, it appears that the $929 billion in Accounts Payable represents the amount owed for items or services purchased on credit. If this is the case, what entities are expected to receive payment, noting that amounts are in excess of authorized spending? While the report does not provide enough information to answer this question, it may be possible to learn more about such transactions via other means. For example, numerous DOD contractors are publically traded companies that regularly produce SEC filings and audited financial statements. Would not prudent fiscal management compel one to inquire further? Similarly, given that Federal Reserve Bank is the fiscal agent of the federal government, it has a record of all transactions.

3. With regard to the 170 adjustments that amount to $2.1 trillion, Skidmore has repeatedly asked the OIG to provide an addendum which would list these transactions so that the public can see what the Army says they were presumably for. To date, the OIG has not provided any information, even with a FOIA request.

The report also offers a footnote in Appendix C Table 4 to indicate that: "DFAS Indianapolis personnel stated that the majority of the increase is related to budget execution adjustments from prior years that must be applied to establish the correct beginning balances for the general ledger accounts reported on this line." If the OIG were willing to provide additional information, it would be possible to learn more about the nature of these adjustments and when the original transactions occurred. While it could be that these adjustments represent a one-time event to reconcile the budget in advance of the first ever DOD independent audit that was conducted in 2018, as shown in the compiled reports available at **https://solari.com/blog/dod-and-hud-missing-money-supporting-documentation/**, these types of substantial unsupported adjustments occur regularly.

To date, the OIG is no longer responding to our inquiries. Further, evidence suggests that authorities are hiding important information from lawmakers. For example, a recent C-Span video recording came to our attention in which David Norquist, Comptroller of the DOD, offered an explanation to Congressman Walter Jones regarding the nature of the Army's $6.5 trillion in unsupported adjustments. Norquist's testimony is available on YouTube (West, 2018), and the following assessment was originally provided by Kotlikoff and Skidmore (2018).

In his testimony, Norquist claimed that the unsupported journal voucher entries are the result of changes in the "property book" that amount to hundreds of billions of dollars. According to Norquist, the system that tracks the property book is not integrated with the system that tracks the general fund ledger, and thus large unsupported adjustments are required for reconciliation. From his testimony, Mr. Norquist says that changes in the valuation of property and equipment due to depreciation, base closures, equipment becoming obsolete, etc. are leading to large undocumentable adjustments.

Let us examine his statement. The original Army OIG report (2016) highlighting unsupported adjustments of $6.5 trillion indicates that $164 billion in undocumentable adjustments were related to property (see page 27 of the report). First, the $164 billion in unsupported adjustments is substantial and yet there is no indication regarding what properties, equipment, etc. required changes in valuation. However, what is more important is that while $164 billion is a substantial figure, it accounts for only two percent of the $6.5 trillion. Why were an additional $6.3 trillion in unsupported adjustments needed? Because the publicly available reports do not offer detailed explanations and additional data are not forthcoming, we are left to "trust" that the authorities are offering an accurate assessment, and yet it is clear that Norquist withheld vital information, thus making his testimony deceptive.

Further evaluation is in order. Consider the Army for which we found $11.5 trillion in unsupported adjustments over the 1998-2016 period. During this period, authorized general fund Army spending was just over $2 trillion. We know from other sources that about 40 percent of the Army's general fund budget is allocated to personnel costs, and therefore was not used for purchasing property and equipment. For simplicity, assume that the remaining amount (60 percent of the $2 trillion, or $1.2 trillion) was used to purchase property and equipment, and assume all of this spending is fully written off at 100 percent. For how many years could the Army write off all non-personnel spending and then call it an unsupported adjustment? Between 1998 and 2016, the Army's average annual budget was about $118 billion, of which roughly $71 billion annually was for non-personnel spending. Dividing $11.5 trillion by $71 billion shows that the Army could have fully written off all non-personnel spending for the past 163 years (assuming a stable budget allocation in real terms), and then called it an unsupported adjustment. From this evaluation, it seems that Mr. Norquist's explanation does not hold up to a modest level of scrutiny.

As the questions we posed regarding the $21 trillion in unverifiable transactions gained traction in the media, the issue received even more attention in late 2018 when incoming representative Alexandria Ocasio-Cortez referred to the $21 trillion in a Tweet:

> *$21 TRILLION of Pentagon financial transactions "could not be traced, documented, or explained." $21T in Pentagon accounting errors. Medicare for All costs ~$32T. That means 66% of Medicare for All could have been funded already by the Pentagon. And that's before premiums.*

Numerous media outlets including the *New York Times* (Qiu, 2018) and the *Washington Post* (Blake, 2019) "fact" checked Ocasio-Cortez's statement. The near universal assessment was that Ocasio-Cortez's Tweet was misleading—the $21 trillion in undocumentable transactions do not reflect actual unauthorized spending. However, as noted by Kotlikoff (2019) there is a very important point that was missed by nearly all media outlets.

Despite our efforts, the federal government has not shared any of the underlying data or information regarding the nature of the undocumentable transactions. To illustrate, Mark Skidmore has repeatedly asked the OIG to provide an addendum to the report published by the OIG (2016), which indicated that the Army had $6.5 trillion in undocumentable transactions. For example, Skidmore requested that the OIG provide more information about the nature of 170 transactions that generated $2.1 trillion in undocumentable adjustments (see page 6 of the report). Why would the Army make up such enormous phony numbers, as asserted in a recent article by Lindorff (2018) and his sources? On the other hand, it is difficult to imagine how huge unauthorized sums could flow in and/or out of the Army. We argue that it is impossible to verify without greater transparency.

We have tried to make the case that in order to determine what these unsupported adjustments were presumably for, one would need access to the underlying information. And yet the OIG has to date refused to provide any data, even with a FOIA request. Without additional supporting documents, we must decide whether or not we have faith that our government officials are sharing accurate information. Unfortunately, as discussed above Norquist is clearly omitting important information in his testimony to Congressman Walter Jones. Greater transparency is needed to re-establish some level of public trust. Instead, we have been fully blocked from accessing additional information. Further, note that through 2017 all of the government reports we collected were unredacted and thus deemed not to be an issue of national security. Then in early 2018 we identified the latest OIG report (2017), which was fully redacted. That is, nearly all the numbers in the report had been blocked out; suddenly these reports had become a threat to national security.

Standard 56

Shortly, after we made information about the $21 trillion in unsupported adjustments more accessible to the public, the DOD announced that it would conduct its first ever external independent audit, which it failed. Concerned that the audit process would reveal sensitive information, Pentagon officials turned to the Federal Accounting Standards Advisory Board (FASAB) for advice. Several months into the audit FASAB posted a new document (FASAB report, 2018), which recommended that the government be allowed to misstate and move funds in order to conceal expenditures if it is deemed necessary to protect national security interests. The statement is known as Standard 56. A summary of the recommendation is available on page 3 of the document:

> *This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.*

The federal government accepted the FASAB recommendation on October 4, 2018, which was just in time for it to be applied to the financial statements generated by the DOD audit. It is important to note that Standard 56 was adopted with the full support of both the GAO and the OMB, making it a bipartisan effort on the parts of the executive branch and Congress. See Ferri and Lurie, Solari Report (2019) and Federation of American Scientists (2018) for a more detailed assessment of Standard 56. Importantly, Standard 56 applies to all federal entities that issue unclassified general purpose reports (GPFFR), including entities that are: 1) budgeted for by elected federal officials, 2) owned by the federal government, 3) or controlled by the federal government. Standard 56 applies to at least 154 entities including entities ranging from the Department of Agriculture, Department of Housing and Urban Development, to the Farm Credit System Insurance Corporation, and government entities that are unrelated to issues of national security. It is also alarming that Standard 56 can include publicly traded corporations with significant funding and/or federal government control.

With these new accounting rules, which is a full departure from Generally Accepted Accounting Principles (GAAP), a few people with high level security clearances have the authority to determine what is deemed to be a national security issue and this same group has the authority to restate financial reports in order to conceal actual revenue and expenditure flows. Further, the federal government will not disclose whether or not financial reports have been restated. The new social contract appears to be that the federal government will pretend to publish real financial statements, and the public will pretend that they are meaningful. No one outside this circle of national security advisors will know the degree to which modifications were made, thus making evaluation of government financial statements impossible for anyone outside this circle. From this point forward, the federal government will keep two sets of financial reports, one modified (and useless) set for the public and one true set that will remain undisclosed. D. Scott Showalter, Chair of FASAB, has written a forthcoming article about the ruling (Showalter, 2019) in which he states:

> *Ultimately the board (FASAB) concluded that finding a way to include most financial information correctly in public financial statements was better than not providing financial statements publicly.*

In other words, the assessment of the board is that if they had not adopted this ruling, the federal government would no longer be able to provide financial statements to the public. Further, though he suggests the new approach will "include most financial information correctly," he neglects to say that the ruling applies to all 154 federal entities and that authority is fully transferred to a small invisible group of people who determine when an issue is a matter of national security and can then make adjustments to public financial statements in any way they please without any indication that the financial statements had been altered.

The FASAB recommendation institutionalizes non-transparency in federal financial reporting. Up to now, many aspects of federal finances have been opaque because government has failed to comply with existing financial reporting laws, but at least the laws worked in favor of citizen interests. With Standard 56 in place, citizens have no recourse; non-transparency is a matter of executive branch authority and policy. This change has important implications for the integrity of the republic and it greatly expands the opportunity for fraud or the financing of illegal operations, as accountability and transparency are eliminated. Unfortunately, this is just one of several accounting rule changes that has reduced transparency. Below, we discuss two other important changes.

Changes to Financial Reporting in the Private Sector

According to an article published by *BusinessWeek* (Kopecki, 2006), President Bush bestowed the Director of National Intelligence with the power to exempt publicly traded companies from standard financial reporting laws set forth by the Securities and Exchange Commission. According to the article, at least since the Carter administration, the Office of the President has had the authority to exempt companies working on top secret projects from financial reporting if it was deemed by the President to be in the interest of national security. However, in 2006 President Bush delegated that authority to the Director of National Intelligence. To our knowledge, nothing is known about the degree to which the intelligence branch of the federal government has granted exemptions to private corporations. The ability of the intelligence branch of government to exempt companies from financial reporting laws is very important, but few realize it exists.

In the aftermath of the financial crisis, the Financial Accounting Standards Board (FASB) suspended "mark-to-market" rules on bank assets (Foley, 2009). In the midst of the financial crisis and collapsing real estate values, FASB allowed financial institutions to ignore market valuations in determining their asset valuations. The concern was that bank liabilities (bad loans) would not be fully offset by declining asset valuations (the foreclosed properties). Under pressure from Congress, the FASB decided to allow financial institutions to book smaller losses on foreclosed properties by allowing these companies to value their assets at what they think they may be worth in the future. The move enabled financial institutions with trillions of dollars of mortgage-related assets to avoid insolvency. FASB changed the rules to prevent the insolvency of the financial institutions. While the U.S. is now well beyond the last crisis, the suspension of "mark-to-market" is still in place. Thus, it is difficult to assess the true financial condition of these companies. Importantly, many of the financial institutions affected by the suspension of "mark-to-market" provide depository functions for the U.S. government through the New York Federal Reserve and also serve as primary dealers in the U.S. Treasury securities market. The potential for conflicts of interest are significant.

Implications and Conclusions

Here is the current state of financial reporting in the U.S. First, we have a federal government with the authority to create fake books for the public, and not indicate where or how the financial statements have been altered. Second, the national intelligence branch of government has the authority to exempt companies from standard reporting requirements. Again, investors and the general public have no way of knowing which companies have altered financial statements. Third, financial institutions are free to value their assets in ways that improve the appearance of their financial condition. The potential negative consequences of these changes for U.S. citizens are profound.

At a fundamental level, we must all ask ourselves whether this arrangement is compatible with a functioning representative democracy and U.S. constitutional financial reporting requirements. Is it possible for citizens to assess how their tax dollars (and future tax dollars via debt issuance) are being used when publicly available financial reports are altered with no way of knowing the degree to which they have been changed? In our assessment, Standard 56 formally severs the flow of information between the governing body and the governed, thus eliminating accountability and transparency necessary for the United States to be called a representative democracy. While the structure or skeleton of representative democracy is still in place, the essential prerequisite of transparency has been stripped away. If we are not a representative democracy, what form of government do we have?

Economists and policymakers depend greatly on publicly available financial information to assess the effectiveness of government programs. Is it possible for researchers to conduct policy evaluation or financial analysis under Standard 56? With the implementation of Standard 56, how will researchers and policy analysts evaluate government spending and programs? How can researchers be sure the data available to them offer an accurate reflection of actual government activities? Recall that under the new standard there is no obligation on the part of government authorities to reveal where or to what degree financial reports have been altered.

On the private sector side, how do investors and financial advisors assess companies and allocate resources to the most productive entities when they cannot know which companies receive exemptions from standard financial reporting rules, and cannot know the true value of the assets for financial institutions? Is this arrangement compatible with an efficient market-oriented economy? What misallocation of resources occurs because of cloaked financial information?

Even more troubling is that with the two-way reporting exemptions (public and private), it is now possible for government authorities to funnel public resources (funds and assets) to corporations without public disclosure. Recall that a limited number of government officials who are invisible to the public now have the authority to alter publicly available financial statements and exempt companies from standard reporting requirements. This combination fully opens the door for large scale fraud.

In past years, the OIG provided periodic reviews of government agency financial reporting. We have shown that these reports reveal enormous problems within HUD and DOD, the scale of which is almost unfathomable. The most recent similar OIG report for the DOD was fully redacted; apparently the revelation of huge accounting discrepancies is now a national security issue. Shortly after the redacted report was made available, the government altered its accounting practices and policies to allow fake financial reports to be distributed to the public while concealing the true financial statements. In the words of Fitts (2019), "The time has come to invoke the rule of 'Caveat Emptor'—Buyer Beware." As a matter of executive branch policy, the U.S. government will not provide adequate financial disclosure. Thus, the responsibility of collecting the needed information for assessing and pricing the quality of credit and promises made is now fully transferred to citizens and investors. One should no longer rely on the government to provide accurate government financial information or assurances of private sector financial reporting accuracy.

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United States Office of the Inspector General (2017). “The XXXXXXXX Financial Statement Compilation Adjustments and Information Technology Corrective Action Plan Validation Process.” Accessed 1/23/2019: https://home.solari.com/wp-content/uploads/2018/06/Financial-Statement-Compilation-of-Adjustments-and-Information-Technolog….pdf

West, M. (2018). “David Norquist Explains the ‘Missing’ Trillions in Journal Vouchers.” Accessed on 1/23/2019: https://www.youtube.com/watch?v=NoOFhjDjGqU&feature=youtu.be

Endnotes

1. All original federal government source documents can be found at https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/.

2. In this book chapter we use these two terms as well as “unverified transactions,” “undocumentable transactions,” and “undocumentable adjustments” interchangeably.

3. These data were obtained from historical tables available at https://www.whitehouse.gov/omb/budget/Historicals.

Supporting DOD and HUD Documentation

Year	DOD	Government Source Document
2018	Unspecified	See Here
2017	Unspecified	See All Pages (#s 100% Redacted)
2016	Unspecified	See Page #78[39]
2015	Unspecified	See Page #83[37], See Page #59, 78[38]
2014	Unspecified	See Page #59, 79[2]
2013	Unspecified	See Page #81, #101[3]
2012	Unspecified	See Page #84, #104[4]
2011	Unspecified	See Page #73[5]
2010	Unspecified	See Page #8, #9[6]
2009	Unspecified	See Page #28[7]
2008	Unspecified	See Page #49[8]
2007	Unspecified	See Page #46[9]
2006	Unspecified	See Page #178[10]
2005	Unspecified	See Page #18, #50, #296[11]
2004	Unspecified	See Page #19[12]
2003	Unspecified	See Page #2[13]
2002	Unspecified	See Page #2[14]
2001	Unspecified	See Page #2[15]
2000	$1.1 trillion (includes $320.8 billion from Air Force)	See Page #1[16] See Page #147[36]
1999	$2.3 trillion	See Page #9[17]
1998	$1.7 trillion	See Page #5[18]

Year	DOD Army	Government Source Document
2015	$6.5 trillion	See Page #1[24]
2014		
2013		
2012	$110.9 billion	See Page #91[25]
2011	$14.6 billion	See Page #100[26]
2010	$874.8 billion	See Page #4[40]
2009	$311.3 billion	See Page #88[28]
2008	$595.8 billion	See Page #91[29]
2007	$1.1 trillion	See Page #5[41]
2006	$270.1 billion	See Page #107[30]
2005	$248.5 billion	See Page #140, #141[11]
2004	$258.1 billion	See Page #125[32]
2003	$268.3 billion	See Page #191[33]
2002	$500.1 billion	See Page #232[34]
2001		
2000	$361.5 billion	See Page #168[35]
1999		
1998		

Year	DOD Navy	Government Source Document
2015		
2014		
2013		
2012		
2011		
2010		

Year	DOD Navy	Government Source Document
2009		
2008		
2007		
2006		
2005		
2004		
2003		
2002		
2001		
2000	$161.6 billion	See Page #4[42]
1999		
1998	$880 billion	See Page #1[43]

Year	DOD Air Force	Government Source Document
2015	$90.2 billion	See Page #8[44]
2014		
2013		
2012	$1.6 trillion	See Page #4[44]
2011		
2010		
2009	$1.4 trillion	See Page #8[45]
2008		
2007		
2006		
2005		
2004		
2003	Unspecified	See Page #41[46]
2002	Unspecified	See Page #150[47]
2001	Unspecified	See Page #70[48]
2000	$320 billion	See Page #147[36]
1999		
1998		

Year	HUD	Government Source Document
2015	$278.5 billion	See Page #4[19]
2014	$1.9 billion	See Page #5[20]
2013		
2012		
2011		
2010		
2009		
2008		
2007		
2006		
2005		
2004		
2003		
2002		
2001		
2000		
1999	$59.6 billion	See Page #4[22]
1998	$17.6 billion	See Page #4[22]

Related Reading

The following documents are available at **https://library.solari.com**.

- $4 Trillion + Missing Money: What's the Action?
- The Financial Coup d'État & Missing Money: Links
- The Financial Coup & Missing Money: Quotes
- DOD Inspector General SemiAnnual Report to Congress: 10/1/16-3/31/17

FOIA Request

The following documents are available at **https://missingmoney.solari.com**.

- FOIA Request
- Response to FOIA Request

Original Sources

Note: On October 5, 2017, we discovered that the link to the report "Army General Fund Adjustments Not Adequately Documented or Supported" had been disabled. Within several days, the links to other OIG documents we had identified in our search were also disabled. The sequential and non-random nature of this disabling process suggests a purposeful decision on the part of OIG to make key documents unavailable to the public via the website (as opposed to website reorganization or some other explanation). We revisited the website intermittently to see whether the documents had been reposted under different URLs; until very recently, they had not been reposted. On December 11, 2017, we learned that the key documents had been reposted on the OIG website, but with different URLs. Documents now appear to be reposted on new URLS. As we find the new URLS, we are adding them in the footnotes below.

The links listed below are available at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**.

Old Link: 1. ~~2015 Semiannual Report to Congress, DOD~~ Click here for (New Link)
Old Link: 2. ~~2014 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 3. ~~2013 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 4. ~~2012 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 5. ~~2011 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 6. ~~2010 Testimony of the Deputy Inspector General, DOD~~ Click here for (New Link)
Old Link: 7. ~~2009 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 8. ~~2008 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 9. ~~2007 Agency Financial Report, DOD~~ Click here for (New Link)
Old Link: 10. ~~2006 Performance and Accountability Report, DOD~~ Click here for (New Link)
Old Link: 11. ~~2005 Performance and Accountability Report, DOD~~ Click here for (New Link)
Old Link: 12. ~~2004 Performance and Accountability Report, DOD~~ Click here for (New Link)
Old Link: 13. ~~2003 Performance and Accountability Report, DOD~~ Click here for (New Link)
14. ~~2002 Testimony from the Office of the Inspector General, DOD~~
15. ~~2001 Agency Financial Report, DOD~~
Old Link: 16. ~~2000 Testimony of the Inspector General, DOD~~ Click here for (New Link)
Old Link: 17. ~~1999 Testimony of the Inspector General, DOD~~ Click here for (New Link)
Old Link: 18. ~~1998 Testimony of the Inspector General, DOD~~ Click here for (New Link)
Old Link: 19. ~~2017 Testimony of David A. Montoya, Inspector General, HUD~~ Click here for (New Link)

Old Link: 20. ~~2016 Testimony of David A. Montoya, Inspector General, HUD~~ Click here for (New Link)
21. ~~2002 Statement of Kenneth M. Donohue, Inspector General, HUD~~
22. ~~1999 Statement of Susan Gaffney, Inspector General, HUD~~
23. http://www.gao.gov/assets/670/668739.pdf
Old Link: 24. ~~Army General Fund Adjustments Not Adequately Documented or Supported~~ Click here for (New Link)
25. 2012 United States Army Annual Financial Statement, DOD
26. 2011 United States Army Annual Financial Statement, DOD
27. 2010 United States Army Annual Financial Statement, DOD
28. 2009 United States Army Annual Financial Statement, DOD
29. 2008 United States Army Annual Financial Statement, DOD
30. 2006 United States Army Annual Financial Statement, DOD
31. 2005 United States Army Annual Financial Statement, DOD
32. 2004 United States Army Annual Financial Statement, DOD
33. 2003 United States Army Annual Financial Statement, DOD
34. 2002 United States Army Annual Financial Statement, DOD
35. 2000 United States Army Annual Financial Statement, DOD
36. 2000 United States Air Force Annual Financial Statements, Secretary of Defense
Old Link: 37. ~~2015 Semiannual Report to Congress, Office of the Inspector General, DOD~~ Click here for (New Link)
38. 2015 Agency Financial Report, Financial Section, DOD
39. Agency Financial Report, Financial Section, DOD
Old Link: 40. ~~Defense Departmental Reporting System-Budgetary Was Not Effectively Implemented for the Army General Fund, DOD~~ Click here for (New Link)
Old Link: 41. ~~Internal Controls over FY 2007 Army Adjusting Journal Vouchers, Office of Inspector General, DOD~~ Click here for (New Link)
Old Link: 42. ~~Navy General Fund Audit Report, Office of Inspector General, DOD~~ Click here for (New Link)
Old Link: 43. ~~Navy General Fund Financial Statements~~ Click here for (New Link)
Old Link: 44. ~~Followup Audit: Additional Actions Needed to Effectively Provide Complete Audit Trails for Air Force Journal Vouchers~~ (New Link)
Old Link: 45. ~~Deficiencies in Journal Vouchers That Affected the FY 2009 Air Force General Fund Statement of Budgetary Resources, Office of Inspector General, DOD~~ Click here for (New Link)
46. FY 2003 United States Air Force Annual Financial Statements, Secretary of Defense
47. FY 2002 United States Air Force Annual Financial Statements, Secretary of Defense
48. FY 2001 United States Air Force Annual Financial Statements, Secretary of Defense

Chapter IV. U.S. Federal Finances: The Law

"**William Roper:** *So, now you give the Devil the benefit of law!*
Sir Thomas More: *Yes! What would you do? Cut a great road through the law to get after the Devil?*
William Roper: *Yes, I'd cut down every law in England to do that!*
Sir Thomas More: *Oh? And when the last law was down, and the Devil turned 'round on you, where would you hide, Roper, the laws all being flat? This country is planted thick with laws, from coast to coast, Man's laws, not God's! And if you cut them down, and you're just the man to do it, do you really think you could stand upright in the winds that would blow then? Yes, I'd give the Devil benefit of law, for my own safety's sake!"*
~ From Roger Bolt's *A Man for All Seasons*

By Catherine Austin Fitts

Money is a man-made construct. To understand money and its governance and management, it is essential to understand the laws, regulations, and rules that reflect a society's agreements regarding what it is, who will oversee and implement its monetary and fiscal operations, and how those operations will work.

In one sense, the financial system of currency, bonding, mortgage and bank credit, taxation, and appropriations created and managed by the United States federal government is no different than hopscotch, Monopoly, or Dungeons & Dragons. Before you play, you need to know the rules of the game.

Learning the law related to U.S. federal finances is challenging if you have not gone to law school. To ease the task for citizens, journalists, and investors who appreciate the power and importance of the federal finances and want to understand them, The Solari Report commissioned attorneys Michele Ferri and Jonathan Lurie to prepare seven briefing papers to summarize the legal infrastructure of the U.S. federal financial system.

1. The History and Organization of the Federal Reserve: The What and Why of the United States' Most Powerful Banking Organization
2. The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause
3. The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them
4. The Black Budget: The Crossroads of (Un)Constitutional Appropriations and Reporting
5. Federal Accounting Standards Advisory Policy #56: Understanding New Government Financial Accounting Loopholes
6. National Security Exemptions and SEC Rule 10b-5
7. Classification for Investors 101

These papers are available to the public at **constitution.solari.com**.

About the Authors

The briefing papers were written and edited by Michele Ferri and Jonathan Lurie of The Law Offices of Lurie and Ferri for use by The Solari Report. Michele Ferri and Jonathan Lurie are both practicing attorneys out of California. The Law Offices of Lurie and Ferri focus on working with start-up businesses as well as on intellectual property and business law issues. They can be found at **http://www.lflawoffices.com/** or contacted at **partners@lflawoffices.com**.

A. Monetary: Federal Reserve

1. The History and Organization of the Federal Reserve: The What and Why of the United States' Most Powerful Banking Organization

"*Whoever controls the volume of money in any country is absolute master of all industry and commerce.*"
~ James A. Garfield, 20th President of the United States

Table of Contents

I. Introduction

The Federal Reserve is one of the most influential organizations in the U.S. when it comes to economic policy. It is also one of the least well understood elements of the government—especially in that it is not really truly a government organization. Its top level officials are a government agency of the Executive branch. However, the Federal Reserve, and especially its 12 Federal Reserve District Banks, occupy a strange twilight zone between government agency and private banking organization.

This status has come up in court cases, where the district banks of the Federal Reserve have argued successfully that they are not a government agency—instead being classified as "federally created instrumentalities." (*Scott v. Federal Reserve Bank of Kansas City*, No. 04-2357 (8th Circ. Ct of App, 2005) (available at **http://media.ca8.uscourts.gov/opndir/05/04/042357P.pdf**)). A cynical person might say that they are part of the Federal government where advantageous and separate when it is not. However, it is enough to say that the Federal Reserve has a complex, hybrid structure to it.

The Federal Reserve itself has quite a bit of involvement in creating the monetary policy of the U.S. The most commonly discussed ways it influences the economy include acting as a last resort lender to member banks, regulating private banking, and—perhaps above all—setting the discount rate on loans to solve temporary liquidity issues for private banks across the county.

As the bank of the U.S. Federal Government, there is obviously great concern and interest in the financial goings on of the Federal Reserve. This has led to multiple attempts to audit the Federal Reserve—usually with Congress turning to the Government Accountability Office (GAO). The GAO is a Congressional agency which investigates federal spending. As we've discussed in previous articles, these duties are accomplished with varying levels of success by topic. (See *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them*, available at **https://constitution.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**.) Congress has requested studies as to the lengths to which the GAO can investigate the financial goings on of the Federal Reserve. (See e.g., *Federal Reserve System Audits: Restrictions of GAO's Access*, available at **https://www.gao.gov/products/T-GGD-94-44**.) In 1978, the Federal Banking Agency Audit Act placed the Federal Reserve under the audit authority of the GAO–reversing the 1933 Banking Act provisions that originally removed this authority. (31 USCA §714, available at **http://www4.law.cornell.edu/uscode/31/714.html**.) Since this change, there have been dozens of GAO audits of the Federal Reserve. These audits have led to suggestions from the GAO on everything from check clearing policies to larger regulatory reforms (see id.). This being said, there are some notable exceptions to the areas the GAO can look into, including:

> *"(1) transactions for or with a foreign central bank, government of a foreign country, or nonprivate international financing organization; (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, open market operations; (3) transactions made under the direction of the Federal Open Market Committee; or (4) a part of a discussion or communication among or between members of the Board of Governors and officers and employees of the Federal Reserve System related to items" (id.).*

These are substantial exemptions. In order to understand just how substantial, it's necessary to more fully understand the structure and role of the Federal Reserve. It's worth noting that there have been multiple attempts in Congress to implement a more thorough audit nearly every year—including last year. (See e.g., H.R. 24, *Federal Reserve Transparency Act of 2017*, available at **https://www.congress.gov/bill/115th-congress/house-bill/24?q=%7B%22search%22%3A%5B%22Federal+Reserve+Transparency+Act+of+2017%22%5D%7D&r=4**.) These attempts have never succeeded. In past articles, we have discussed the problematic lack of transparency in government spending—especially in certain executive agencies. The Department of Defense and the Department of Housing and Urban Development have over $21T unaccounted for—approximately the same amount as our current national debt. (See e.g., *The Missing Money*, available at **http://missingmoney.solari.com**.) There is an obvious need for greater financial transparency and regulatory compliance in the government.

In order to understand the role and issues of the Federal Reserve System, this series intends to take a look at the inner workings and functions of the Federal Reserve. To do a true deep dive on this issue can and has taken volumes to properly explore every avenue. Our goal with this series is to instead give a strong overview of the Federal Reserve, its functions, and its issues. Later articles will discuss the Federal Reserve Act in more depth (as well as the twilight-zone legal classification of a "federally created instrumentality"), the lending practices of the Federal Reserve, and some of the problems inherent to the most powerful banking organization in the U.S. and potentially the world.

The Federal Reserve handles the government's accounts, funds, and security transactions, and implements monetary policy (mainly through the New York Federal Reserve Bank, discussed below). However, in order to give the best understanding of the Federal Reserve itself, we will start by looking at the history and structure of the Federal Reserve—the what and why of the United States' most powerful bank.

II. History and Creation of the Federal Reserve

The Federal Reserve was first signed into existence by then-President Woodrow Wilson over a century ago on December 23, 1913. (See *Federal Reserve Act*, Ch. 6, 38 Stat. 251, enacted December 23, 1913, 12 U.S.C. §§ 221 to 522, available at **http://legisworks.org/sal/38/stats/STATUTE-38-Pg251a.pdf**.) The Federal Reserve Act created the Federal Reserve System and a centralized banking system for the U.S. It also granted this newly minted Federal Reserve System, among many other things we will discuss below, the power to issue Federal Reserve Notes (see id.).

The stated goal of President Wilson and Congress was to promote economic stability through the uniformity and certainty of a central banking system which would promote and handle much of the monetary policy of the U.S. The move was almost without question the most substantial reform in U.S. financial law in the history of the country. (See *1913 Federal Reserve Act*, available at **https://www.investopedia.com/terms/f/1913-federal-reserve-act.asp**.)

The enormous financial reform bill came to President Wilson with the support of many Democrats of the time and the respective chairmen of the House and Senate Banking and Currency committees (see id.). However, the law was not prepared to make such a titanic change permanent just yet. The initial 1913 act limited the grant of power to twenty years, requiring renewal in or before 1933. (See *The Federal Reserve Act*, 12 U.S.C. §§ 221 to 522.) However, Congress moved to renew the Act and make it permanent well before this deadline. In February of 1927 the Act was amended to perpetuate the Federal Reserve "until dissolved by Act of Congress or until forfeiture of franchise for violation of law" (see 44 Stat. 1234). This move to make the Federal Reserve System permanent by renewing the Federal Reserve Act was far from a certainty during this time period. History buffs out there will certainly have noticed something about the timing of this renewal—it falls just before the beginning of the Great Depression. (See *1913 Federal Reserve Act*, available at **https://www.investopedia.com/terms/f/1913-federal-reserve-act.asp**.) The Federal Reserve, and most financial institutions of the time, were not particularly popular with the public. As the years progressed, and the Great Depression deepened, this opinion would only get worse. It's also worth mentioning that the Bureau of Internal Revenue (later the IRS) was formed at the same time as the Federal Reserve in 1913. This came shortly after the 16th Amendment allowed for constitutional federal income tax after 50 years of creating and repealing income tax as a concept. During World War I the income tax spiked substantially—as high as 77%—it only came back down to around 24% by 1929 but continued to rise throughout the Great Depression. (See *Brief History of the IRS*, available at **https://www.irs.gov/about-irs/brief-history-of-irs**.) This just exacerbated the extremely poor public opinion of financial institutions at the time. It's very possible that had the renewal come in 1933 as planned there might be no Federal Reserve system today. (See *1913 Federal Reserve Act*, available at **https://www.investopedia.com/terms/f/1913-federal-reserve-act.asp**.)

However, even in the throes of the Great Depression, the recently strengthened Federal Reserve saw some changes to its structure and purpose. The Banking Act of 1933 further amended the Federal Reserve Act in a number of ways. (See Pub. L. 73-66 available at **https://fraser.stlouisfed.org/scribd/?title_id=991&filepath=/docs/historical/congressional/1933_bankingact_publiclaw66.pdf**.) The Banking Act of 1933 created the Federal Open Market Committee (FOMC)—a 12 member committee of top level officials from the Federal Reserve which we will discuss at length later in this article. This created a committee that remains one of the most powerful and influential arbiters of financial policy decisions in the U.S. to this day. The Act gave the FOMC power over essentially all open-market operations of the member banks of the Federal Reserve (see id.). It additionally added a requirement that the FOMC meet at least four times per year (see Pub. L. 73-66). Today, they generally meet double that number, about eight times in a year. (See *1913 Federal Reserve Act*, available at **https://www.investopedia.com/terms/f/1913-federal-reserve-act.asp**.)

However, as we will discuss in a later article, these meetings are not open to the public, although they do publish edited and redacted meeting minutes and transcripts.

Since the creation of the FOMC, the Federal Reserve Act has seen well over 200 amendments (see id.). However, it continues to be at the center of U.S. financial policy. As of November 16, 1977, the Federal Reserve Act was amended to provide the FOMC and the Federal Reserve a clear goal: "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" (*The Federal Reserve Act*, Section 2A, available at **https://www.federalreserve.gov/aboutthefed/section2a.htm**). This amendment also required the FOMC Chairman to appear before Congress at semi-annual hearings and report on their current and future steps toward achieving these goals. Congress wanted testimony to make sure the Federal Reserve was operating as intended.

III. Structure of the Federal Reserve System

In order to understand the function and faults of the operations of the Federal Reserve, and most importantly whether and how they work to achieve their stated goals, it is important to first understand the structure of the Federal Reserve itself. While linked to the federal government, much of the Federal Reserve essentially operates as a private corporation would. They do not even receive funding appropriated by Congress. They would hardly need it with approximately $100B in profits in 2015 alone, of which $97.7B went to the U.S. Treasury. The Federal Reserve is required to turn over all money it makes in excess of its costs to the U.S Treasury every year. The Federal Reserve derives its income for operations and salaries from "the interest on government securities that it has acquired through open market operations…the interest on foreign currency investments held by the Federal Reserve System; fees received for services provided to depository institutions, such as check clearing, funds transfers…automated clearing house operations; and interest on loans to depository institutions" (*How is the Federal Reserve System Structured*, available at **https://www.richmondfed.org/faqs/frs**).

The Federal Reserve's chief governing body—the Board of Governors—is an executive agency with the salaries of the individual members set by the federal government. This means the top levels of the Federal Reserve have direct ties to and report to the federal government. However, from there the organization's connection to the government becomes much looser—with other elements of the Federal Reserve connected to the government essentially only by oversight from the Board of Governors. In a lot of ways, the Federal Reserve essentially runs itself as a private business that hands over the money it doesn't pay itself to the U.S. Treasury (see id.).

At the very top of the Federal Reserve System is the Board of Governors, with the FOMC and Federal Advisory Committee (FAC) directly below them as advisors to their decision making process. That being said, the majority of the FOMC is made up of the Board of Governors and has complete control over all open market operations. The Board of Governors and FOMC oversee 12 Federal Reserve district banks which each are the head of a large district of banks and have their own Boards of Directors. These district banks have no direct ties to the government. Each of these 12 district banks have a number of branches and member banks, all of which have their own Boards of Directors and also have no direct ties to the government. All of these layers have their own roles and responsibilities under the law and their own requirements for appointments to those positions (see id.).

A. The Fed's Chain of Command

We've mentioned a few times already that the Federal Reserve flirts with the line between a government agency and a private sector entity. We will not fully investigate the implications and case law on that in this article. However, as we've mentioned, the highest level officials report directly to the government. While federal law regulates the structure and function of the Federal Reserve quite a bit, as we'll see here and in later articles, the actual operation of the Federal Reserve runs much closer to that of a private corporation. (See *Roles and Responsibilities of Federal Reserve Directors*, available at **https://www.federalreserve.gov/aboutthefed/directors/pdf/roles_responsibilities_FINALweb013013.pdf**.)

The Federal Reserve Act provides goals for the public interest that are theoretically at the core of all moves out of the Federal Reserve—as you would expect of a government agency. However, the structure and oversight mostly comes from the Board of Governors, the FOMC, the Boards of Directors of the Federal Reserve district banks, and the FAC (see id.).

The Reserve district banks themselves are supervised by the Board of Governors. The Board of Governors itself is an agency of the federal government (see id.). Their members are appointed by the President after advice and consent from the Senate and they collaborate with Washington, D.C. on many of their responsibilities. However, while the Board of Governors has substantial impact on financial policy, the Federal Reserve district banks and branches are still by and large the majority of the Federal Reserve's operating presence—including implementing financial policy and recommending policy to the Board of Governors (see id.).

Under the Federal Reserve Act, each district bank is supervised by a nine member Board of Directors (see id.). While there are 12 main district banks, as discussed below, most of them have at least one branch besides their head office. There are 274 existing director positions as of today—108 head office positions and 166 branch director positions (see id.). These directors are meant to act as the link between the Board of Governors and the public as well as supervising day to day functions of the district banks and their geographical districts. While we'll get more into appointments later, these nine member boards all have 6 members appointed by the district bank itself and three members appointed by the Board of Governors (see id.).

The current Chair of the Board of Governors of the Federal Reserve is, as of February 5th 2018, Jerome Powell. He replaced Dr. Janet Yellen just recently. The Chairman is appointed by the current sitting President from among the members of the Board of Governors and has a four year term which can be renewed as the President sees fit so long as the Senate confirms them. The members themselves are appointed for staggered 14 year terms. These terms are not changed by being named chair. The theoretical stated goal behind such long terms is to avoid political pressure in financial decisions—instead allowing members to focus on their Congressionally mandated goals (see id.). As of right now, only 3 of the 7 positions are filled—Jerome Powell (R) as chair, Randall Quarles (R) as vice-chair, and Lael Brainard (D). (See *Board of Governors Members, 1914-Present*, available at **https://www.federalreserve.gov/aboutthefed/bios/board/default.htm**.)

IV. Federal Open Market Committee

Even with the Board of Governors in mind, there is an argument that it is in fact the FOMC which represents the most influential element of the Federal Reserve when it comes to planning and making financial policy changes. This is simply because they are in charge of all open market operations. (See *The Federal Reserve Act*, Section 12a, available at
https://www.federalreserve.gov/aboutthefed/section12a.htm.)

The Federal Reserve Act created the FOMC, consisting of "the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve district banks." The bank representatives must be presidents or first vice presidents of a Federal Reserve district bank, and are elected by the Federal Reserve district banks in a somewhat lopsided manner. The Federal Reserve Bank of New York determines one of the representatives on its own. The remaining four representatives are each elected by multiple district banks: the Banks of Boston, Philadelphia, and Richmond elect one, the Banks of Cleveland and Chicago elect one, the Banks of Atlanta, Dallas, and St. Louis elect one, and the Banks of Minneapolis, Kansas City, and San Francisco elect the last. (See *The Federal Reserve Act*, Section 12a, available at **https://www.federalreserve.gov/aboutthefed/section12a.htm**.) The composition of the FOMC ends up being 12 members: "the seven members of the Board of Governors; the president of the

Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents . . .” although all the various Banks’ Presidents generally attend FOMC meetings (*Roles and Responsibilities of Federal Reserve Directors*, p. 6).

The FOMC works to make “key decisions regarding the conduct of open market operations, which affect the stock of reserve balances held by depository institutions and the size and composition of the Federal Reserve’s asset holdings” (see id.). Further, the Act requires no Federal Reserve bank to “engage or decline to engage in open-market operations. . .except in accordance with the direction of and regulations adopted by the [FOMC]” (*The Federal Reserve Act*, Section 12a). This is an enormous amount of power, regulating the vast majority of implementation of financial policy out of the Federal Reserve.

V. Federal Reserve Advisory Bodies

While the Board of Governors has the closest link to the Federal Government within the Federal Reserve, their actions still come with a great deal of guidance from the individual member banks. Four committees directly advise the Board of Governors: The Federal Advisory Council (FAC), the Community Depository Institutions Advisory Council (CDIAC), the Division of Financial Stability, and the Community Advisory Council (CAC). They act as a sort of go between for the member banks and the Board of Governors. (See *About the Fed: Advisory Councils*, available at **https://www.federalreserve.gov/aboutthefed/cdiac.htm**.)

The Federal Reserve Act created the Federal Advisory Council, consisting of “as many members as there are Federal reserve districts” (*The Federal Reserve Act*, Section 12, **https://www.federalreserve.gov/aboutthefed/section12.htm**). Each year, each member bank selects one member of the FAC. The FAC then meets at least four times a year in Washington, D.C., in order:

> *“(1) to confer directly with the Board of Governors . . . on general business conditions; (2) to make. . . representations concerning matters within the jurisdiction of said board; (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.”* (*The Federal Reserve Act*, Section 12, available at **https://www.federalreserve.gov/aboutthefed/section12.htm**)

The CDIAC, on the other hand, is not a statutory body. It was formed by the Board of Governors in 2010 to provide input on issues of interest to community depository institutions. (See *About the Fed: Advisory Councils*, available at **https://www.federalreserve.gov/aboutthefed/cdiac.htm**.) It selects one member from each Federal district bank, and meets twice a year to discuss “the economy, lending conditions, and other issues of interest to community depository institutions” (see id.).

In November of 2010, the Federal Reserve’s Board of Governors also established the Office of Financial Stability Policy and Research, which was renamed the Division of Financial Stability and made a division of the Board itself in 2016 (Federal Reserve Press Release, May 11, 2016, available at **https://www.federalreserve.gov/newsevents/pressreleases/other20160511a.htm**). The Division is the research and monitoring organization responsible for coordinating with other Board divisions and the various Reserve banks in order to find structural risks to financial stability and formulate policy responses to said risks.

More recently, in 2015, the CAC was formed by the Board of Governors to complement the FAC and CDIAC. (See *About the Fed: Advisory Councils*, available at **https://www.federalreserve.gov/aboutthefed/cac.htm**.) Its purpose is to focus on the "needs of consumers and communities, with a particular focus on the concerns of low- and moderate-income populations" (see id.). The committee currently has 15 members and meets semi-annually (see id.).

VI. The 12 Private Banks That Form the Federal Reserve

The Board of Governors may sit atop the Federal Reserve, working closely with the federal government as an executive agency. However, an enormous number of duties, powers, and day to day activities are squarely in the hands of the 12 Federal Reserve district banks—all private banks with minimal connection to the federal government. These 12 banks each head one of the 12 Federal Reserve System districts, often with multiple branch offices. They are responsible for managing commercial banking in their districts (including the various Federal Reserve member banks), storing currency, processing payments, and generally acting as "bankers' banks" by providing banking services to other commercial banks in their districts. (See *The Structure and Functions of the Federal Reserve*, available at **https://www.federalreserveeducation.org/about-the-fed/structure-and-functions**.)

These districts are also, somewhat counterintuitively, not limited by State borders. Instead, the Federal Reserve Act mandated that they "shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States" (*The Federal Reserve Act*, Section 2, available at **https://www.federalreserve.gov/aboutthefed/section2.htm**). They are all privately owned by members. However, there are no laws (that we found) requiring disclosure or confidentiality of the ownership interests, and finding that information is an opaque process at best.

A. The New York Fed

The Federal Reserve Bank of New York is the largest of the district banks, at least in regards to the assets held and volume of financial activity. The activities they conduct, their location in New York City, and the assets they hold combine to entrench the New York Fed into a (if we're putting it nicely) "first among equals" position among the 12 districts.

The New York Fed has a leading role in the Federal Open Market Committee (discussed in further detail below) and tends to be the main force implementing the monetary policy decided in D.C. The president of the New York Fed is a permanent voting member of the FOMC, and the FOMC uses the New York Fed to buy and sell a portfolio of U.S. government securities[1] as part of the FOMC's open market operations (*The New York Fed: Who We Are and What We Do*, available at **https://www.newyorkfed.org/aboutthefed/fedpoint/fed13.html**), (*Domestic Open Market Operations During 2016*, pp. 14-15, available at **https://www.newyorkfed.org/medialibrary/media/markets/omo/omo2016-pdf.pdf**).

The New York Fed also carries out national exchange rate policy for the Treasury Department, the Federal Reserve System, and some foreign banks and international organizations (*The New York Fed: Who We Are and What We Do*). One of the ways they accomplish this is by acting as fiscal agent of the Treasury Department by managing the Exchange Stabilization Fund[2] (ESF) (*Fedpoint: Exchange Stabilization Fund*, available at **https://www.newyorkfed.org/aboutthefed/fedpoint/fed14.html**). They also "maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of $2 billion and $3 billion, respectively," and warehouse up to $5 billion in foreign currencies (*Domestic Open Market Operations During 2016*, p. 15). The New York Fed also holds foreign official gold reserves, due to "the convenience of centralizing gold holdings in a place where international payments can be made quickly" (*The New York Fed: Who We Are and What We Do*). What's more, they offer a list of primary dealers—banks and firms allowed to directly purchase government securities with the intent of reselling them. (See *Federal Reserve of New York: Primary Dealers*, available at **https://www.newyorkfed.org/markets/primarydealers.html**.) These primary dealers work directly with the New York Fed to create markets for such securities (see id.). The New York Fed also provides information on the history of such sales (*Federal Reserve of New York: Primary Dealers Statistics*, available at **https://www.newyorkfed.org/markets/gsds/search.html**).

Finally, the New York Fed also acts as the depository of the U.S. government. All the Federal Reserve District Banks have the duty of being fiscal agent and bank of the U.S. government. However, the New York Fed handles the lion's share of this—maintaining accounts, processing government checks, collecting federal tax deposits, etc. (*Federal Reserve Education: Financial Services*, available at **https://www.federalreserveeducation.org/about-the-fed/structure-and-functions/financial-services**). This also means that the New York Fed holds a substantial portion of the gold of the U.S. government in their vaults—along with the gold of several other banks and a few foreign governments. They don't own this gold; however, it represents the largest known depository of monetary gold in the world. The New York Fed receives a handling fee for the gold they store (*Federal Reserve Bank of New York: Gold Vault*, available at **https://www.newyorkfed.org/aboutthefed/goldvault.html**). This role as the bankers of the U.S. government also presumably provides the New York Fed, and really all the Federal Reserve District Banks, with an enormous amount of financial data on which they can operate.

B. The Other Federal Reserve District Banks

The Reserve Banks of the other 11 districts tend to have a less exaggerated role in U.S. financial policy. However, as discussed above, they perform a variety of financial functions for their districts and produce a great deal of financial research, although the size and scope of their activities vary.

The Federal Reserve District Banks of San Francisco, Minneapolis, and Kansas City vote together to determine one of the voting members of the FOMC. The San Francisco Fed (*About the 12th District*, available at **https://www.frbsf.org/our-district/about/**) covers the Twelfth District including Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington, and the territories of the Northern Mariana Islands, American Samoa, and Guam. The San Francisco Fed covers the largest area and population of the member bank Districts and is second to the New York Fed in assets held (see id). It is also "the headquarters for the Federal Reserve's Cash Product Office, which oversees and supports the entire system's cash distribution process" (see id.). However, despite its size, the San Francisco Fed still pales in comparison to the fairly well entrenched authority of the New York Fed. The Federal Reserve Bank of Minneapolis (*The Ninth District,* available at **https://minneapolisfed.org/about/more-about-the-fed/the-ninth-district**) covers the Ninth District of the Federal Reserve, including Minnesota, Montana, North and South Dakota, and parts of Wisconsin, and Michigan. The Federal Reserve District Bank of Kansas City (*The Federal Reserve Bank of Kansas City Information,* available at **https://www.kansascityfed.org/aboutus/kcfedinformation**) covers the Tenth District of the Federal Reserve, including Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and parts of Missouri and New Mexico.

The Federal Reserve District Banks of Atlanta, Dallas, and St. Louis vote together to determine another FOMC voting member. The Dallas Fed (*About the Dallas Fed*, available at **https://www.dallasfed.org/fed**) covers the Eleventh Federal Reserve District, including Texas and parts of Louisiana and New Mexico. The Dallas Fed is an authority in the energy industry, on U.S.-Mexico border economics, and operates the U.S. Electronic Payment Solution Center which processes federal benefit payments (*Dallas Fed: Year in Review, 2016*, available at **https://www.dallasfed.org/fed/annual/2016/yir.aspx**). The Federal Reserve District Bank of Atlanta (*The Atlanta Fed,* available at **https://www.frbatlanta.org/about/atlantafed.aspx**) covers the Sixth District which includes Alabama, Florida, Georgia, and parts of Tennessee, Louisiana, and Mississippi. The Federal Reserve District Bank of St. Louis (*About the St. Louis Fed,* available at **https://www.stlouisfed.org/about-us**) covers the Eighth Federal Reserve District, including Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri, and Tennessee.

The Federal Reserve District Banks of Philadelphia, Boston, and Richmond choose one voting seat on the FOMC. The Philadelphia Fed (*Who We Are, What We Do: An Overview,* available at **https://www.philadelphiafed.org/about-the-fed/who-we-are**) covers the Third District of the Federal Reserve, which includes parts of Pennsylvania, New Jersey, and Delaware. It conducts research on the economy, and its regional manufacturing index is considered a fairly accurate proxy for nationwide manufacturing conditions (*Manufacturing Business Outlook Survey,* available at **https://www.philadelphiafed.org/research-and-data/regional-economy/business-outlook-survey**). The Federal Reserve Bank of Boston (*Maps of the Federal Reserve System,* available at **https://www.federalreserve.gov/boarddocs/rptcongress/annual07/pdf/maps.pdf**) covers the First District of the Federal Reserve, including New England, Maine, Massachusetts, New Hampshire, Rhode

Island, Vermont, and most of Connecticut. The Federal Reserve District Bank of Richmond (*About the Richmond Fed,* available at **https://www.richmondfed.org/-/media/richmondfedorg/about_us/who_we_are/pdf/richmondfed_q_and_a.pdf**) covers the Fifth District of the Federal Reserve, including the District of Columbia, Maryland, North Carolina, South Carolina, Virginia, and most of West Virginia.

The Federal Reserve District Banks of Cleveland and Chicago determine one voting seat on the FOMC. The Chicago Fed (*Overview of the Seventh District Economy,* available at **https://www.chicagofed.org/utilities/about-us/seventh-district-economy**) covers the Seventh Federal Reserve District, including Iowa and parts of Illinois, Indiana, Wisconsin, and Michigan. The Federal Reserve District Bank of Cleveland (*The Cleveland Fed at a Glance,* available at **https://www.clevelandfed.org/en/about-us/at-a-glance.aspx**) covers the Federal Reserve System's Fourth District, including Ohio and parts of Pennsylvania, Kentucky, and West Virginia.

C. How Banks Become a Member

Essentially any private bank—state or national—can apply to become a member bank which is part of the Federal Reserve. So long as the bank is incorporated under the laws of its state and the laws of the United States, any bank can go through the process set forth in the Federal Reserve Act to become a member bank (*The Federal Reserve Act*, Section 9, available at **https://www.federalreserve.gov/aboutthefed/section9.htm**). The process requires an application to the Board of Governors, requesting stock in the Federal Reserve. All national banks are required to become member banks, and many state-chartered banks do so as well. Out of the commercial banks in the United States, 38 percent are member banks of the Federal Reserve System (*The Structure and Function of the Federal Reserve*, available at **https://www.federalreserveeducation.org/about-the-fed/structure-and-functions**).

The application process for state and national banks is basically exactly the same (*The Federal Reserve Act*, Section 9). In fact, a state bank can even convert into a national bank under the Federal Reserve Act by having enough unimpaired capital (generally a minimum of $4M) and a simple majority vote of shareholders where at least 51% of shareholders vote (*The Federal Reserve Act*, Section 8, available at **https://www.federalreserve.gov/aboutthefed/section8.htm**). The only exceptions are where such a conversion would in some way violate another existing law. The actual organization and structure of a bank after such a conversion changes very little, except for a few required amendments to articles of association—hardly a laborious change if there is already director and shareholder approval (see id.). Banks are barred from making the conversion if they're facing down a cease and desist order from their State or the Fed, or if they face a ruling against them from a State Attorney General (see id.).

The actual application process requires the purchase of stock in the Federal Reserve (*The Federal Reserve Act*, Section 9, available at **https://www.federalreserve.gov/aboutthefed/section9.htm**). The application is considered by the Board of Governors and accepted, at least under the Federal Reserve Act, where the bank is in an acceptable financial condition and its leadership and corporate culture don't act against the Congressionally mandated goals of the Federal Reserve (see id.). After the application is accepted, the bank in question is issued stock and required to pay a stock subscription upon the call of the Board of Governors (see id.). This stock is not voting stock unless it is held by a member bank, and no member can hold more than $25,000 worth of stock in the Federal Reserve (*The Federal Reserve Act*, Section 2, available at **https://**

www.federalreserve.gov/aboutthefed/section2.htm). These banks also become subject to inspection by the Board of Governors or their representatives at any time. The Board of Governors can also cause a bank to forfeit its membership and revoke their stock at any time if they feel they have not complied with the goals of the Federal Reserve or failed to comply with the provisions of the Federal Reserve Act and related laws such as the National Banking Act (*The Federal Reserve Act*, Section 9). Banks can voluntarily withdraw from the Federal Reserve System with 6 months of notice to the Board of Governors (see id.).

D. Rights and Powers of Members

In addition to the activities most banks undertake, member banks of the Federal Reserve have a few special powers they use in the course of business. A lot of these powers are too complicated to fully explore in this article—or even in a textbook for that matter. With this in mind we'll only be giving a general discussion of them here. However, look for a future article where we will take a deeper dive on these powers.

For instance, as mentioned in the introduction, the Federal Reserve banks often offer loans at a discounted rate to provide temporary liquidity to banks and stabilize financial markets (*Policy Tools: Discount Rate*, available at **https://www.federalreserve.gov/monetarypolicy/discountrate.htm**). While historically, these discounted loans were given to other depository institutions, the 2007-2009 financial crises saw the use of an old 1932 authorization to lend to other businesses (*Federal Reserve Credit Programs During the Meltdown*, available at **https://www.federalreservehistory.org/essays/fed_credit_programs**).

The 1932 amendment allowed for discounts for individuals, partnerships, and corporations in "unusual and exigent circumstances" (*The Federal Reserve Act*, Section 13, available at **https://www.federalreserve.gov/aboutthefed/section13.htm**). This form of discounting requires both authorization from the Board of Governors and evidence the recipient of the discount "is unable to secure adequate credit accommodations from other banking institutions. . ." (id.). The Board is also required to put policies and procedures in place to avoid aiding failing and insolvent financial companies, to terminate discount programs in a timely fashion, and secure satisfactory collateral for discounted loans (see id.). Any discount programs also require the prior approval of the Secretary of the Treasury. Further, after any such loans are authorized, the Board is required to make reports to the Senate's committees on Banking, Housing, and Urban Affairs, and the House of Representatives' Committee on Financial Services (see id.).

The member banks are also authorized to purchase bankers' acceptances as part of their market operations. Bankers' acceptances are a form of short term loan used to finance trade. Used as a sort of advance on payment when goods were shipped long distance, bankers' advances tended to be low risk short term investments (*The Tools and Transmission of Federal Reserve Monetary Policy in the 1920s*, **https://www.federalreserve.gov/econresdata/notes/feds-notes/2016/tools-and-transmission-of-federal-reserve-monetary-policy-in-the-1920s-20161122.html**). The member banks were authorized to accept bankers' acceptances growing out of importation, exportation, or domestic shopping of goods. ([Formerly 12 USC 372, as amended by act of March 3, 1915 (38 Stat. 958); by act of Sept. 7, 1916 (39 Stat. 752), which completely revised this section; and by acts of June 21, 1917 (40 Stat. 235) and Oct. 8, 1982 (96 Stat. 1239). Omitted from the U.S. Code.]) Member banks were also authorized to use those acceptances for "the purpose of furnishing dollar exchange as required by the usages of trade" (id.).

Federal Reserve banks may also make short term advances (no longer than 15 or 90 days, depending on the type of note) on secured promissory notes to their member banks (12 USC 347). The rates of these advances are determined by each Federal Reserve bank, subject to review by the Board of Governors. Similar advances can be provided to individuals, partnerships, and corporations on promissory notes "secured by direct obligations of the United States or . . . fully guaranteed as to principal and interest by, any agency of the United States" (12 USC 347c).

The member banks are also permitted to act as insurance agents in locations with a population of 5000 or less (see *Insurance Activities: Comptroller's Handbook*, June 2002, available at **https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/insurance-activities/pub-ch-insurance-activities.pdf,** p. 2; 12 USC 92). However, that authorization is somewhat obsolete, as national banks can also conduct insurance activities regardless of population under 12 USC 24(Seventh). (See *Insurance Activities: Comptroller's Handbook* at p. 2.)

Finally, the Fed, under direction of the FOMC, can also exercise its powers simply by purchasing assets from its member banks, in a process called Quantitative Easing (QE). QE (colloquially called "printing money") involves a central bank, like the Fed, purchasing securities from banks in order to give those banks more liquid funds to (hopefully) spend and stimulate the economy. It's sometimes referred to as printing money because the securities are usually bought by issuing credit to banks, essentially out of thin air. (See *What Is Quantitative Easing,* available at **https://www.thebalance.com/what-is-quantitative-easing-definition-and-explanation-3305881**.) For instance, the Fed did this between 2008-2013 to combat the financial crises, by buying bank debt, U.S. Treasury notes, and mortgage-backed securities (yes, including the toxic subprime mortgages that caused the whole mess) through the New York Fed's trading desk.

VII. The Boards That Oversee the Banks (Board of Governors and Board(s) of Directors)

All the Federal District Banks, branches, and member banks have their own Board of Directors associated with them—much like most corporations do. As opposed to the political appoints of the Board of Governors—appointed by the President and confirmed by the Senate—these Boards of Directors are voted in primarily by the private banks themselves. This being said, these Boards' work is a little different than the usual corporate Board of Directors due to requirements of the Federal Reserve Act. They also have roles and responsibilities created by the Act which go beyond the usual role one would expect from your average private corporation's Board of Directors.

A. Appointments of Board Members

The individual nine person Boards of Directors all have their own rules and limitations for who can be appointed and how. The Board of Governors has some more vague positional requirements for directors on these Boards, asking that they be familiar with the economic conditions and business community of the region they are selected for. (See *Roles and Responsibilities of Federal Reserve Directors* at p. 21.) However, these are not legal requirements so much as stated preferences (see id.). This being said, the Federal Reserve Act offers quite a bit of structure into how these directors are appointed (*The Federal Reserve Act*, Section 4, available at **https://www.federalreserve.gov/aboutthefed/section4.htm**). The result of all these rules is a Board of Directors halfway between what you'd expect of a private corporation and a government run entity ostensibly for the public interest.

As we've mentioned, there is a nine member Board of Directors running each member bank of the Federal Reserve. There is no age requirement or limitation for these positions, or even a requirement that you still work at the bank as retired individuals are occasionally given the positions. (See *Roles and Responsibilities of Federal Reserve Directors* at p. 21.) The business affiliations of directors are considered in the selection process as part of achieving the Federal Reserve Act's goal of diversity of perspective. However, in theory, the directors are not supposed to be an advocate for any particular interest group besides the public's best interest (see id.). For instance, elected officials and Administration appointees are not allowed on the Board.

This being said, looking at the appointment process of these directors provides a pretty clear idea of their goals and structure. The nine directors are broken down into three "classes"—Class A, B, and C (*The Federal Reserve Act*, Section 4). Each of these classes has three members. Class A is appointed by the district bank itself and represents district member banks. Class B is also appointed by the district bank but theoretically represents the public at large. Finally, Class C is appointed by the Board of Governors and also theoretically represents the public (see id.). The Board of Governors also appoints the chair and deputy chair of every Board of Directors from the three Class C directors (see id.). Each of these classes has their own eligibility requirements.

It is worth noting that the branches of the Federal Reserve as a whole also have their own Board of Directors of five to seven members each. The majority of these directors are appointed by a Reserve district bank with the rest appointed by the Board of Governors. There are no classes to Branch Directors; however, directors appointed by the Reserve banks generally need to fulfill the same eligibility requirements of Class A or B directors while those appointed by the Board of Governors must fulfill Class B requirements (see id.).

The eligibility requirements for each class of directors are set by the Federal Reserve Act (see id.). For all of the classes, no Senator or Representative in Congress can sit as a director—or on the Board of Governors for that matter (see id.). Once somebody is an officer (president, vice president, etc.) or director at one bank, they're not allowed to be a Class A director at another bank unless the nomination comes from the bank having the largest aggregate resources of any of those of which that person is an officer or director. In Class B, the nominees outright cannot be an officer, director, or employee of any bank. Class C shares the same limitations, but also bars stockholders of any bank (see id.). These limitations on Class B and C are intended to help ensure these directors serve the interests of the public.

Each class carries a legal requirement that members be appointed without discrimination on the basis of race, creed, color, sex, or national origin. Class B carries a certain amount of consideration for the interests of agriculture, commerce, industry, services, labor, and consumers. In fact, the Federal Reserve Act requires such consideration in appointments—although it also requires that these interests not be the only consideration. Similar rules are in place for the election of Class C directors by the Board of Governors (see id.).

The actual election and appointment of Class A and B directors works as follows. Each member bank nominates one potential director each for Class A and Class B—sending these nominations to the chairman of the Board of Directors for their district. All these nominations are compiled by this chairman and sent to each member bank within 15 days of the completion of the list. After this, each member bank individually votes on their preferences for each position, and the nominee receiving a majority of the highest preference level (generally tiered one to three) is appointed. If there's no majority at the highest preference level, the lower tier preferences are tallied and counted in deciding who to appoint (see id.).

For Class C, the appointments are a little simpler but have a few more requirements. The Board of Governors outright appoints these directors, so the appointment process is quite straightforward. However, those appointed to Class C must have lived in the district they are appointed in for at least two years and have "tested banking experience." This latter requirement is fairly ill defined but generally requires some previous work in the industry. Once appointed, Class C directors serve as Federal Reserve agents—essentially an agent of an Executive Agency—reporting to the Board of Governors. As mentioned before, the chairman of each board is appointed from among these three directors (see id.).

The duration of appointments is staggered between the directors. For this reason, at the first meeting of any Board of Directors for a Federal Reserve bank they have the odd duty of deciding the order in which they will go. Each class—A, B, and C—has to designate one member who will have a one year term, one for a two year term, and one for a three year term. After this, each director appointed has a three year term. If there is an unexpected vacancy on a board, the successor stays an additional period equal to their predecessor's term. This prevents the logistical nightmare of potentially replacing nine directors at once (see id.).

This leaves an odd situation for most Boards of Directors. For an organization that most believe to be very closely tied to the government, the majority of every Board of Directors is appointed by private banks. This is slightly offset by a couple of things. First, the Board of Governors appoints the head of every Board of Directors. Second, the Class B directors at least theoretically represent the public. However, in reality most Boards of Directors operate very similarly to a private corporation with the exception of reporting to the Board of Governors.

B. Roles and Responsibilities of Board Members

We've seen that there are a number of different boards and director roles—Board of Directors, Branch Directors, Board of Governors, and the FOMC. Each of these roles has their own duties set forth by the Federal Reserve Act and the Board of Governors (see *Roles and Responsibilities of Federal Reserve Directors*).

The Directors are generally intended to be more in touch with the industries and economy of their immediate area and make monetary policy suggestions in line with the needs of that area. This comes in a lot of forms but—above all—it comes in a biweekly recommendation from each Reserve Bank Board as to the appropriate action to take in regards to discount rates (see id. at 32). Directors theoretically act as the link between the Federal Reserve and the public, giving the Board of Governors and the Federal Reserve recommendations from smaller economic climates across the nation (see id.).

While directors are involved in general functions of the Federal Reserve, they are not supposed to be making specific supervisory decisions for the banks they are associated with. They do implement some internal audit procedures and the like under the Federal Reserve Act. However, they are largely not involved with day to day functions (see id. at 2).

This being said, the Boards of Directors do have a substantial impact on these day to day functions by appointing the executives of the bank they are associated with. They have the power under the Federal Reserve Act to appoint a president, vice president, and such other officers as necessary to handle day to day duties. The president is appointed by the Class B and C directors, with approval of the Board of Governors, for a term of 5 years. All other executives simply report to this president, although the first time a vice-president is appointed, the same procedure is followed as for the appointment of a president. The Boards of Directors also have the power to set the duties of these officers and dismiss them as they please (see id. At 35).

The Board of Governors and the FOMC have a larger decision making role within the Federal Reserve. They receive the reports from all the different Boards of Directors and from the 12 Reserve district banks and use them to make and implement broader monetary policy decisions. These decisions, along with the recommendations and information from the individual Boards of Directors, are shared with the public two weeks before FOMC meetings in something known as the Beige Book (*Beige Book: Summary of Commentary on Current Economic Conditions by Federal Reserve District* available at **https://www.federalreserve.gov/monetarypolicy/beige-book-default.htm**).

Additionally, Directors "act as a link between the Federal Reserve and the private sector, with information flowing in both directions" (*Roles and Responsibilities of Federal Reserve Directors*). While doing this, directors are required to keep confidential information they receive from the public, and cannot disclose monetary policy action until it has officially been disclosed (*How is the Federal Reserve Structured?* available at **https://www.richmondfed.org/faqs/frs**). This, among other transparency issues, has led to some criticism of the Federal Reserve System.

VIII. Conclusion

The Federal Reserve System is much less federal than the name would have you believe. There is a fair bit of government guidance from the Board of Governors, as well as from the directors the Board of Governors gets to choose. However, the actual system itself is primarily made up of private banks with a majority of privately appointed directors running the show at individual member banks and offering advice on monetary policy changes. While the upper levels of the organization are a government agency, this leaves much of the daily goings-on of the Federal Reserve in individual banks inaccessible to the public.

The goal of President Wilson and Congress in creating the Federal Reserve System was to promote economic stability through the uniformity and certainty of a central banking system which would promote and handle much of the monetary policy of the U.S. More recently, Congress expanded this aim, "[promoting] effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." The idea behind a centralized banking system is that it protects consumers from individual banks taking advantage of them as well as providing stability to the banking system.

However, the banking system in recent years has not really been known for its stability. As it stands, the Federal Reserve Act and associated law puts a lot of power to fulfill ostensibly government functions in entirely or partially private elements of the Federal Reserve. For example, the New York Fed—a private bank with government guidance—has a tremendous amount of power and influence over the financial state and policy of the U.S. The FOMC likewise has an enormous amount of power for a committee that is nearly half composed of what are, at the end of the day, private banking interests.

This state of affairs, coupled with the rocky trajectory of the banking industry over the last several decades, has led to quite a bit of criticism directed at the Federal Reserve. Critics have targeted everything from the structure of the Federal Reserve System, to its very efficacy in achieving its stated goals. This is an extremely complicated discussion. Look to future articles which will look more at the powers granted by the Federal Reserve Act, the loaning practices of the Federal Reserve, and some of these criticisms.

There is certainly a very credible argument that placing substantial control over monetary policy in the hands of private organizations which could profit from those policies is not ideal to say the least. This being said, the power split between public and private within the Federal Reserve System is complicated to unpack. However, it is plain to see that while the function and goals of the Federal Reserve are simple to recite, they are much more difficult to achieve in practice. The question of whether the current structure of the Federal Reserve is the best means of achieving those goals is similarly difficult to parse.

March 30, 2018

Endnotes

1. These include Treasury securities, government-sponsored enterprise debt securities, and federal agency and government-sponsored enterprise mortgage-backed securities.

2. The Solari Report has discussed the ESF at length previously. See https://constitution.solari.com/treasury/ and The Exchange Stabilization Fund with Rob Kirby, available at https://home.solari.com/the-exchange-stabilization-fund-with-rob-kirby/

B. Fiscal: U.S. Treasury

2. The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause

"No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time."
~Article I, Section 9, Clause 7, United States Constitution

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I. Introduction

The Founding Fathers envisioned a government of checks and balances, and entrusted the "Power of the Purse" to the legislative branch. One vital part to that separation of powers is the Appropriations and Statement and Account Clauses of the Constitution, found in Article I, Section 9, Clause 7 of the Constitution. It is generally thought of as containing two provisions: the Appropriations Clause, and the Statement and Account Clause. Together, they form a key part of Congress's "Power of the Purse" and establish Congress as the primary guardian of the federal government's finances (Gary Kepplinger, *The Heritage Guide to the Constitution: Appropriations Clause*, available at **https://www.heritage.org/constitution/#!/articles/1/essays/67/appropriations-clause**).

Madison emphasized the legislative power of the purse in the Federalist Papers by writing that the "power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people" (Federalist No. 58, available at **http://www.foundingfathers.info/federalistpapers/fedindex.htm**).

A. Appropriations Clause

Speaking of the "Power of the Purse" in relation to the Appropriations Clause is somewhat misleading, as the Clause is not a direct grant of power. Instead it is a restriction on the power of the other branches of government that "affirmatively obligates Congress to exercise a power already in its possession" (Kate Stith, *Congress' Power of the Purse*, Jan. 1, 1988 at p. 1348, available at **https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=2282&context=fss_papers**) courtesy of the Taxing and Spending Clause (Article I, Section 8, Clause 1).[1] In essence, it forbids the other branches of government from spending any money not appropriated by the legislative branch, while the actual affirmative power to control federal funds comes from outside the Appropriation Clause (id.).

It is supplemented by various framework acts passed by Congress, such as the Anti-Deficiency Act (31 U.S.C. § 1341, available at **https://www.law.cornell.edu/uscode/text/31/1341**) and the Miscellaneous Receipts Act (31 U.S.C. § 3302, available at **https://www.law.cornell.edu/uscode/text/31/3302**) (Kate Stith, *Congress' Power of the Purse*, Jan. 1, 1988 at p. 1348). These framework acts fill in the gaps of the Appropriations Clause and direct its function in practice. For instance, the Miscellaneous Receipts Act obligates any agent of the United States to deposit any money received from any source into the Treasury, which ensures that the other branches of government don't trespass on the legislative branch's domain of taxing or otherwise raising funds (id.). The Anti-Deficiency Act then reiterates and adds detail to the Appropriations Clause by forbidding the expenditure of public funds without legislative appropriation, and forbidding federal agencies from exceeding their appropriated funds (id.).

Apart from funding new acts, Congress can and does use the Appropriations Clause and its framework acts to adjust, suspend, or repeal existing laws, simply by adjusting the amount of funding the laws receive, or placing restrictions on the use of such funds (United States v. Dickerson 310 US 544 (1940); Robertson v. Seattle Audubon Society 503 US 429 (1992); United States v. Bean 537 US 71 (2002)).

B. Permanent and Indefinite Appropriations

Unfortunately, over the years, Congress has legislated in a manner that ultimately weakens the restrictions of the Appropriations Clause, primarily through appropriations for specific bills that are permanent in duration (see 31 U.S. Code § 1305 at **https://www.law.cornell.edu/uscode/text/31/1305**, listing miscellaneous permanent appropriations) and often permanent and indefinite in scope until Congress affirmatively revisits the matter. Examples include paying the interest on the national debt (31 U.S. Code § 3123, available at **https://www.law.cornell.edu/uscode/text/31/3123**), various housing and rent subsidies,[2] the federal Judgement Fund (31 U.S.C. § 1304, available at **https://www.law.cornell.edu/uscode/text/31/1304**), and Federal Reserve banks in their capacity as fiscal agents of the United States (31 U.S. Code § 3302(f), available at **https://www.law.cornell.edu/uscode/text/31/3302**).

A permanent appropriation is a "standing" appropriation (Principles of Federal Appropriations Law: Fourth Edition, Chapter 2, p. 13, available at **https://www.gao.gov/assets/680/675709.pdf**). Once a permanent appropriation is made, it does not require further authorization from Congress as long as it is used for its specified purpose (id.). An indefinite appropriation has no express limitation on the amount of money appropriated (id.). While such appropriations are not always a true "blank check," they come very close. The amount may be determined at a later date or, in the cases of interest here, in "such sums as may be necessary" (id.). Some require the funds needed to be set each year, while others simply draw from the Treasury.

This essentially means that Congress can take a specific issue and pass a bill saying, "you can have an amount of money ranging from 'we'll set a budget each year' to 'give us a budget estimate' and this appropriation doesn't end until we say it does." In other words, Congress has a tendency to write and sign different blank checks to various agencies while technically retaining the authority to take the checks back. It's like when you subscribe to a magazine, or sign up for a gym membership, and then forget to cancel your subscription, except on a national scale. That is a bit different from the separation of powers the Appropriation Clause envisions, with Congress as the watchful guardian of the public's finances.

C. Statement and Account Clause

If the Appropriations Clause is the requirement that Congress approve spending, the Statement and Account provision is the requirement that they tell us how their approved money was spent. Drawn from the same sentence of the Constitution as the above-discussed Appropriations Clause, the Statement and Account Clause places a crucially important mandate on Congress—to account to the public for how, where, and by what authority the government spends money (Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013, available at **https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1669&context=ylpr**). The clause creates a requirement that the government produce an account of receipts and expenditures "from time to time" (U.S. Const Art. 1, Sec 9, Clause 7). These reports must be made "regularly" (not the most specific requirement) and must include all public money (see Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013 at p. 510). Scholarly interpretation of "regularly" suggests that the duration between these reports must be relatively short—more than annually but still not too far apart (id. at 511). However, there is essentially no judicial interpretation of what is an acceptable period.

This transparency in government finances is a crucially important constitutional requirement. As the Supreme Court has recognized in *Brock v. Pierce County*, "the protection of the public fisc is a matter that is of interest to every citizen" (*Brock v. Pierce County*, 476 US 253 (1986)). Ensuring the legitimacy of government financial actions is central to a functioning democracy. Unfortunately, there are enormous numbers of loopholes and discrepancies in the government Statement and Accounting practices of today—to the tune of trillions of dollars ("DOD and HUD Missing Money: Supporting Documentation," see **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**). This is far from ideal for a Constitutional clause with the goals of ensuring transparency, preventing corruption, and maintaining oversight over the government's financial state of affairs. The clause also, like the Appropriations Clause, enforces the balance of power between government branches by requiring Congress to actively oversee how the executive branch makes use of funds (see Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013).

Also like the Appropriations Clause, the Statement and Account Clause is not a self-executing provision and essentially just relies on Congress to implement the clause through legislation (see id. at 515). This originally involved agencies submitting budget requests to the Treasury every year, which were recorded in something called the Book of Estimates (see id. at 519). This book included detailed item by item requests from agencies and all the revenue sent to the Treasury. It was a mess. Nobody had the same format or managed their accounting in the same way and, once the book was put together, the Secretary of the Treasury would just send the incomprehensible pile of raw data to Congress with no review or changes whatsoever. Congress passed amendments to the statutes discussing how the Statements and Accounting Clause obligations were handled in 1875, which formalized the Book of Estimates as the official means of satisfying the Statements and Accounting Clause (see id.).

This essentially useless practice continued until the accounting issues of World War I led Congress to pass the Accounting Act of 1921 (Pub.L. 67–13, 42 Stat. 20, enacted June 10, 1921, available at **http://www.legisworks.org/congress/67/publaw-13.pdf**)—creating a single unified cash budget for the U.S. government. This Act required the President to make a yearly budget proposal (the President's Budget) and created an Executive Agency, the Bureau of the Budget, to help with this (see id.). This obviously created a strange situation; the Executive branch was handling the process designed in part to allow the Legislative branch to check the Executive (see id.). The Act did create the General Accounting Office, changed to the Government Accountability Office (GAO) in 2004 by the GAO Human Capital Reform Act, as a congressional agency to audit the Executive's handling of the accounting (see S.1522, available at **https://www.congress.gov/bill/108th-congress/senate-bill/1522**). However, the GAO had no actual role in producing the President's Budget. They only reviewed it. Another issue with the President's Budget is that it was primarily focused on creating a negotiating tool for appropriations discussions rather than a transparent accounting for public consumption (see Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013).

In 1974, the Congressional Budget Office was created to make an independent congressional budget (the Economic Outlook) and improve budget oversight. However, the process had many of the same issues as the 1921 Act (see id. at 525). President Johnson himself said that "[t]he traditional administrative budget is becoming an increasingly less complete and less reliable measure of the Government's activities and their economic impact" (see id.).

Today, the obligations of the Statement and Accounting Clause are fulfilled by the President's Budget, the Economic Outlook, and one more reporting tool—the Consolidated Financial Report issued by the Treasury (see id.). Even all together, there are a number of issues with these reporting mechanisms. The President's Budget, the Executive branch's crack at the Legislative branch's duty to oversee the Executive, is still the most widely known of the reports (see id. at 526). The accounting has enormous gaps as mentioned above. These include, but are far from limited to, Social Security trusts, defense spending, and the accounting of quite a few government-related entities such as the U.S. Postal Service (which currently owes around $11B to the government) and the businesses in which the government owns a tremendous amount of stock after the bailouts of the last decade—Fannie Mae and Freddie Mac, for instance (see id. at 527). These are just a few examples from among the hundreds and hundreds of government-related entities with no accounting in any of the government reporting tools discussed above.

These holes in reporting, along with a number of statutes limiting the financial reporting requirements of the government, have led many to question whether the government is fulfilling its constitutional obligations under the Statements and Accounting Clause.

II. Legislative and Judicial History

A. Federalist Papers and Drafting the Constitution

The Appropriations Clause was a very early addition to the Constitution (Gary Kepplinger, *The Heritage Guide to the Constitution: Appropriations Clause*). The original Virginia Plan, essentially a sort of first draft of the Constitution prepared before the Constitutional Convention, already included plans to put appropriation of funds within the powers of the Legislature. This original plan was much more restrictive than what ultimately came out of the Constitutional Convention; however, it shared the goal of providing a check of power against the Executive to the Legislative branch. The idea is that the Executive wields incredible powers, while the Legislative branch holds the resources to act on those powers. It's no surprise that what debate there was over the Appropriations Clause at the Constitutional Convention was focused on the roles of the House and the Senate in this power and making sure that the power was an effective check on the Executive. The former issue was primarily a debate over how smaller states—overrepresented in the Senate—would still have power over appropriation bills originating in the House. The latter was essentially a debate over ensuring the check was sufficiently powerful. The framers of the Constitution were unanimous in their belief that this sort of check on the Executive was incredibly important (see id.).

The Statement and Account provisions were introduced by George Mason in the last days of the Convention. Initially, the proposal included an annual reporting requirement. However, this was reduced to "time to time" in order to ensure accurate and clear reporting in a form useful to the public without placing too onerous a task on Congress. The goal of the framers was to allow the public access to a clear understanding of how and why "all public money" was spent by the government. There was no debate over the scope of the reporting, only its frequency. Constitutional Framer James McHenry explained the lack of debate, saying "[the People who give their Money ought to know in what manner it is expended." There were some objections to the "time to time" phrasing, suggesting that this level of discretion may lead to secrecy. This sort of secrecy was something the Framers sought to avoid. Even though they appreciated the importance of secrecy in some "military operations and foreign negotiations," they intentionally did not include any exceptions in the reporting requirements. Even proposals to delay publication of such financial moves were rejected by the Framers—favoring transparency over security concerns (see id.).

B. Early Judicial Action

The goals of the Appropriations Clause and the Statement and Account Clause are to create a check on the Executive and provide transparency in government spending (see id.). However, one sentence is not a lot to go on for such a broad power. The powers are not self-executing and, as discussed above, are generally put into force through statute. Even then, the boundaries and limits of this power have required some clarification in the courts over time.

The earliest of these rulings provided an enormous amount of leeway to Congress in deciding exactly what these Constitutional provisions mean and how they are to be enacted. In 1880, the Supreme Court ruled on something known as Hart's Case (see *Hart's Case*, 16 Ct. Cl.459, 484 (1880)). In this case, the Court determined that Congress has complete power to execute and define the duties of both the Appropriations Clause and the Statement and Account Clause (see id.). While the case did not specifically discuss the Statement and Account Clause, referring instead to Article I, Section 9, Clause 7 of the Constitution (the source of both the Appropriations Clause and Statement and Account Clause), it has since been relied on as creating full discretion in implementing the Statement and Account Clause and delegating the duties and powers therein.

Early courts also defined how appropriations work. The process is quite simple; all that is necessary is for Congress to—usually via a statute—enact a law directing monies to be paid from a specific fund or from the Treasury. An appropriation is "per se nothing more than the legislative authorization prescribed by the Constitution for money to be paid out at the Treasury" (see *Campagna v. United States*, 26 Ct. Cl. 316, 317 (1891)).

C. The 20th Century

As time has progressed, Courts have also recognized the goal of the Appropriations Clause. In 1937, the Supreme Court noted the importance of the rule as a check on the Executive branch saying that the Appropriations Clause "was intended as a restriction upon the disbursing authority of the Executive department" (*Cincinnati Soap Co. v. United States*, 301 US 308 (1937)). The courts have also continued to support the premise that the Appropriations Clause means that all spending of public funds must be "authorized by Congress, not that public funds may be expended unless prohibited by Congress" (*United States v. MacCollom*, 426 US 317 (1976)). This ruling enforced the strength of the Appropriations Clause as a check.

However, at the same time as the courts have emphasized the strength and importance of the Appropriations Clause, they have allowed Congress to approach the Appropriations and Statement and Account Clause reporting requirements with as strong or as lax a hand as they see fit. The courts have established that Congress may adopt "any reporting and accounting [Congress] considers appropriate in the public interest" (*United States v. Richardson*, 418 U.S. 166 (1974)). Under the Appropriations Clause, Congress has quite a bit of leeway in how it may enact and condition an appropriation—although the courts have outlined some limits on the conditions which are allowable. (See, e.g., *South Dakota v. Dole*, 483 U.S. 203 (1987) (addressing Congress's ability to impose conditions on the use of federal grants and noting that actions taken must not be prohibited by the Constitution).)

The Statement and Account Clause has no written or ruled on exemptions, requiring transparency from the government. However, there is very little in the way of rulings which limit how Congress can satisfy its reporting requirement. The history of the Clause at the Constitutional Convention implies a premium on transparency which may require Congress not to exclude anything from its reports. After all, the idea of exemptions to the reporting requirement was specifically rejected at the Constitutional Convention (see Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013 at 536).

This thought has led some to challenge statutes undermining the Statement and Account Clause, albeit with little success. The Supreme Court heard a case dealing with the 1949 CIA Act (*United States v. Richardson*, 418 U.S. 166 (1974)). The lawsuit was challenging the fact that the CIA Act exempted CIA activities from federal reporting requirements (50 U.S.C. § 403a, available at **https://www.law.cornell.edu/uscode/text/50/403a**). The suit argued that this bypassed the reporting obligations placed on Congress by the Statement and Account Clause. The Supreme Court, in a five-to-four split decision, dismissed the case entirely based on lack of standing. The theory behind the ruling was that Congress had complete power to define exactly how the reporting requirements of the Statement and Account Clause work (see *United States v. Richardson*, 418 U.S. 166 (1974)).

Just a few years later, another case was brought challenging the CIA Act on the same grounds (*Harrington v. Bush* 553 F.2d. 190 (1977)). The case argued that removing information on national security spending substantially reduced the quality of the reports as a transparent spending accounting for the public. This case didn't even make it as far as the Supreme Court, or any court beyond the D.C. Circuit Court as it was immediately dismissed on the same grounds as Richardson and affirmed on appeal (see id.).

There's certainly something behind these cases; if transparency with no exceptions was the goal of the clause, it is an odd position that Congress can make any exceptions they want. However, no court has ever granted standing in a case challenging reporting exceptions—the list of which has only grown since the CIA Act. Similarly, no court has supported standing to sue over shifting appropriations power to the Executive—even though the goal of the clause has repeatedly been ruled and discussed as separation of powers between the Legislative and Executive branches. These standing rulings rely quite a bit on the sheer amount of discretion provided to Congress regarding the Appropriations Clause and Statement and Account Clause.

III. The Current Judicial Climate

The current judicial climate is generally hostile to cases regarding separation of powers issues such as the Appropriations Clause. As can be seen above, the courts generally defer to Congress in its application of appropriations, and as discussed below, find every excuse possible to dismiss or otherwise settle such cases on other grounds.

A. Role of the Judiciary

The judiciary generally has the power to interpret and safeguard the Constitution. However, courts have a tendency to avoid ruling on the constitutional adequacy of Congressional acts of appropriation in the context of separation of powers (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at p. 32, available at **http://www.law.harvard.edu/faculty/hjackson/ConstitutionalityOfExecutive_38.pdf**). Whenever possible, they tend to either find the plaintiffs' standing insufficient to bring suit, or deem the issue a political question best solved by Congress (id.). Because of this, binding judicial decisions regarding the Appropriations Clause are few and far between (id.).

The Supreme Court has, however, issued some broader rulings relating to Congressional appropriations. First, the Court insists that Congress clearly articulate its purposes when it applies appropriations as a tool to change other provisions of law (see *United States v. Will*, 449 U.S. 200 (1980)). Those purposes need not be wholly rational or appropriate, merely made clear (id.).

Second, Congress may not violate other provisions or protections of the Constitution or Bill of Rights through appropriations. For instance, they may not pass bills of attainder (see *United States v. Lovett*, 328 U.S. 303 (1946)), or violate an individual's First Amendment rights (see *Legal Service Corp. v. Velasquez*, 531 U.S. 533 (2001)). These issues, however, do not turn on the appropriations themselves, so much as what was done with said appropriations.

B. Standing

Determining the standing of the parties is the process of determining whether or not a party even has the right to sue based on suffering some hardship or injury. In order to have standing, a party must show that they, personally, have suffered an injury the court is capable of redressing. For instance, there is a great deal of judicial history denying standing in various environmental lawsuits,[3] where there is no substantive harm to an individual plaintiff's interests except for the existence of a law or government project they personally disapprove of. Instead, the challenging party must show "the party seeking review be himself among the injured, for it is this requirement that gives a litigant a direct stake in the controversy and prevents the judicial process from becoming no more than a vehicle for the vindication of the value interests of concerned bystanders" (*United States v. Students Challenging Regulatory Agency Procedures*, 412 U.S. 669 at 687 (1973) (citing *Sierra Club v. Morton,* 405 U.S. 727 (1971)).

This poses some difficulty when separation of powers disputes come before the courts, because the "harms" suffered are often intangible and vague (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 33). This difficulty exists no matter if a taxpayer is the plaintiff, or if members of Congress itself sue. Plaintiffs in separation of powers cases need to show that (1) they, personally, have been harmed, and (2) some compelling reason why the problem shouldn't be solved politically, by the election of new officials or passage of new acts.

For instance, in *Raines v. Byrd*, 521 U.S. 811 (1997), the plaintiffs were a group of Congressmen who claimed they were injured by the Line Item Veto Act because it gave more power to the executive branch and "diluted" the power of their own votes. However, the Court found this harm was "wholly abstract and widely dispersed" (id.). Courts have followed this ruling in subsequent cases, and even go so far as to emphasize that legislators already have political tools to remedy their grievances, such as by passing another bill, and the interference of the courts is unnecessary (see *Campbell v. Clinton*, 203 F.3d 10 (D.C. Cir. 2000)). The Court will even go so far as to dismiss cases by Congressmen on the grounds of standing where other branches, like the executive, spend funds in violation of appropriation conditions (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 38 (citing *Sanchez-Espinoza v Reagan*, 248 U.S. App. D.C. 146, 210 (D.C. Cir. 1985) (where the executive covertly supported the Contras in violation of the Boland Amendment)).

Taxpayers face even greater barriers to their claims. Even though a taxpayer lacks the same political tools members of Congress do, the courts are nonetheless hostile to any sort of taxpayer standing. Taxpayers must "establish a nexus between that status and the precise nature of the constitutional infringement alleged" (*Flast v. Cohen*, 392 U.S. 83, 102–3 (1968)). Proving this nexus is difficult, even when the allegations are that constitutionally mandated statements and accounts are not being given to taxpayers, as is seen in the budgets of national security agencies (see *United States v. Richardson*, 418 U.S. 166 (1974)). This hostility makes it very unlikely any taxpayer(s) would succeed in proving standing to sue over separation of powers issues, such as the Appropriations Clause (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 36).

This is not to say it is impossible for an individual to prove standing resulting from injury by federal spending programs (Kate Stith, *Congress' Power of the Purse*, Jan 1, 1988 at p. 1387, fn 218). Cases that successfully prove standing have a concrete injury in common, from challenging the results of failed federal bids[4] to direct harm to an individual's use and enjoyment of scenic resources.[5] However, succeeding in proving standing only qualifies a separation of powers case to challenge the next hurdle; whether or not the controversy is a political question.

C. Political Question

The second hurdle cases regarding separation of powers such as those commonly involved in an Appropriations Clause case must face is the tendency of courts to declare such cases a "political question." Political question doctrine essentially means "that in order to preserve the independence of branches essential to the separation of powers, the judiciary must refrain from deciding cases that would force it to speak on inherently political matters that are ordinarily the purview of the political branches" (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 36). This doctrine was laid out in 1803, in one of the most foundational cases the Supreme Court has heard, *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803). There, the Court very clearly delineated what types of controversies the courts should and should not hear, writing "[q]uestions, in their nature political, or which are, by the Constitution and laws, submitted to the executive can never be made in this court" (id. at 170). Ever since, the Court has consistently erred on the side of caution in situations that do not rise to a genuine political impasse (see e.g., *Goldwater v. Carter*, 444 U.S. 996, 997 (1979)).

In general, there are six situations where the courts will declare a controversy as a political question:

> *"[1] a textually demonstrable constitutional commitment of the issue to a coordinate political department; or*
> *[2] a lack of judicially discoverable and manageable standards for resolving it; or*
> *[3] the impossibility of deciding without an initial policy determination of a kind clearly for non judicial discretion; or*
> *[4] the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or*
> *[5] an unusual need for unquestioning adherence to a political decision already made; or*
> *[6] the potentiality of embarrassment from multifarious pronouncements by various departments on one question."* (*Baker v. Carr*, 369 U.S. 186, at 217 (1962).)

If any of these factors are present in a case, the courts will declare it non-justiciable as a political question. Separation of powers issues almost always implicate the political question doctrine, often invoking more than one of the above factors. Not only does the judicial branch repeatedly explain they are not suited to analyzing and enforcing issues of budgeting and accounting (id.), but the nature of separation of powers cases usually involves issues that are already textually committed to a political department.

Examples of this include the case of Sanchez-Espinoza discussed above, where the Court, in addition to dismissing it on standings grounds, stated the issue was also a non-justiciable political question (see *Sanchez-Espinoza v Reagan*, 248 U.S. App. D.C. 146, 210 (D.C. Cir. 1985)). The division of war powers between the executive and legislative, as discussed below, also tends to be declared a political question.

However, as with standing, there are situations where the courts are willing to entertain highly political issues. For instance, where the questions primarily turn on the interpretation of a statute, this gives the court legal standards they can apply to an issue purely from the statute in question, without implicating a political question.[6]

D. The Government Accountability Office and the Comptroller General

The GAO has some auditing powers as discussed above, and is sometimes considered to be a potential solution to the issues inherent in Congress's handling of Statement and Account duties (see Katherine Clark Harris, *The Statement and Account Clause: A Forgotten Constitutional Mandate for Federal Reporting*, 2013 at 540). Further, it has historically received some deference from the courts in regards to GAO determinations. Unfortunately, the Supreme Court's ruling in *Bowsher v. Synar*, 478 U.S. 714 (1986) cast aside some of that deference, and impairs much of the GAO's ability to function as an enforcer of appropriations. In Bowsher, the GAO was attempting to enforce a budget deficit control act, and both individual Congressmen and the National Treasury Employees Union filed suit challenging the constitutionality of the law (see id.).

The Court found that because the Comptroller General could be removed from the position by Congress, the position could not perform duties independently and was subservient to Congress (id. at 727-728), and therefore could not exercise executive powers (id. at 732). Therefore, it could not function in an enforcement role by bringing suit under the Impoundment Control Act.

Further, the enforcement of GAO decisions ultimately comes from Congress itself, in the form of oversight committees or appropriation actions (Kate Stith, *Congress' Power of the Purse*, Jan 1, 1988 at p. 1391), and its audit authority does not extend to all government agencies (id.). Without sufficient authority from Congress, and being forbidden executive powers by the Court, it is unlikely the GAO can perform any meaningful enforcement of appropriations or statement and account issues.

IV. Appropriations and the Executive Branch

The limitations the Appropriations Clause places on the Executive branch are not fully explored, even to this day. In part, this is because, as noted above, the Clause cannot allow Congress to violate other provisions of the Constitution or unduly impinge on the powers of other branches. This is also due to the fact that the powers of the Executive branch tend to expand and contract with the political climate and composition of the Supreme Court. However, there are still some basic separation of powers principles the Court has laid out.

The Supreme Court has classified three basic categories of executive action, and assigned differing levels of scrutiny to each category (see *Youngstown Sheet & Tube Company v. Sawyer*, 343 U.S. 579 (1952)). In the first category, the executive acts with the authorization of Congress, and such action has a high presumption in its favor (id). In the second category, the executive acts without authorization or denial from Congress, and each situation must be analyzed to understand the proper distribution of authority (id.). In the third and final category, the executive takes action in defiance of Congressional will, and presidential power is "at its lowest ebb" (id.). Such action is permitted only with a clear presidential power and is heavily scrutinized by the courts.

Appropriation actions are generally equivalent to Congressional approval or disapproval, since Congress often uses appropriation to amend or remove acts (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 7). Furthermore, the framework Anti-Deficiency Act discussed above was passed expressly to prevent certain forms of executive overreach. This means that executive action in defiance of Congressional appropriation almost certainly belongs to the third category of executive action, and is highly scrutinized by the courts (id.). For any such action to succeed, the executive needs to base such action on a clear, "conclusive and preclusive" executive power granted by the Constitution.

There are some areas where the Constitution does give the executive sufficiently clear power that it has a chance of overcoming judicial scrutiny and defying Congressional acts of appropriation. Some aspects of the President's authority regarding foreign affairs (see id. at 5, (citing *United States v. Curtiss-Wright Export Corp* 299 U.S. 304,319 (1936), *American Insurance Association v. Garamendi*, 539 U.S. 396 (2003)), and in emergency situations[7] have, in the past, been allowed.

However, Congress maintains a broad swath of wartime powers as well, based on its ability to declare war and raise the army (id. at 19). The interplay between the war powers of the legislative and executive branches can often be hard to distinguish (id. at 21). In particular, modern decisions in *Hamdan v. Rumsfeld*, 126 S. Ct. 2759 (2006) and *Medellin v. Texas*, 128 S. Ct. 1346 (2008) have largely overruled past deference to the executive regarding foreign affairs, and returned the Court's analysis to the Youngstown test.

Further, the executive has other methods of circumventing the Appropriations Clause, such as reprogramming funds,[8] relying on the Feed and Forage law,[9] or simply deploying otherwise authorized troops and incurring coercive[10] funding (Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at 25). This state of affairs, where the executive's ability to appropriate funds ebbs and flows with current political climate (and is currently ebbing) has resulted in few conclusive rulings by the courts, and an ongoing struggle between the legislative and executive.

V. Conclusions

The courts have largely avoided addressing issues raised by the Appropriations and Statement and Account Clauses by refusing to find standing, or treating violations as non-judiciable questions they should not unduly interfere with. Thus, the courts have largely left the enforcement of violations of the Clauses to Congress. They've done this to some extent through statutes regulating how the two Clauses must be handled, such as the Anti-Deficiency Act and Miscellaneous Receipts Act discussed above. There are a number of more recent statutes we have not discussed, which have provided guidelines for proper reporting and appropriations actions such as the Government Management Reform Act and the Government Performance and Results Act.

Congress, however, seems determined to weaken the protection the Clauses give them by authorizing appropriations of permanent and indefinite scope in situations such as the national debt and passing statutes limiting government financial reporting requirements such as the CIA Act. While it has the power to enforce the Appropriations Clause by simply placing limits in its own appropriations acts, Congress has the unfortunate tendency to ignore the obligations and limitations placed on them by their own statutes and the Constitution and delegate away their power. However, the judicial history reveals that it is quite difficult to convince courts to hear cases designed to ensure Congress follows either the Constitutional requirements of the Clauses or their own statutory requirements. If the powers of the Clauses are to be taken seriously at the federal level, it is primarily up to Congress to police itself. This is not to say no lawsuit challenging Congress' behavior on Constitutional grounds could ever succeed, just that it would take an incredibly specific set of facts.

Finally, in areas of Executive overreach, where the President ostensibly violates the Clauses, the courts are only slightly more willing to act. Generally, they leave it up to the politics between the legislative and executive, and only weigh in when one clearly and blatantly usurps the power of the other, or if the courts otherwise have an underlying statute to interpret and rule on. This is a poorly defined area of law; the exact details of how appropriations rules should apply are hotly debated. However, in general, where the Executive spends or designates funds without an appropriation from Congress, they have acted beyond the scope of their powers.

The approach of Congress and the Courts has resulted in a hodgepodge of inconsistent powers. Congress will either write blank checks or just flat out ignore the executive's improper spending, the executive will sometimes spend funds without legislative appropriation, properly or improperly, and the judiciary often stays out of the matter. This conflict might have strayed from how the Founders intended the checks and balances of our government to work and the transparency the Founders hoped to offer to the public. It has certainly left the state of the law unclear at best with an uphill battle for any attempt to remedy the situation through the courts alone.

January 12, 2018

Endnotes

1. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;
To borrow Money on the credit of the United States;
To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;
To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;
To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;
To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;
To establish Post Offices and post Roads;
To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;
To constitute Tribunals inferior to the supreme Court;
To define and punish Piracies and Felonies committed on the high Seas, and Offenses against the Law of Nations;
To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;
To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;
To provide and maintain a Navy;
To make Rules for the Government and Regulation of the land and naval Forces;
To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repel Invasions;
To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the Authority of training the Militia according to the discipline prescribed by Congress;
To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards and other needful Buildings;-And
To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

2. 12 U.S. Code § 1701s – Rent supplement payments for qualified lower income families https://www.law.cornell.edu/uscode/text/12/1701s; 12 U.S. Code § 1715z – Homeownership or membership in cooperative association for lower income families https://www.law.cornell.edu/uscode/text/12/1715z; 42 U.S. Code § 1437c – Contributions for low-income housing projects https://www.law.cornell.edu/uscode/text/42/1437c

3. For instance, in *Sierra Club v. Morton*, 405 U.S. 727 (1971), the Sierra Club's general interests in preventing adverse changes to an area's aesthetics and ecology was not sufficient to show individualized harm to it or its members. The circuit courts have since followed this decision.

4. In *B.k Instrument v. U.S.*, 715 F.2d 713 (2d Cir. 1983) the Plaintiff sued when the government agency in question would not allow correction to an accidentally erroneous form, despite Plaintiff offering the lowest bid.

5. In *United States v. Students Challenging Regulatory Agency Procedures*, 412 U.S. 669 (1973), a student association alleged a federally controlled freight rate change directly impacted their aesthetic and scenic enjoyment of the environment around Washington, D.C. The alleged injury was there was personalized and direct to each plaintiff, and rose beyond a "general interest."

6. (*Beaty v. Republic of Iraq*, 480 F.Supp.2d 60 (D.D.C. 2007) (where the interpretation of the Foreign Sovereign Immunities Act was at issue, allowing the court to sidestep an otherwise foreign policy related political question).

7. Three commonly referenced instances: President Washington spent during the Whiskey Rebellion without congressional approval, President Jefferson purchased goods after the Chesapeake-Leopard affair, and Lincoln purchased supplies without congressional approval in the early days of the Civil War.

8. Essentially, moving funds from one part of an agency to another, often informing Congress after the fact.

9. The Feed and Forage Act of 1861 expressly allows the military to exceed appropriations in order to provide clothing, food, fuel, quarters, transportation and medical supplies.

10. For instance, despite the existence of the Anti-Deficiency act, which is supposed to prevent coercive funding, the President is capable of committing troops in advance of specific Congressional authorization or denial, and the consequences of refusing to support the troops can be dire to any political career.

3. The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them

"About 34 percent of the federal government's reported total assets as of September 30, 2016, and approximately 18 percent of the federal government's reported net cost for fiscal year 2016 relate to significant federal entities that, as of the date of GAO's audit report, were unable to issue audited financial statements, were unable to receive audit opinions on the complete set of financial statements, or received a disclaimer of opinion on their fiscal year 2016 financial statements." (U.S. Gov. Accountability Office, GAO-17-283R, *U.S. Government's 2016 and 2015 Consolidated Financial Statements*, (2017) at forward 1, available at **https://www.gao.gov/products/GAO-17-283R**).

Table of Contents

I. Introduction

The Statements and Accounts Clause of the Constitution is the Founders' attempt to ensure the financial transparency of the government (*The Heritage Guide to the Constitution: Appropriations Clause*, available at **http://www.heritage.org/constitution/#!/articles/1/essays/67/appropriations-clause**). As a very basic summary of the constitutional requirement, the Clause requires the government to provide a detailed account of all the money it spends from time to time (see id.). It also requires all money spent to be approved by Congress. The thought was that a government that could spend without any accountability is antithetical to a true democracy as that is a government not beholden to the people (see id.). The application of the Statements and Accounts Clause has generally been left in the hands of Congress. The courts have established that Congress may adopt "any reporting and accounting [Congress] considers appropriate in the public interest" (*United States v. Richardson*, 418 U.S. 166 (1974)).

Unfortunately, Congress has chosen to treat its power as an afterthought—only really bringing up the accounting requirements of the Constitution when politically convenient. What's more, while the Clause was originally contemplated as a Congressional check on the Executive—allowing Congress to oversee and approve Executive spending—Congress has delegated a great deal of its constitutional powers to the very Executive branch the powers were meant to check. (See *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/#ch10**.)

As it is, the current accounting practices of the U.S. government fall far short of the Founders' goals of creating financial transparency for the public. A 2008 study showed that only 5% of U.S. citizens feel like they are provided sufficient information on the financial status of the government; the number has only marginally increased in a 2010 version of the study (*Public Attitudes Towards Government Accountability and Transparency 2010* at p. 2, available at **http://global.oup.com/us/companion.websites/9780199859214/student/chapter3/pdf/accountability.pdf**). This is for good reason. The accounting practices of the government have serious issues with them. Lack of uniformity makes them often incomprehensible; inconsistencies in reporting certain matters or on government corporations such as Fannie Mae or Freddie Mac, long delays in reporting, and more leave the reports the government does provide pursuant to the Statements and Accounts Clause of the Constitution far from useful to a member of the public seeking financial transparency. Fannie Mae, Freddie Mac, and the Federal Reserve are all notable as exceptions to reporting requirements within the Government Accountability Office's (the GAO, a congressional accounting and accountability agency) consolidated financial statements of the U.S. government. (See *Financial Audit: Fiscal Years 2016 and 2015 Consolidated Financial Statements of the U.S. Government* at p. 13, available at **https://www.gao.gov/assets/690/682081.pdf**). The GAO can audit these entities, but does not include them in the financial reports it provides to the public (see id.). Over 30 years of non-compliance on the part of many government agencies, and every agency non-compliant to some degree or another for at least a decade, have not helped the matter. As of today, the Department of Defense and the Department of Housing and Urban Development have over $21 trillion (that's trillion with a very big "T") in undocumented expenditures they've provided to the public just between the years of 1998 and 2015 ("DOD and HUD Missing Money: Supporting Documentation," available at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**). This is more money unaccounted for than the current national debt in just the span of 17 years and only taking two executive agencies into consideration.

All this being said, Congress has not totally ignored the responsibilities of the Statement and Account Clause. There have been a number of statutes passed over the years that have expanded or limited the accounting requirements created by the Clause, attempting to make government financial reports a more useful and comprehensible tool. Unfortunately, these efforts have been plagued with a constant lack of enforcement mechanisms and a near total lack of follow-through on behalf of the government agencies the reporting requirements apply to. We'll be taking a look in this article at the most impactful of these statutory changes and the decades of failures on the part of government agencies to comply with these statutes. It is worth noting that the statutes on this topic could fill a textbook, thus we have chosen several of the most impactful to focus on as they illustrate an ongoing trend in government financial reporting legislation. The general provisions, and issues with the Statements and Accounts Clause have been discussed in depth in a previous article available through The Solari Report (see *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/#ch10**). With that in mind, we will be addressing the Clause, as well as some of the more important elements of the previous article, in only a cursory manner.

II. Statement and Accounts Legislation

While we discussed a historical overview of statement and accounts legislation previously, the last two decades or so have seen a multitude of newer Acts intended to create and enforce accounting and reporting requirements on the federal government. These Acts, while well intentioned, have had varied success in enforcing Congress's will and the requirements of the Constitution. We will discuss a few of the relevant Acts below.

A. Framework Statute Exceptions

As we mentioned previously, Congress enacted various framework statutes, such as the Miscellaneous Receipts Statute (31 U.S.C. § 3302, enacted in 1849, amended in 1982, requiring money given to the federal government to be placed in the Treasury), and the Anti-Deficiency Act (31 U.S.C. § 1341, enacted in 1884, amended in 1950, prohibiting federal agencies from spending money in excess of appropriations). However, these framework Acts have certain exceptions Congress later legislated into existence.

For instance, the Miscellaneous Receipts Statute has three categories of exceptions: collections, revolving funds, and gift authority (Kate Stith, *Congress' Power of the Purse*, Jan 1, 1988 at 1366). Agencies with collections exceptions may keep some of the funds they collect (i.e., for permits, filing fees, and the like) instead of being required to deposit those funds in the Treasury (id.). Revolving funds take it a step further. While they are initially funded by an appropriation, the income from whatever activity the agency undertakes generally provides the necessary funding after (id. at 1366-7). Finally, gift authority allows an agency to receive a gift from a private entity and use it without first depositing the gift into the Treasury (id.).

B. Federal Financial Managers Integrity Act of 1982

In the early '80s, efforts began to try and turn the Statements and Accounts Clause reporting into something more useful which would actually provide the transparency to the public that was the goal of the

Constitution. In 1982, the Federal Financial Managers Integrity Act was passed as an amendment to the Accounting and Auditing Act of 1950 with an aim of placing stricter requirements on government financial reporting as well as creating a means by which to see whether agencies were following these requirements. (See Pub. L. 97-255, available at **https://www.congress.gov/bill/97th-congress/house-bill/1526**.)

First and foremost, the Act required the Comptroller General (the director of the GAO) and the Office of Management and Budget (OMB) to create minimum guidelines for internal accounting at the executive agencies. These requirements were meant to ensure that the accounting measures followed applicable laws, safeguarded against waste, loss, or spending without a Congressional appropriation, and properly recorded revenues and expenditures so as to maintain accountability for all assets (id.).

Once these requirements were in place, the heads of each agency were required to prepare a statement every year saying whether or not their accounting practices were compliant with the requirements of the Comptroller and the OMB. Where they did not comply, the agencies had to produce an additional report identifying their weaknesses and plans to fix those weaknesses. These reports were all made available to the public, with the exception of disclosures prohibited by law or where it is kept secret by executive order for foreign policy or national security purposes (id.).

These steps, as well as the accounting requirements released by the Comptroller and the OMB, did make steps forward in improving the quality of government financial reporting and helped bring it in line with the vision of the Statement and Accounts Clause. However, the law still had some serious weaknesses. First, it did not include a reporting requirement for government corporations. This created an enormous reporting loophole. Second, there was an issue you may have already noticed—no real enforcement mechanism (see id.).

As mentioned in our last article, the courts are very hesitant to entertain lawsuits regarding the Statements and Accounts Clause—whether from taxpayers or from Congress itself. (See *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/#ch10**) (citing Bob Smith and Sarah Miller, *The Constitutionality of Executive Spending Powers* at p. 32, available at **http://www.law.harvard.edu/faculty/hjackson/ConstitutionalityOfExecutive_38.pdf**).) The Act itself here has no carrot or stick associated with it to ensure that agencies have complied with provisions beyond the inconvenience of producing a report as to their financial weaknesses (see Pub.L. 97-255, available at **https://www.congress.gov/bill/97th-congress/house-bill/1526**).

This led to something we will see to be a trend in laws on government financial reporting, a law in place which executive agencies felt free to essentially ignore. (See *Fiscal Years 2016 and 2015 Consolidated Financial Statements of the U.S. Government* at p. 1, available at **https://www.gao.gov/products/GAO-15-341R**.)

C. Chief Financial Officers Act of 1990

The Chief Financial Officers Act (CFO Act), enacted in 1990, represented a move by Congress to try and make government accounting practices more uniform, comprehensible, and useful (see Pub.L. 101-576, available at **https://www.gpo.gov/fdsys/pkg/STATUTE-104/pdf/STATUTE-104-Pg2838.pdf**). As an initial step, the CFO Act required 24 covered U.S. agencies[1] to create and staff a Chief Financial Officers office. This office would coordinate on budget reporting with the Office of Management and Budget (OMB) in the hopes of establishing groundwork for more comprehensive accounting practices (id.).

The Act also put greater onus on the OMB to bring government accounting practices into the 20th century, requiring development of a five year plan to shore up the gaping holes in the statements and accounts of government agencies such as the Department of Defense (DoD) and the Department of Housing and Urban Development (HUD). To this end, the Act created a Deputy Director for Management within the OMB to coordinate with the agency CFOs and create guidelines for how they must behave. It also created a new position known as the Controller of the Office of Federal Financial Management, appointed by the President and confirmed by the Senate, to aid in this endeavor. The OMB also must annually submit an evaluation to Congress of how the executive agencies and government corporations—Fannie Mae, Freddie Mac, and PBS, for example—are doing when it comes to financial reporting (see id.).

Under the Act, the individual agency CFOs are responsible for preparing financing statements for regular audit in order to ensure accuracy in accounting. The CFOs also were tasked by the Act with integrating accounting and budget information into a form consistent with those used to make budgets, put together a uniform financial management system for their agency, and—perhaps most importantly—make sure that the system they put together allowed for actual useful measurement of the financial performance of the CFO's agency. Government corporations are additionally required to independently put together an annual report on their internal accounting in compliance with reporting requirements such as those in the Federal Managers Financial Integrity Act. These reports are required no later than 180 days after the end of the fiscal year. The CFO reports similarly need to be compliant with the requirements of these sorts of laws but also must comply with internal control standards from the OMB, accounting principles and standards to ensure uniformity and quality, and other requirements out of the OMB and the Department of the Treasury. They must also be complete, uniform, reliable, consistent, and timely (see *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform*, available at **https://www.gao.gov/special.pubs/af12194.pdf**).

These are some great ideas; they had the potential to change the way government accounting was done and truly live up to the goals of the Statement and Accounts Clause of the Constitution. However, the requirements have been largely ignored for years—both agencies and government corporations habitually do not make CFO Act compliant reports (see *Fiscal Years 2016 and 2015 Consolidated Financial Statements of the U.S. Government* at p. 1, available at **https://www.gao.gov/products/GAO-15-341R**). As we will discuss further, the DoD has never once successfully made a CFO compliant accounting in the nearly 30 years since the law was passed.

D. Federal Credit Reform Act of 1990

Continuing a trend towards government financial responsibility in 1990, Congress also passed the Federal Credit Reform Act (FCRA, although not to be confused with the Federal Credit Reporting Act). (See Pub.L. 101-508, available at **https://www.fiscal.treasury.gov/files/ussgl/fcra.pdf**.) This Act was designed to improve accounting practices and functionality when it came to Federal credit programs (see *Credit Reform Accounting*, available at **https://www.fiscal.treasury.gov/files/ussgl/fcra.pdf**). The FCRA came in the wake of the savings & loan (S&L) crisis of the 1980s—a financial catastrophe where a combination of increased discount rates rendering an enormous number of savings and loan companies insolvent and the lack of regulation allowing these insolvent companies to turn to very risky investing practices such as junk bonds led to over a thousand savings and loan companies going under—and the housing bubble that came along with it (Black, William K., *The Best Way to Rob a Bank Is to Own One* (2005) at pp. 64-65). This meant that the FCRA was designed to prevent a similar housing crisis in the future.

Part of the issue that created the S&L crisis was that the Federal government did not have to report or account for its own loan loss reserves the way a normal lender would. When loans are made, normally a loan loss reserve is set up to cover loan losses up to a certain percent of the lender's loan portfolio. Before the FCRA, the government simply didn't have to do this. They didn't appropriate funds for losses or even report them—exclusively reporting the gains from these loans. The FCRA, coupled with the Financial Institutions Reform, Recovery, and Enforcement Act from the year before in 1989, took steps to change these reporting practices, require appropriations from Congress for Federal loan losses, and limit the types of securities the Federal government could deal in (see Pub.L. 101-508 and Pub.L. 101-73, available at **http://legisworks.org/GPO/STATUTE-103-Pg183.pdf**).

The FCRA also moved credit program reporting to an accrual basis style of accounting. This meant that revenues were reported when cash was actually received and expenses accounted for immediately as the expenses are incurred as opposed to when they are actually paid (see Pub.L. 101-508). This was important for a number of reasons. First and foremost it created uniformity; where some accounting is on an accrual basis and other on a cash basis within a single government, it makes it nearly impossible to meaningfully interpret financial records. The accrual accounting method also has the advantage of preventing a situation where the government can act on a project or undertaking without full knowledge of the costs associated with it. It's worth noting that this was not a general adoption of accrual accounting for all of the U.S. government. Instead, it exclusively adopted it for Federal credit programs. As of the publication of this article, the U.S. government has still not adopted a uniform accounting method—accrual or otherwise—and still suffers from the accounting issues discussed above.

The Act also required the President's budget to incorporate and report on the costs of direct loan and loan guarantee programs. The budget also needs to forecast potential obligations from new loans in the upcoming year in order to better predict Congressional appropriations as well as update estimates as new information becomes available (see id.). What's more, the Act clarifies that no Federal credit program can move forward without an existing appropriation from Congress every year (see id.).

The exceptions to this are for student loans and veterans' home loans, which are subject to essentially unlimited appropriations—an Appropriations Clause issue unto itself as we discussed in the last article. (See *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/#ch10**) (citing *Principles of Federal Appropriations Law: Fourth Edition, Chapter 2*, at p. 13, available at **https://www.gao.gov/assets/680/675709.pdf**).) This was not the only or most extreme Appropriations overreach of the FCRA. It also provided an appropriation authorization in the future for any amount necessary for a Federal agency to pay any cost on associated with a Federal loan or on their own salaries (see Pub.L. 101-508). This may be understandable from a logistical standpoint but, from an Appropriations Clause standpoint, it essentially was an example of Congress delegating away its check on the Executive branch by writing a blank check. This is especially concerning given that outstanding Federal loans stand in the trillions of dollars (*Understanding Fair Value Accounting*, available at **http://www.crfb.org/blogs/understanding-fair-value-accounting**).

E. Government Performance and Results Act

The Government Performance and Results Act (GPRA) was enacted in 1993, and was intended to resolve longstanding management problems and improve transparency (U.S. Gov. Accountability Office, GAO-04-38, *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results*, (2004) at p. 4, available at **https://www.gao.gov/new.items/d0438.pdf**). The GPRA required executive agencies to develop strategic plans every 3 years, annual performance plans, and report annually on their plans' progress (id. at 5). The strategic plans require agencies to consult with Congress and "define their missions, establish results-oriented goals, and identify the strategies that will be needed to achieve those goals" (id.). The annual performance plans and reports then implement the 3 year strategic plans. The OMB is then responsible for "[ensuring] that agency plans and reports are consistent with the President's budget and administration policies" (id.).

In 2004 the GAO released a somewhat optimistic report summarizing the progress under the GPRA, and what the agency learned so far. The report concluded the GPRA "laid a solid foundation of results-oriented agency planning, measurement, and reporting" for improving federal program effectiveness (id. at 6). However, the report also acknowledged that "[w]hile a great deal of progress has been made in making federal agencies more results oriented, numerous challenges still exist" (id.). One of the critical issues, as one might expect, was a lack of "top leadership commitment and sustained attention to achieving results" both at the agencies in question and the OMB itself (id.).

The law was later updated by the GPRA Modernization Act of 2010, which overhauled the GPRA and addressed some key issues. Strategic plans are now required every 4 years and can be modified after significant changes in operating circumstances (in line with presidential terms) (Kamensky, John, *GPRA Modernization Act of 2010 Explained*, (2011) at p. 2, available at **https://www.scribd.com/document/47464749/GPRA-Modernization-Act-of-2010-Explained**). Congressional consultation regarding strategic plans must occur every 2 years, and agencies need to consult periodically with their respective authorizing, appropriations, and oversight committees (id.). Annual plans now have to cover a two year period, and agencies must include additional information on how they plan to achieve their strategic goals (id. at 3).

Furthermore, the Act adds a new "review and respond" process on the OMB's side, with scaling responses based on if agency goals remain unmet for 1, 2, or 3 years (id. at 2-3). If agency goals remain unmet for 1 year, the agency must submit a plan to improve performance and put a senior official in charge of the improvement plan (id. at 4). If the agency fails for 2 years, the agency must report to Congress with a plan to improve performance, and a list of the necessary funding reprogramming and/or transfers necessary to undertake the plan (id.). If the agency fails for 3 years in a row, they must report to Congress with (1) reauthorization proposals for each underperforming activity, (2) proposed statutory changes, and (3) planned executive actions, program terminations, or budget reductions (id.).

The updated Act also requires the OMB to consult with Congress and submit a variety of government wide annual performance plans with each budget. As part of their performance plans, they need to develop federal priority goals, and coordinate with agency priority goals in order to "improve performance and management across the federal government" (id. at 5). The OMB is also required to generate quarterly reports on their government wide coordination efforts (id.).

Agencies are currently more or less making an effort to comply with the new requirements, although there are some difficulties (U.S. Gov. Accountability Office, GAO-16-510, *Managing for Results: Agencies Need to Fully Identify and Report Major Management Challenges and Actions to Resolve them in their Agency Performance Plans*, (2016), available at **https://www.gao.gov/products/GAO-16-510**). The GAO found "that 14 of 24 agencies reviewed did not describe their major management challenges in their [agency performance plans] as required" (id.). Even though many of those have since implemented or at least addressed the GAO recommendations, there are some stragglers. In particular, the Departments of the Treasury, Defense, Agriculture, and Commerce have done nothing as of 2017 (id.).

F. Government Management Reform Act

In 1994, the Government Management Reform Act (GMRA) was signed into law by former-President Bill Clinton (see Pub.L 103-356, available at **https://www.usaid.gov/sites/default/files/documents/1868/5401a5.pdf**). This represented yet another step towards improving the financial reporting practices of the executive agencies. It called for annual audited financial statements from all CFO Act agencies moving forward, as well as an audit of the overarching financials done annually by the GAO. The required reports must include a discussion of the overall financial position of the offices, activities, and projects of each agency as well as the results of their operations. These reports are made available to the public. The GMRA also moved up the annual due dates of these reports and provided a more comprehensive time table of due dates for these reports with the hopes of improving the efficiency of the reporting process (see id.). These audit requirements were expanded even further in a 2002 amendment known as the Accountability of Tax Dollars Act (see Pub.L. 107-289, available at **https://www.congress.gov/107/plaws/publ289/PLAW-107publ289.pdf**).

The audit provisions of the GMRA have received some criticism. A 2008 study found the majority of people saying that these audits were extremely expensive and weren't providing substantial useful information either to the public or those making decisions in government. The numbers from the public were especially bad, with only 5% of U.S. citizens saying that they felt they were receiving enough information on the financial activity of the government (see *Public Attitudes Towards Government Accountability and Transparency 2010* at p. 2, available at **http://global.oup.com/us/companion.websites/9780199859214/student/chapter3/pdf/accountability.pdf**). This isn't altogether surprising; even with the additional steps in the GMRA, compliance on the part of executive agencies has been fairly abysmal. We'll discuss further the trillions in unreported government spending later in this article, but suffice it to say the sharpest sword is useless if nobody ever takes it out of its sheath.

This being said, the GMRA has had an impact on the efficiency of agencies specifically dedicated to reporting, such as the OMB, the Department of the Treasury, and the GAO. For example, the Department of the Treasury has taken the time it takes to prepare financial statements from six months to around two and half—streamlining its practices and improving the quality of its opinions (Jeffrey Steinhoff & Robert Dacey, *The Government Management and Reform Act of 1994: A Retrospective of Achievements and Remaining Challenges and a Look to the Future*, at p. 1, available at **https://www.kpmg-institutes.com/content/dam/kpmg/governmentinstitute/pdf/archive/gmra-retrospective.pdf**).

G. Federal Financial Management Improvement Act of 1996

As we've seen, attempt after attempt was made over time to pass acts improving the financial reporting of executive agencies. However, these efforts were largely discouraged by agencies simply failing to follow through on the requirements the above acts created and a lack of enforcement mechanisms—legislative or judicial—to bring them in line. The Federal Financial Management Improvement Act of 1996 (FFMIA) immediately recognized this unfortunate state of affairs in the very text of the Act—criticizing the fact that, true to the name of the Act, federal financials had long been MIA (see Pub.L. 104-208, available at **https://www.congress.gov/bill/97th-congress/house-bill/1526**).

The very beginning of the Act noted the many Acts that had been passed in recent years and the efforts made to improve Federal accounting but noted that:

> *"Federal accounting standards [had] not been uniformly implemented in financial management systems for agencies…[and] Federal financial management continues to be seriously deficient. Federal financial management and fiscal practices had failed to…identify costs fully; reflect the total liabilities of congressional actions; [or] accurately report the financial condition of the Federal Government. (3) Current Federal accounting practices [have] not accurately report[ed] financial results of the Federal Government or the full costs of programs and activities. The continued use of these practices undermines the Government's ability to provide credible and reliable financial data and encourages already widespread Government waste, and will not assist in achieving a balanced budget." (id.).*

They further noted the sheer breadth of waste and inefficiency, how this undermined the faith of the public, and the need to improve accounting practices in order to restore public faith (id.). With this in mind, the FFMIA set out with the noble goal of once again imposing stricter reporting standards on government agencies, creating uniform reporting standards for the U.S. Government, and making this financial information available to the public as required by the Statements and Accounts Clause of the Constitution.

The FFMIA set out with the goal of complementing and enhancing the Acts we've already discussed; thus it mostly just enhanced already existing reporting requirements. Agencies were required to give more thorough audited reports and explanations of how and why they failed to fulfill reporting requirements, and the actions they would be taking to fix this fact (see id.). This report on agency failings would be followed up with a remediation plan which would bring them in compliance with reporting requirements within 3 years. However, once again, the FFMIA included no repercussions or follow-up elements for continued failure to comply with the government's own self-imposed reporting requirements (see id.).

With this in mind, having read the rest of this article, and given that we are still writing this article two decades after this Act was passed, you can likely predict the long-term effectiveness of the FFMIA. Once again, despite excellent steps to lay a groundwork of government financial responsibility, without enforcement mechanisms or enforcement actions, government agencies continued to fail to comply with financial reporting laws and procedures year after year (U.S. Gov. Accountability Office, GAO-17-283R, *U.S. Government's 2016 and 2015 Consolidated Financial Statements*, (2017) at forward 1). This has been a continuing issue through the present (see id.).

H. The Federal Funding Accountability and Transparency Act of 2006 and the Digital Accountability and Transparency Act of 2014

The Federal Funding Accountability and Transparency Act of 2006 (FFATA) and its 2008 amendment were intended to foster transparency by creating a single searchable site, open to the public, that contains comprehensive information on each federal award, from amount and transaction type to the receiving entity's name and location (U.S. Senate, Senate Report 113–139, *Digital Accountability and Transparency Act of 2013 Report*, (2014), available at **https://www.congress.gov/113/crpt/srpt139/CRPT-113srpt139.pdf**). This information was hosted on USASpending.gov (available at **https://www.usaspending.gov/Pages/Default.aspx**), but the site was plagued with issues, not the least of which was the accuracy and completeness of the contained data.

These issues led to the passage of the Digital Accountability and Transparency Act (DATA), which was enacted in 2014, expanding on the existing FFATA, and integrating the reporting requirements of the CFO Act and the American Recovery and Reinvestment Act of 2009 (ARRA), a recession stimulus package. (See DATA Foundation, *The DATA Act: Vision & Value*, (2016) available at **http://www.datafoundation.org/data-act-vision-and-value-report/**.) The goal of the DATA is to fix issues on USASpending.gov and "expand current requirements to publish Federal spending information online… mandate that the information appear in a form that is both easily searchable and downloadable, make uniform the manner in which agencies provide such data for online posting, and require audit[s] and report[s] on agency compliance…" (*Digital Accountability and Transparency Act of 2013 Report*).

Under the expanded requirements of DATA, agencies are in theory required to post information about their budget, including funds spent, funds remaining to be spent, and funds reprogrammed or transferred, in a form that can be downloaded in bulk (id. at 4). Where practicable, agencies are supposed to provide location data regarding where the funds are spent as well (id.). Reporting of standardized agency budget data began in May of 2017, and the data are supposed to be published on USASpending in May 2018 (*The DATA Act: Vision & Value*, Figure 1).

Furthermore, the DATA mandates improved data accuracy. To that end, the Act requires audits of the data submitted by agencies (*Digital Accountability and Transparency Act of 2013 Report*, at pp. 5-6). Previous audits from before DATA was enacted showed significant discrepancies between the reports of federal agencies and the data that eventually made it to the public website (id.).

The current form of USASpending.gov is in a transitory state while DATA is being implemented, but shows a great deal of promise. Its spending map (available at **https://www.usaspending.gov/transparency/Pages/SpendingMap.aspx**) is filterable by amount, agency, grant type, state, county, zip code, and spending district. Currently, the site only covers FFATA information,[2] but a beta version of USASpending already contains some agency budget data (available at **https://beta.usaspending.gov/**). It's a promising work in progress, and we hope to have more information on the implementation of DATA in the latter half of 2018.

However, while the DATA has largely been successful and on schedule so far (*The DATA Act: Vision & Value*), with proponents being optimistic as to future developments (DATA Foundation, *DATA Act 2022: Changing Technology, Changing Culture*, (2017) available at **http://www.datafoundation.org/data-act-2022/**), there have been some hiccups. For instance, as is a recurring theme of this article, the Department of Defense Office of the Inspector General reported the Department of Defense was not in compliance with the reporting requirements of DATA in the fiscal year of 2017 (U.S. Department of Defense Office of Inspector General, DODIG-2018-020, *DoD Compliance With the Digital Accountability and Transparency*

Act of 2014, (2017) available at **http://www.dodig.mil/reports.html/Article/1365972/dod-compliance-with-the-digital-accountability-and-transparency-act-of-2014/**).

III. Statement and Accounts Shenanigans

There are two main (and often interchangeable) issues that plague the various reporting statutes we discussed. First, there are still inconsistencies in the accounting systems of various federal agencies. For instance, while the DoD has contemplated using accrual basis accounting in the past, it ultimately failed to implement the changes despite the benefits accrual basis accounting brought other parts of the federal government (Christopher H. Hanks, *Financial Accountability at the DoD: Reviewing the Bidding*, *Defense A R Journal* (2009) available at **https://www.thefreelibrary.com/Financial+accountability+at+the+DoD%3A+reviewing+the+bidding.-a0205637486**). Second, various agencies fail to comply with the reporting requirements required by law. This is often due to inconsistent accounting practices (like the DoD) or lack of sufficient commitment or direction from agency leadership.

A. Agencies' Failure to Report

As noted multiple times above, various agencies have failed to comply with many of the reporting requirements of the discussed Acts. It is somewhat disturbing to note that the GAO reports:

> *"About 34 percent of the federal government's reported total assets as of September 30, 2016, and approximately 18 percent of the federal government's reported net cost for fiscal year 2016 relate to significant federal entities that, as of the date of GAO's audit report, were unable to issue audited financial statements, were unable to receive audit opinions on the complete set of financial statements, or received a disclaimer of opinion on their fiscal year 2016 financial statements."* (U.S. Gov. Accountability Office, GAO-17-283R, *U.S. Government's 2016 and 2015 Consolidated Financial Statements*, (2017) at forward 1, available at **https://www.gao.gov/products/GAO-17-283R**).

In the fiscal year of 2015, 12 out of the 24 CFO reporting agencies did not comply with FFMIA requirements, with a similar circumstance the next year (id. at 247). In 2016, 9 out of 21 agencies were noncompliant, and three failed to report by the time the consolidated financial statement was published: the DoD, HUD, and NSF (id.).

Some are more egregious than others, and none are quite as persistent or flagrant as the Department of Defense. The DoD has yet to achieve compliance with the CFO Act, let alone many of the subsequent reporting or transparency acts (*Financial Accountability at the DoD: Reviewing the Bidding*). As of January 2017, the GAO has reiterated this problem, describing "serious financial management problems at the Department of Defense (DOD) that prevented its financial statements from being auditable" and stating that DOD "has consistently been unable to receive an audit opinion on its financial statements in the past" (*U.S. Government's 2016 and 2015 Consolidated Financial Statements*, at forward 3). A bipartisan bill was introduced to add enforcement "teeth" to the DoD's reporting duties in 2015, but it died in committee, with no action taken since February 2015 (*Audit the Pentagon Act of 2015*, available at **https://www.congress.gov/bill/114th-congress/senate-bill/327/related-bills**).

HUD has its own reporting problems, on a smaller scale but no less flagrant than the DoD. The GAO report, when explaining why substantial sections of the report were not accurate or reliable, noted that several agencies did not report anything regarding improper payment amounts for high risk programs, including "[HUD's] Single Family Insurance Claims, HUD's Community Planning and Development Entitlement Grants, [and] HUD's HOME Investments Program" (*U.S. Government's 2016 and 2015 Consolidated Financial Statements*, at 263, footnote 57). Likewise, HUD has failed to comply with GPRA Modernization Act reporting requirements (U.S. Gov. Accountability Office, GAO-16-497, *Department of Housing and Urban Development: Actions Needed to Incorporate Key Practices into Management Functions and Program Oversight*, (2016) available at **https://www.gao.gov/assets/680/678551.pdf**).

B. Missing Money

These issues we've discussed aren't simply issues of transparency and accountability, or efficiency. The sheer disorder has left rather prodigiously large sums of money missing (Solari Report, *The Missing Money*, available at **https://missingmoney.solari.com/**). As we mentioned above, some accounts hold this undocumented missing money at over $21 trillion dollars, exceeding even the national debt (id.).

One of the ways such "missing money" shows up is as journal voucher adjustments. The Under Secretary of Defense (Comptroller)/Chief Financial Officer defines journal vouchers as "summary-level accounting adjustments made when balances between systems cannot be reconciled. Often these journal vouchers are unsupported, meaning they lack supporting documentation…having too many journal vouchers may be an indicator of underlying problems, such as weak internal controls. For an auditor, journal vouchers are a red-flag for transactions not being captured, reported, or summarized correctly." (See U.S. Dept. of Defense, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report ES-11*, (2015) available at **http://comptroller.defense.gov/Portals/45/documents/fiar/FIAR_Plan_May_2015.pdf**.) One result of having systemic journal vouchers is an inability to audit the books properly, as is often the case with DoD accounting reporting.

For instance, in the fiscal year of 2015, the DoD Inspector General found the Army "did not adequately support $2.8 trillion in [journal voucher] adjustments for third quarter and $6.5 trillion in JV adjustments for yearend" (U.S. Department of Defense, DODIG-2016-113, *Army General Fund Adjustments Not Adequately Documented or Supported* (2016), at p. 5, available at **https://media.defense.gov/2016/Jul/26/2001714261/-1/-1/1/DODIG-2016-113.pdf**).

IV. The Black Budget

All the issues we've discussed so far occur more or less in the public eye (if not the public attention). However, there are situations where both the appropriations discussed in the last article and the reporting requirements discussed in this one come together into one extremely constitutionally problematic issue. There are some subjects in which the government exempts monies from both the constitutional requirements of a congressional appropriation and the need to report the use of that money to the public.

One such situation is the Exchange Stabilization Fund, or ESF, created by the Gold Reserve Act of 1934 (31 U.S. Code § 5117, available at **https://www.law.cornell.edu/uscode/text/31/5117**). The ESF was originally created as a tool to allow the U.S. to enact foreign exchange interventions and impact the exchange rates of U.S. and foreign currency. However, with 94.77B in its coffers (U.S. Dept. of the

Treasury, OIG-18-021, *Audit of the Exchange Stabilization Fund's Fiscal Years 2017 and 2016 Financial Statements*, available at **https://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-18-021.pdf**), it is a funding tool solely under the control of an executive agency—the United States Treasury Department. It requires no appropriations to use, and has no reporting requirement whatsoever[3] to keep the public abreast of what is done with about as much money as the net worth of Jeff Bezos. This is obviously problematic; not only is it fundamentally misaligned with the goals of the Constitution, the complete lack of transparency on this much money obviously creates the potential for incompetence, malfeasance, or mismanagement.

The Solari Report has covered the topic of the ESF, and potential issues with the Fund, in the past. However, what has not yet been discussed is the holes punched through appropriations and reporting requirements with legislation such as the NSA Act (50 U.S.C. § 401, enacted in 1947) and the CIA Act (50 U.S.C. § 403, enacted in 1949)—the Black Budget. There is obviously some need for confidentiality in covert operations, otherwise they'd call them overt operations. However, Congress has left an enormous amount of leeway for the unappropriated spending of unreported funds with very little in the way of a check Congress can place on what happens with these funds. This is an issue that overlaps with the problems discussed in both this and our last article—executive overreach and agency failure to comply with reporting requirements. In the coming weeks, expect a larger article discussing the issue of the Black Budget more fully.

V. Conclusion

The Founders of this country envisioned a government accountable to its people. The Statement and Accounts Clause of the Constitution is one of the very few that had nearly no debate whatsoever—there were no objections whatsoever to the reporting requirements, only their frequency. Constitutional Framer James McHenry explained the lack of debate, saying, "the People who give their Money ought to know in what manner it is expended." This requires complete and comprehensible reporting from the government.

To its credit, Congress has certainly made many attempts to legislate reporting requirements that will make financial information of a type useful to understanding the actions of the U.S. government available to the public. However, their failure to enforce these legislative efforts have left us where we are today—with decades of non-compliance and financial reporting so non-uniform as to often be useless to the public. Government entities such as the GAO have long worked to change this; however, there is a notable lack of commitment on the part of government agencies to address their fundamental financial failings despite the guidance and prodding of the GAO and others.

This is something that needs to change. Not only does the public have a Constitutional right to know how and where its money is used, there is a fundamental danger in removing financial transparency from a government meant to serve its people. If you gave an investment advisor your money and they disappeared with it never to talk to you again about what they were doing with it, you'd certainly have concerns. The government should not be held to a different standard.

As we've discussed in our previous article, this is an issue unlikely to be settled in the courts (see *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/#ch10**). The power to determine appropriate reporting lies nearly entirely in the hands of Congress, as does the power to enforce those reporting standards. As of now, the standards are there, but they are ignored and not enforced. If this is going to change, it will almost certainly take a broader political movement, from Congress or otherwise, to do it.

James Madison noted in *The Federalist Papers* that the "power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people" (*Federalist No. 58*, available at **http://www.foundingfathers.info/federalistpapers/fedindex.htm**). Without knowing how money is used by the government, the power of the purse is a weapon incapable of being used with precision and left for the public to wield blindfolded.

The state of federal financial reporting has left more money unaccounted for than the entire national debt, and that is an issue that affects every person and every local government. While Congress is slowly making efforts to improve reporting standards, those efforts are patchwork and often ignored. Ultimately, Congress is an extension of the people, which is why the Founding Fathers gave them the powers of the purse in the first place. It is the people's responsibility to hold their direct representative in the federal government responsible. Congress can be held accountable at the polls, and can be pressured by discussion at the local government level. The more pressure put on your Congressman, through calls, letters, local government, or at the polls, the more likely Congress and the government will take more decisive action. The fiscal accountability of the U.S. government is, ultimately, in the hands of the people.
January 23, 2018

Endnotes

1. The reporting agencies are: The Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, the Interior, Justice, Labor, State, Transportation, the Treasury, Veterans Affairs, the Environmental Protection Agency, the General Services Administration, the National Aeronautics and Space Administration, the National Science Foundation, the Office of Personnel Management, the Small Business Administration, the Social Security Administration, the U.S. Agency for International Development, and the U.S. Nuclear Regulatory Commission.

2. According to the USASpending site, its data currently covers:
   "All prime recipient contract transactions more than $3,000.
   All grant, loan, and other financial assistance transactions of more than $25,000.
   First-tier sub-recipient contract, grant, and loan transactions of more than $25,000.
   Micro-purchases of less than $3,000 made with a federal credit card are collected by the General Services Administration and displayed monthly in a SmartPay spreadsheet. This same data may also be displayed on the charts, graphs, or summaries."
   It excludes:
   "Federal salaries and compensation
   Individuals' names receiving direct assistance payments, such as benefits or entitlements
   Award information that could result in a security risk to the recipient
   Tax credit data
   Appropriation amounts"

3. The Solari Report has discussed the ESF in detail at https://home.solari.com/the-exchange-stabilization-fund-with-rob-kirby/.

4. The Black Budget: The Crossroads of (Un)Constitutional Appropriations and Reporting

The $52.6 billion "black budget" for fiscal 2013, obtained by The Washington Post *from former intelligence contractor Edward Snowden, maps a bureaucratic and operational landscape that has never been subject to public scrutiny. Although the government has annually released its overall level of intelligence spending since 2007, it has not divulged how it uses the money or how it performs against the goals set by the president and Congress.* (Gellman, Barton and Miller, Greg, "U.S. spy network's successes, failures and objectives detailed in 'black budget' summary," *Washington Post* (08/31/2013), available at **https://cyber-peace.org/wp-content/uploads/2013/06/%E2%80%98Black-budget%E2%80%99-summary-details-U.S.pdf**).

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I. The Strengths and Weaknesses of the Power of the Purse

When created, the Constitution handed the Power of the Purse to Congress and—by extension—the people that Congress represents. The thought was that the surest check on a government came through control of its finances. However, the strongest check is useless without both a means by which to wield it and the understanding of how and where to do so. This idea is the underpinnings of the Appropriations Clause and Statements and Accounts Clause of the Constitution. These elements of the Constitution are the means by which Congress, in theory, applies and guides the sword that is the Power of the Purse—arguably the strongest power of the people. (See *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**, citing Gary Kepplinger, *The Heritage Guide to the Constitution: Appropriations Clause*, available at **http://www.heritage.org/constitution/#!/articles/1/essays/67/appropriations-clause**.)

The Appropriations Clause requires Congress to give the say-so on government spending by appropriating funds for a project through legislative action, often including restrictions on how the funds are to be spent, before the Executive branch can spend money. The Statements and Accounts Clause requires the government to provide, from time to time, an accounting of how they spend your money. The idea is that this allows Congress, theoretically your representative in government, to control how and where money is spent. The reporting requirements give a more immediate accounting to the public of what was done with their taxes—at least this is the theory (see id. available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**).

Unfortunately, the reality is that there are quite a few loopholes and issues that undermine the value of the Appropriations Clause and often render the reporting requirements of the Statements and Accounts Clause virtually useless. Congress itself has nearly full control of what they consider appropriate under these two clauses. As we've discussed in previous articles, they often substantially undermine their Appropriations powers by writing virtual blank checks to the Executive. There are also quite a few statutes which have undermined the Appropriations powers by allowing the Executive branch and agencies greater freedom to shift around funds under Congress' nose (see id.).

When it comes to the Statements and Accounts Clause, Congress has made valiant legislative efforts to improve the numerous flaws with their current accounting practices. However, a combination of a lack of enforcement mechanisms included in their legislation, failure to enforce through other means, and an extreme lack of effort on the parts of some executive agencies to comply with the accounting legislation (especially the Department of Defense and the Department of Housing and Urban Development) have rendered the lion's share of government financial reporting virtually useless to the public and Congress' decision making process. (See *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them*, available at **https://constitution.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**.)

These issues are ongoing and need close examination from both the public, local governments, and Congress itself. As it is, lapses in reporting have allowed for $21 trillion in unaccounted funds from just the DoD and HUD. That's just accounting for the period between 1998 and 2015—an amount larger than the current national debt in under two decades ("DoD and HUD Missing Money: Supporting

Documentation," available at **https://missingmoney.solari.com/dod-and-hud-missing-money-supporting-documentation/**). There are wide reaching issues here, and each of them is incredibly important to the fiscal health of the U.S. and upholding the intent of the Constitution.

If $21 trillion can go missing in the sunshine, who knows how much goes missing when these reporting and appropriations provisions are loosened or removed? At the crossroads where all these Constitutional issues meet is appropriations for and fiscal reporting—or complete lack thereof—of programs such as the National Intelligence Program (NIP), the DoD's Military Intelligence Program (MIP), and similar programs. The MIP is a program created in 2005 by the DoD and has all intelligence programs supporting the U.S. government under its umbrella. These programs, taken together, are colloquially known by the fairly theatrical term "the Black Budget."

II. What Is the Black Budget?

Put simply, the Black Budget refers to the government budget set aside for secret operations such as military research projects, covert operations, and the like. Off the bat, this surely sounds like the realms of a Tom Clancy novel. The term was originally coined in a 2013 *Washington Post* article discussing a copy of the budget—leaked by Edward Snowden—for funds allocated to the CIA, NIP, MIP, and other spying projects (Gellman, Barton and Miller, Greg, "U.S. spy network's successes, failures and objectives detailed in 'black budget' summary," *Washington Post* (08/31/2013), available at **https://cyber-peace.org/wp-content/uploads/2013/06/%E2%80%98Black-budget%E2%80%99-summary-details-U.S.pdf**). However, the fundamental issues with this Black Budget deal with accounting and Constitutional issues. This is money with very little to no appropriations or reporting requirements as would normally be required by the Constitution.

The reasoning behind this is fairly obvious; there is a certain amount of logical need for confidentiality when it comes to covert operations, assets, and their funding. If not, we'd call them overt operations. However, this is no small amount of funds we are talking about. In 2015, the NIP requested a budget of $45.6B and the MIP requested $13.3B (*Intelligence Budget Data*, available at **https://fas.org/irp/budget/**). The final numbers for NIP and the MIP combined have floated around $70-$80B per year for the last decade (id.). That's more than the entire GDP of Guatemala every single year (*List of Countries by Projected GDP*, available at **http://statisticstimes.com/economy/countries-by-projected-gdp.php**).

Just getting an exact total number for these budget requests can be a bit difficult; you can imagine how little there is on specifics within the budget requests. Very rarely, the name of a program is included within the copies of the budget requests provided to the public but certainly not the amount requested for the project—never mind any more specific breakdown of how funds are to be used (*FY 2016 Budget Congressional Justification Book*, available at **https://fas.org/irp/budget/mip-fy2016.pdf**) (provided in response to a FOIA request).

A FOIA request is capable of receiving a copy of the unclassified portions of these Black Budget accountings. However, the emphasis in that sentence should be heavily on unclassified (id.). A 2016 FOIA request on the Black Budget responded with 178 pages with not a single number included within—not even the total amount requested. It is just page after page of blank charts (id.). The information within was all withheld pursuant to the FOIA exemptions for national security interests (5 U.S.C. § 552(b)(l)), the statutory exemption created to FOIA for unclassified technical data for space or military application (5

U.S.C. § 552(b)(3) referring to 10 U.S.C. § 130, available at **https://www.law.cornell.edu/uscode/text/5/552b**) and Executive Order 13526 (available at **https://www.archives.gov/isoo/policy-documents/cnsi-eo.html**), which is an Obama-era order on the handling of classified materials (*FY 2016 Budget Congressional Justification Book*, available at **https://fas.org/irp/budget/mip-fy2016.pdf**). Thus, the result is blank page on blank page prefaced with a short discussion of very general goals of the MIP (see id.).

The budget requests of the MIP are summarized in a nine volume *Congressional Justification Book* (*FY 2016 Budget Congressional Justification Book*, see id.). This includes general discussion of ongoing goals such as combating terrorism and counter-terrorism efforts (see id.). Access to the details of these reports is extremely limited, even within Congress itself. In general, any access whatsoever is generally limited to the House Permanent Select Committee on Intelligence (HPSCI) and the Senate Select Committee on Intelligence (SSCI) (see Rosenbach, Erin and Peritz, Aki, *Congressional Oversight of the Intelligence Community*, available at **https://www.belfercenter.org/publication/congressional-oversight-intelligence-community**).

The HPSCI is a 22 member committee made up of members of the House with at least one member each from the House Appropriations, Foreign Affairs, Armed Services, and Judiciary Committees. The SSCI is a 15 member affair usually consisting of 8 members of the majority party, 7 members of the minority party, and a standing spot for a member of the Senate versions of the above discussed House Committees. HPSCI looks at both the MIP and the NIP budgets. SSCI looks at NIP and the agencies it funds. This power has some overlap with the duties of a few other committees such as the Senate Armed Services Committee. The two committees also occasionally compete over their jurisdiction. What's more, there is fairly consistent push and pull between the Executive and Legislative branches as to what an appropriate level of oversight should be (see id.).

An example of this is, as will be discussed in depth later, Section 502 of the National Security Act of 1947, which requires the Executive to "keep congressional intelligence committees fully and currently informed of all intelligence activities of the United States…." This is to ensure that the representatives of the people that are allowed to be involved in the Black Budget at least know what's going on. However, the Executive branch has frequently interpreted this requirement as only requiring notice to the "Gang of Eight"—the Senate and House Majority and Minority Leaders, and the Chairs and ranking members of the House and Senate Intelligence Committees. This substantially limits Congress' decision making ability. What's more, the White House generally has final say on what is and isn't confidential from the majority of Congress, even further limiting the ability of Congress as a whole to make informed appropriations of funds on behalf of the people (see id.).

After 9/11, Congress ostensibly changed its approach to intelligence oversight. Legislators looked at their previous interaction and determined to substantially increase their oversight capabilities. They removed the term limits on the above discussed committees in 2005 with the goal of allowing committee members to gather the experience necessary to understand the information they're interacting with. They also sought to combine appropriations with program authorization in order to make the people dealing with intelligence issues as specialized as possible. To this effect, they made a House Appropriations Select Intelligence Oversight Panel comprising 10 House Appropriations Committee members and three people out of the HPSCI. However, overall there hasn't been much action to create more comprehensive oversight and certainly no public oversight (see id.).

As mentioned above, it's understandable that some of this doesn't make it to the public at large. However, it's important that it's provided to Congress—the people's representative—in a way that allows them to know what they're offering money to and what of the funds are appropriate to disclose to the public. This is as opposed to a system where everything is confidential as a norm and Congress has very little idea what they're appropriating funds for. As it is, Congress' financial accountability branch—the Government Accountability Office—is not even allowed to audit intelligence activities (see Executive Order 12333, available at **https://www.archives.gov/federal-register/codification/executive-order/12333.html#3.4**). While there are advantages to the limited group of Congresspersons receiving briefings on intelligence budgets, there are also obvious negative issues with such a system.

Even in just the last few days, there have been concerns that the bill that ended the recent government shutdown included provisions allowing the Executive branch to fund covert action without Congressional oversight or going through the usual Congressional oversight committees. The provision is currently a subject of debate, with a potential amendment to remove the exception opposed by some in Congress. (See Kelly, Erin, "Spending Bill Limited Congress' Oversight of Secret Intelligence Activities, Senators Say," available at **https://www.usatoday.com/story/news/politics/2018/01/23/senate-intel-leaders-say-bill-reopen-government-strips-them-power-gives-white-hgives-white-house-mor/1057919001/**.) As it stands, this bill waives the later discussed (already very limited) reporting and appropriation requirements of the National Security Act. It's not hard to see why it has raised more than a few eyebrows. Steps to change the language of the waiver were reportedly blocked in Congress. (See Nelson, Steven, "Provision in Shutdown-Ending Bill Stokes Fear of Oversight-Free Intelligence Spending," available at **http://www.washingtonexaminer.com/provision-in-shutdown-ending-bill-stokes-fear-of-oversight-free-intelligence-spending/article/2646894**.)

With such a recent move towards limiting Congress' and the people's oversight in a situation already sparse on oversight, appropriations compliance, and reporting compliance, the time has never been better to ask, what is the Black Budget? How did it come to be? How does it work and, perhaps most importantly, how and why is it considered legal and constitutional?

III. The Origins of the Black Budget

The Black Budget is more of a media concept than a legal concept. However, the name is an easy way of referring to the budget, appropriation, and reporting loopholes created primarily by statute in the late '40s through the National Security Act and the CIA Act. From there, the loopholes have been expanded and altered by statutes, executive orders, and policy changes–generally allowing even greater freedom to Black Budget issues. In more recent years, there have also been some limited moves granting greater oversight to the government. However, as mentioned above, just a few weeks back we've seen an enormous step backwards in the approach to the Black Budget. (see id.) These changes are so fresh as to be very difficult to effectively discuss; there's simply too much still up in the air. With this in mind, it's best to start from the beginning—the National Security Act and CIA Act creating what we now discuss as the Black Budget.

A. Introducing the 1947 National Security Act

The National Security Act was, on its face, a move to combine the Department of War, Department of the Army, the Department of the Navy, as well as several other military departments and agencies under the power of the newly created position of the Secretary of Defense. The most notable of these Departments and agencies was perhaps the CIA—newly created by the National Security Act—the first peacetime intelligence agency the U.S. had ever organized. These were all incredibly important moves. However, buried in all these sweeping governmental changes were the seeds that would create the Black Budget as we know it today (see National Security Act of 1947, 50 U.S.C.3001, available at **https://www.dni.gov/index.php/ic-legal-reference-book/national-security-act-of-1947**).

The National Security Act provided the groundwork for intelligence reporting and appropriations rules for years to come. Up until the recent changes from the bill ending the government shutdown, they were the baseline over which the Executive and Legislative branches argued over exactly what was constitutionally required in terms of reporting and appropriations for the Black Budget (see Rosenbach, Erin and Peritz, Aki, *Congressional Oversight of the Intelligence Community*).

As we've discussed in our previous articles, the courts have repeatedly deferred to Congress to set its own reporting standards. Whatever they say is appropriate is usually taken as meeting the Constitutional standards for the Statements and Accounts Clause—although there remains the issue that Congress still needs to enforce its own standards. The National Security Act was Congress setting the groundwork for what sort of reporting would be required for Black Budget spending (*see The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**).

Under the National Security Act, all that was required is annual reports of "expenditures, work, and accomplishments" to "congressional intelligence committees, the Committee on Appropriations of the Senate, and the Committee on Appropriations of the House of Representatives" (see National Security Act of 1947, 50 U.S.C. 3001). As you might imagine, this is a standard allowing a tremendous amount of leeway as to the specificity of reporting required by the fairly vague terms of "expenditures, work, and accomplishments." It also creates the above discussed push and pull between the Executive and Legislative branches of who exactly needs to be informed of Black Budget spending. Certainly the public can be left out under this standard, as well as the bulk of Congress. However, there remains the question discussed above of whether this requires reporting to the Gang of Eight or a full report to the entirety of both House and Senate intelligence committees, as well as all members of the House and Senate Appropriations Committees (see Rosenbach, Erin and Peritz, Aki, *Congressional Oversight of the Intelligence Community*).

Speaking of the Appropriations Clause, the National Security Act also allowed for reprogramming of funds within the National Intelligence Program, or to other agencies "for the development and fielding of systems of common concern related to the collection, processing, analysis, exploitation, and dissemination of intelligence information; or . . . to address critical gaps in intelligence information sharing or access capabilities" (see National Security Act of 1947, 50 U.S.C. 3001). This can be done "with the approval of the Director of the Office of Management and Budget [the OMB]; and after consultation with the heads of departments containing [affected] agencies or organizations within the intelligence community . . . and, in the case of the [CIA], after consultation with the Director of the [CIA]" (id.). Reprogramming funds is a fairly common thing to see in agency funding provisions, allowing agencies to shift money originally allotted for one thing to something not contemplated at the time funds were appropriated by Congress. The idea behind it is that it allows for the reality of requiring a certain amount of flexibility in the use of funds in order to keep government humming along smoothly without constant bottlenecks (*Reprogramming and Transfer Authority*, at p. 17, available at **https://www.loc.gov/rr/frd/Military_Law/pdf/FLD_2013_Ch12.pdf**).

However, when Congress allows for reprogramming, it has effectively given away a portion of the Appropriations Clause power of the people—a real Constitutional issue if a somewhat necessary one. (See *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause* , available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**.)

Even with this in mind, the National Security Act allowed for lesser notice to or approval from Congress (as the OMB is an Executive agency) and a level of flexibility in moving funds (especially between different agencies) nearly no other reprogramming rules had ever granted. This allowed greater freedom from Congressional appropriations rules than had ever existed before—the origins of the Black Budget.

That being said, the National Security Act did have certain restrictions. Covered agencies, such as the CIA, had to follow existing procedures applicable to reprogramming notifications, and had to submit a report to appropriate committees as discussed above. Funds could only be reprogrammed or transferred if "transferred to an activity that is a higher priority intelligence activity" (National Security Act of 1947, 50 U.S.C. 3001) or "the transfer or reprogramming supports an emergent need, improves program effectiveness, or increases efficiency" (id.). However, one notable issue with that standard is that it generally leaves agencies free to justify the reprogramming after the fact, asking forgiveness instead of permission. It is also a fairly subjective standard, especially when the majority of the details of the programs and actions are known to a very small circle other than those making the reprogramming decisions.

One other limitation on Black Budget reprogramming under the National Security Act was the amount of reprogramming that could be done without approval. The total amounts in a fiscal year had to be "less than $150,000,000, and less than 5 percent of amounts available to a department or agency under the National Intelligence Program," without "the concurrence of the head of the department involved" (id.). For reference, that is about the equivalent of $1.7B in today's dollars (see *Dollar Times* available at **https://www.dollartimes.com/inflation/inflation.php?amount=150000000&year=1947**). However, getting the concurrence of a department head (especially when giving money to an agency, instead of clawing it away) is so trivial a hurdle as to be essentially irrelevant. Indeed, there has been no need to raise the $150 million dollar limit since it was first established in 1947, despite substantial inflation.

Outside of the reporting requirements, the National Security Act also created a Director of Central Intelligence (DCI) who collects, correlates, and disseminates intelligence, provides direction for intelligence gathering outside the United States, and performs other functions and duties related to national security intelligence as the President or the Director of National Intelligence (DNI) directs (see National Security Act of 1947, 50 U.S.C. 3001). This role would continue to grow in importance over the years.

As you can see, the National Security Act laid foundations for how the intelligence community would need to report on its activities and how it could shift funds for its covert programs. However, the National Security Act outright created the CIA. It was essentially trying to make sure it had covered the basics to allow the newly formed agency to function. It was not until two years later in 1949 that the CIA Act was passed and provided more precise rules on reporting and appropriations and put a final stamp of Congressional approval on the Black Budget.

B. Introducing the 1949 CIA Act

The National Security Act created the CIA, but that was not the true focus of the Act—it was a huge sweeping change in the structure of the government. This made the CIA an important change among many important changes, not the full focus of the Act. The 1949 CIA Act comprised additions to those sections of the 1947 National Security Act that dealt with the creation of CIA. It also gave a Congressional stamp of approval to the creation of a Black Budget through new appropriations provisions and sweeping reporting exemptions (see Pub.L. 110 or 50 U.S.C. §403f, available at **http://www.legisworks.org/congress/81/publaw-110.pdf**).

Under the Act, the CIA was authorized to "[t]ransfer to and receive from other Government agencies such sums as may be approved by the [OMB], for the performance of any [intelligence activities] and any other Government agency is authorized to transfer to or receive from the [CIA] such sums without regard to any provisions of law limiting or prohibiting transfers between appropriations" (50 U.S.C. §403f(a)). It was also empowered to reimburse other government agencies for personnel assigned to the CIA (which those agencies could assign without regard to any law to the contrary), rent and repair premises, and fix age limits to CIA positions without regard to any law to the contrary (see id.). This is mostly in line with the previous National Security Act reprogramming provisions, but it gave the CIA a few new toys: more flexibility for interagency reprogramming, and the ability to rent and purchase property with less reporting and oversight (see id.). However, chief among the changes was a doozy you probably spotted—complete freedom from any provisions or laws outside the CIA Act which would otherwise limit shifting funds to programs or agencies not originally anticipated by a Congressional appropriation pursuant to the Appropriations Clause of the Constitution (see id.).

To take the normal dangers of reprogramming even further, the CIA Act also authorized the CIA to spend notwithstanding other laws, and with minimal oversight, stating:

> *"[t]he sums made available to the Agency may be expended without regard to the provisions of law and regulations relating to the expenditure of Government funds; and for objects of a confidential, extraordinary, or emergency nature, such expenditures to be accounted for solely on the certificate of the Director and every such certificate shall be deemed a sufficient voucher for the amount therein certified."* (id. available at **http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title50-section3510&num=0&edition=prelim#sourcecredit**)

There are some added reporting requirements in the Act; the Director is required to report transfers for the acquisition of land by submitting a report "to the Select Committee on Intelligence of the Senate and the Permanent Select Committee on Intelligence of the House of Representatives" (id.). However, the bulk of the CIA Act limited reporting requirements for the intelligence community substantially.

Under the Act, the CIA was further exempted from most reporting laws, including any laws "which require the publication or disclosure of the organization, functions, names, official titles, salaries, or numbers of personnel employed by the Agency" (id.). As mentioned before, there's obviously some logic behind keeping covert operatives and covert action secret. However, these exemptions are so broad as to create the Black Budget issues we see today.

The Act also added some clarification to the reporting requirements for non-financial activity. Classified semi-annual reports summarizing activities are required to be given to the DCI, and then given to the intelligence committees. "Such reports shall, at a minimum, include a list of the title or subject of each inspection, investigation, review, or audit . . . and a description of significant problems, abuses, and deficiencies relating to the administration of programs and operations . . . a description of the recommendations for corrective action . . . [and] a statement of whether corrective action has been completed" (id.). However, overall the CIA Act served to dramatically reduce restrictions on reporting and reprogramming for the intelligence community and, eventually, for the Black Budget.

C. Private Contractor Reporting Requirements

The intelligence community also uses private contractors, and to some degree the Black Budget reporting protections are extended to them as well. In particular, and in addition to any protections of classified information, private contractors can be exempted from SEC reporting requirements by the Director of National Intelligence through a series of executive actions by Presidents Reagan and G.W. Bush (see Executive Order 12333, available at **https://www.archives.gov/federal-register/codification/executive-order/12333.html**, and Memorandum on Assignment of Function Relating to Granting of Authority for Issuance of Certain Directives, available at **https://www.gpo.gov/fdsys/pkg/FR-2006-05-12/html/06-4538.htm**). They each used executive actions to change how private contractors were used by Black Budget agencies, allowing greater secrecy and creating larger holes in the reporting requirements of the intelligence community. President Reagan used an executive order, and President G.W. Bush used a presidential memo.

Executive orders have a few legal requirements in order to be used, while Presidential memos have none. Executive orders must be able to cite the legal authority the president has to make the order, report the estimated fiscal costs of the order, and be published to the Federal Register. A memo, on the other hand, may do any of those things, but none of that is required. Instead, it simply directs an agency to act in a certain manner (see Quester, Rachel, *Executive or Memorandum? Let's Call the Whole Thing an Action*, available at **https://www.npr.org/2017/01/30/512066715/executive-order-or-memorandum-lets-call-the-whole-thing-an-action**).

President Reagan used Executive Order 12333 in 1981, in order to allow the outsourcing of classified projects to private contractors. The order states:

> *"Agencies within the Intelligence Community are authorized to enter into contracts or arrangements for the provision of goods or services with private companies or institutions in the United States and need not reveal the sponsorship of such contracts or arrangements for authorized intelligence purposes. Contracts or arrangements with academic institutions may be undertaken only with the consent of appropriate officials of the institution."* (see Executive Order 12333, Section 2.7)

In a later memorandum, President G.W. Bush waived the SEC reporting requirements for contractors. The SEC Act itself grants the authority to any president to exempt contractors from reporting via 15 U.S. Code § 78m(b)(3)(A), which states:

> *"With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation*

> *with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance."* (15 U.S. Code § 78m(b)(3)(A), available at **https://www.law.cornell.edu/uscode/text/15/78m**))

The use of this section was authorized by an obtusely named presidential memo to the Director of National Intelligence: "Memorandum on Assignment of Function Relating to Granting of Authority for Issuance of Certain Directives," stating:

> *"I hereby assign to you [the Director of National Intelligence] the function of the President under . . . [15 U.S.C. 78m(b)(3)(A)]. In performing such function, you should consult the heads of departments and agencies, as appropriate."* (Memorandum for the Director of National Intelligence, May 5, 2006).

This memo granted the required "Presidential authority" of section 78m(b)(3)(A) to the Director of National Intelligence, enabling the Director to exempt private contractors from SEC reporting requirements (id.). The combination of President Reagan's executive order and President G.W. Bush's presidential memo carved out a section of reporting requirements for private entities, in addition to the executive agencies themselves.

This creates an issue similar to and intertwined with the governmental reporting requirements discussed previously, but now drastically compounded in that it extends all those issues to private entities as well—allowing for much greater loss of transparency. While private entities don't have a constitutional mandate for reporting, the agencies funding them do, and exemption from SEC reporting for private contractors is its own troubling can of worms considering that the SEC is the government body tasked with protecting fair competition in the marketplace (see *About the SEC*, available at **https://www.sec.gov/about.shtml**). The sheer lack of transparency is magnified when government spending is further obscured through private companies with no reporting requirements and the public and much of Congress is left with no knowledge of the specifics—what is purchased, the prices, the intellectual property details of the private agreements, and more are all left behind a wall inaccessible to all but a very few in Congress if at all.

D. Action Increasing Government Oversight of the Black Budget

The history of the Black Budget hasn't all been action creating loophole after loophole to Constitutional reporting and appropriations requirements. As each new controversy arises (such as Vice President Cheney ordering information to be withheld from Congress,[1] a "very serious" covert program in 2009,[2] and the terrifying breadth of the 47 wiretapping leaks), there has also been action in more recent history to improve the transparency of the intelligence community.

There has been some effort on this front even before the troubling revelations of whistleblowers such as William Binney and Edward Snowden as to the sheer extent of some domestic surveillance projects funded by the Black Budget. Mr. Binney has even alleged that, further than mere government bloat, the situation in the NSA is a "set-up for corruption," explaining:

> *"[t]he NSA and the intelligence agencies are exempt from auditing by the US Government.…You're head of the NSA and you're handed somewhere between $10-15 billion a year to spend any way you see fit and nobody will check on how you spend it. It means that you can take $1 million home a month without nobody missing it and even if they did they would not follow up to see what you did with it. It's a set-up for corruption and that's exactly what is going on."* (William Binney, *The Future of Freedom*, available at **https://www.youtube.com/watch?v=3owk7vEEOvs**)

For instance, the Hughes-Ryan Amendment was one such attempt to bring greater government oversight to the Black Budget. Passed in 1974 as an amendment to the Foreign Assistance Act, the Amendment required the President to report CIA activities to Congressional committees (Foreign Assistance Act of 1974, Public L. No. 93-559 (December 30, 1974), 88 Stat. 1795, available at **https://www.gpo.gov/fdsys/pkg/STATUTE-88/pdf/STATUTE-88-Pg1795.pdf**). The Amendment stated:

> *"No funds appropriated under the authority of this or any other Act may be expended by or on behalf of the Central Intelligence Agency for operations in foreign countries, other than activities intended solely for obtaining necessary intelligence, unless and until the President finds that each such operation is important to the national security of the United States and reports, in a timely fashion, a description and scope of such operation to the appropriate committees of the Congress, including the Committee on Foreign Relations of the United States Senate and the Committee on Foreign Affairs of the United States House of Representatives."* (id. at 88 Stat. 1804)

In 1980, the Hughes-Ryan Amendment was supplemented by a statutory requirement directing intelligence reporting to two intelligence committees (Intelligence Authorization Act for Fiscal Year 1981, Public L. No. 96-450, (October 14, 1908), 94 STAT. 1975) available at **https://www.gpo.gov/fdsys/pkg/STATUTE-94/pdf/STATUTE-94-Pg1975.pdf**). The new statute requires all agencies involved in intelligence activities to "keep the Select Committee on Intelligence of the Senate and the Permanent Select Committee on Intelligence of the House of Representatives . . . fully and currently informed of all intelligence activities . . ." (id. at 94 STAT. 1978). However, "if the President determines it is essential to limit prior notice to meet extraordinary circumstances affecting vital interests of the United States, such notice shall be limited"[3] to a smaller group of Congressmen (id.). This obviously has some fairly substantial leeway to circumvent reporting. However, it was still a substantial step forward at the time.

In 1991, Congress took further steps to increase accountability on the intelligence community. In the Intelligence Authorization Act for Fiscal Year 1991 (Public L. No. 102-88 (August 14, 1991), H.R.1455, available at **https://www.congress.gov/bill/102nd-congress/house-bill/1455/text**), Congress officially repealed Hughes-Ryan, while supporting its objectives by replacing it with new reporting requirements and more precise definitions. The new Act requires the President to "ensure that the intelligence committees[4] are kept fully and currently informed . . . of all intelligence activities, other than a covert action[5] . . . including any significant anticipated intelligence activity and any significant intelligence failure. . ." (id.). The intelligence committees must also be given "any information or material concerning intelligence activities, other than covert actions . . . which is requested by either of the intelligence committees . . ." (id.). While this helps, there have nonetheless been multiple subsequent scandals regarding unreported intelligence programs,[6] and what Congress doesn't know, they can't request information on.

The provisions additionally require that when covert action "is necessary to support identifiable foreign policy objectives of the United States and is important to the national security of the United States" (id.), the President must set forth the reasons action is required in a written finding, either before or 48 hours after action is taken. The finding must specify each federal agency funding or participating in the action, and whether any third parties will fund or participate in the action (id.).

However, the Act also has a pair of clauses ensuring a certain degree of non-interference. On the one hand, the Act states "[n]othing in this title shall be construed as requiring the approval of the intelligence committees as a condition precedent to the initiation of any significant anticipated intelligence activity" (id.). On the other, "[n]othing in this Act shall be construed as authority to withhold information from the intelligence committees on the grounds . . . [it] would constitute the unauthorized disclosure of classified information . . ." (id.). In other words, the intelligence committees are entitled to know pretty much everything the intelligence community is doing, but likewise cannot interfere in operations aside from, ostensibly, cutting funding.

A few years later, in the Intelligence Authorization Act for fiscal year 1994, Congress added a requirement for an unclassified annual report on the activities of the intelligence community (Public L. No. 103-178 (December 3, 1993), H.R.2330, available at **https://www.congress.gov/103/bills/hr2330/BILLS-103hr2330enr.pdf**). The annual report needed to describe "the activities of the intelligence community during the preceding fiscal year . . that can be described in an unclassified manner; and the areas of the world and the issues that . . will require increased or unusual attention . . . during the next fiscal year" (id. at 11). They must also discuss significant successes and failures of the intelligence community "that can be described in an unclassified manner" (id.). This once again leaves quite a bit of wiggle room. However, versions of the annual (and now semi-annual) reports can be received via a FOIA request[7] or occasionally found online.[8]

More recently, in the Implementing Recommendations of the 9/11 Commission Act of 2007 (Public L. No. 110-53 (August 3, 2007)), available at **https://www.congress.gov/bill/110th-congress/house-bill/1/text**), the Director of National Intelligence is required to "disclose to the public the aggregate amount of funds appropriated by Congress for the National Intelligence Program for such fiscal year." However, there is still an option to decline disclosing even aggregate fund data:

> *"[T]he President may waive or postpone the disclosure required . . . [by] submitting to the [intelligence committees] (1) a statement, in unclassified form, that the disclosure would damage national security; and (2) a statement detailing the reasons for the waiver or postponement, which may be submitted in classified form."* (id. at p. 121 Stat. 335)

Even still, this has led to some further reporting from the intelligence community—albeit generally on very surface level matters—which can once again be received via a FOIA request[9] or occasionally found online.[10] The total amount requested for intelligence activities through NIP and MIP is posted online with some regularity after the 2007 Act.[11] However, in terms of readily available information, there's simply not a lot out there for the public.

Over the years, Congress has instituted a variety of reporting requirements, with mixed success. Each new controversy arising out of the intelligence community usually prompts some manner of new reporting requirement, but the information to the public is often sorely lacking nonetheless. The reports that do exist publicly are often high level overviews lacking any detail or specificity, or redacted to uselessness. The classified documents submitted to the intelligence committees ostensibly have more detail, but the repeated complaints from Congress regarding the intelligence community's omissions in reporting certainly leaves room for doubt.

IV. The Black Budget and the Constitution—Is It Legal?

The unfortunate answer to this question is an almost certain yes. The very idea of the Black Budget certainly does not seem in line with the Constitutional goal of a public holding its government—and especially the Executive branch—accountable through the power of the purse. However, as we've discussed in previous articles, the courts have given extreme deference to Congress to enforce its own powers of the purse through its own actions. They've consistently refused to hear cases on the topic of either Constitutional appropriations or reporting on the grounds of either standing to sue (even when the case is brought by Congressmen) or political question (a legal concept that the courts should settle issues firmly within the realms of the executive or legislative branches). (See supra *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, available at **https://constitution.solari.com/the-appropriations-clause-a-history-of-the-constitutions-as-of-yet-underused-clause/**, and see *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them*, available at **https://constitution.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**.)

So, is the Black Budget constitutional? That's a challenging question. It certainly doesn't seem to follow the intent of the Constitution. However, from a legal standpoint, it's hard to imagine a lawsuit that would succeed at challenging the constitutionality of the Black Budget without a particularly extraordinary set of facts. To illustrate this, let's take a look at the most famous case challenging the Black Budget and the CIA Act—*United States v. Richardson*, 418 U.S. 166 (1974), available at **https://www.oyez.org/cases/1973/72-885**.

Richardson was one of the first cases to really challenge the Appropriations Clause constitutionality of Black Budget practices and specifically the CIA Act appropriations provisions. The lawsuit was one of two suits challenging the CIA Act to be brought in the late '60s and early '70s by an insurance adjuster by the name of William Richardson. The first failed to go anywhere but the second, arguing that the CIA Act violated the Appropriations Clause of the Constitution, made it all the way to the Supreme Court.

The highest Court in the land shut down the claims against the CIA Act, and very nearly any other future similar claim, completely. They ruled that, as a taxpayer who had not suffered any particularized injury, Richardson did not have the right to sue over the CIA Act's appropriations rules in the first place. This is a fairly common approach to taxpayer standing, or lack thereof, under the law. In order to have standing to sue, it is generally required that you have suffered more than a generalized grievance—an injury specific to you that is not suffered by the public at large. The Chief Justice at the time, Warren Burger, said in the case:

> *As our society has become more complex, our numbers more vast, our lives more varied, and our resources more strained, citizens increasingly request the intervention of the courts on a greater variety of issues than at any period of our national development. The acceptance of new categories of judicially cognizable injury has not eliminated the basic principle that, to invoke judicial power, the claimant must have a "personal stake in the outcome," in short, something more than "generalized grievances. . .."* (*United States v. Richardson*, supra, 418 U.S. 166, at 179)

The Supreme Court was not unanimous in its ruling on the issue; the case came out as a 5-4 split. The dissent suggested that standing should not be denied when an injury is widespread but truly exists as it denies redress on the grounds that too many people are injured. The argument of the dissent went along the lines that as long as the plaintiff can establish an injury to their personal rights as opposed to a more general right of the public, they should be granted standing. Justice Brennan's dissent argued this had been done by Richardson as the appropriations and reporting rules of the CIA Act impacted his "right as a voter to receive information to aid his decision how and for whom to vote" (*United States v. Richardson, supra,* 418 U.S. 166, at 236). However, this is an argument that has never been adopted in any actual Supreme Court ruling on standing. This means that, after Richardson, the door was shut on any would-be lawsuit unless a particularized injury could be established—an incredibly difficult task when it comes to financial reporting and appropriations provisions if what is discussed above is taken off the table.

This falls in line with a history of the courts eschewing these sorts of Constitutional reporting and appropriations issues in favor of placing the responsibility on Congress to provide solutions to any existing problems (see supra *The Appropriations Clause: A History of the Constitution's (As of Yet) Underused Clause*, and see supra *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them*). It also falls in line with, as mentioned, the usual approach to standing in the courts. This means that, if the situation is to be changed, it will be on Congress and the people and state and local governments who put pressure on their representatives or take matters into their own hands to take action.

February 7, 2018

Endnotes

1. https://www.reuters.com/article/idUSN1275615
2. http://www.nbcnews.com/id/31849628/ns/politics-capitol_hil
3. Specifically, to the "Gang of Eight."
4. The Select Committee on Intelligence of the Senate and the Permanent Select Committee on Intelligence of the House of Representatives.
5. The Act defines covert action as an activity or activities of the United States Government to influence political, economic, or military conditions abroad, where it is intended that the role of the United States Government will not be apparent or acknowledged publicly, but does not include:
   (1) activities the primary purpose of which is to acquire intelligence, traditional counterintelligence activities, traditional activities to improve or maintain the operational security of United States Government programs, or administrative activities; (2) traditional diplomatic or military activities or routine support to such activities; (3) traditional law enforcement activities conducted by United States Government law enforcement agencies or routine support to such activities; or (4) activities to provide routine support to the overt activities (other than activities described in paragraph (1), (2), or (3)) of other United States Government agencies abroad. (f) No covert action may be conducted which is intended to influence United States political processes, public opinion, policies, or media.'
6. BBC article, CIA "often lied to congressmen." http://news.bbc.co.uk/2/hi/americas/8143081.stm
7. https://fas.org/irp/dni/icig/sar-0313.pdf
8. https://www.dni.gov/files/documents/ICIG/April-Sept-2016-SAR.pdf

9. https://www.dni.gov/index.php/foia; https://www.dni.gov/index.php/download-odni-foia-reports

10. https://www.dhs.gov/sites/default/files/publications/crcl-annual-2016.pdf

11. https://www.dni.gov/index.php/what-we-do/ic-budget

5. Federal Accounting Standards Advisory Policy #56: Understanding New Government Financial Accounting Loopholes

Table of Contents

I. Introduction

Financial accountability for the government is a cornerstone of a functioning representative democracy. The ability for the people to know where taxpayer money goes to is crucial to having an informed opinion regarding the actions of your representatives and to react accordingly. Unfortunately, as we've discussed in previous articles, the current state of government accounting is far from ideal—often bordering on useless to the public. This is largely due to lax enforcement of existing laws such as the Chief Financial Officers (CFO) Act, but also stems from the very real tension between completely transparent government financial disclosure and national security interests (see *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them*, available at **https://constitution.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**). As of the last few months, this tension has taken the future of government financial disclosure to the public to new levels of opacity. The Federal Accounting Standards Advisory Board (FASAB) has released Statement of Federal Financial Accounting Standards 56 (Standard 56), taking government accounting practices from laxly enforced reporting standards to a new benchmark entirely—expressly approved obfuscation of reporting and, in some cases, outright concealing financials.

This sounds fairly alarmist at first blush but, simply put, Standard 56 creates a set of situations where government entities may move numbers around to conceal where money is actually spent or even not report spending outright. Many of the concepts in Standard 56 are not new and have been discussed in FASAB reports for nearly a decade. However, these new changes make a substantial portion of government financial reporting so unreliable as to not be a useful tool to the public (see FASAB *Statement of Federal Financial Accounting Standards 56*, available at **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**).

In order to fully understand Standard 56, we will be taking a fairly deep dive on the new accounting standards it creates—from the history leading up to the new rules, to summarizing the exact changes of Standard 56. We've said that Standard 56 isn't new, and this is true; it has hundreds and hundreds of pages of memorandums and the like which came before it, outlining the exact parameters of these new reporting rules. For that reason, a complete summary of what a government entity must report will not be possible—or likely even useful—in an article of this length. That being said, we will explore the role of FASAB itself, the functional changes of Standard 56, and how it will impact the ability of the U.S. taxpayer to see how their money is spent.

II. History of the Federal Accounting Standards Advisory Board (FASAB)

FASAB came about as a response to the requirements of the CFO Act. We previously wrote about the CFO Act in *The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government's Failure to Follow Them* (available at **https://constitution.solari.com/the-u-s-statutes-creating-modern-constitutional-financial-management-and-reporting-requirements-and-the-governments-failure-to-follow-them/**). Under the Act, the individual CFOs of covered federal agencies are responsible for preparing financial statements for regular audit in order to ensure accuracy in accounting. The CFOs also were tasked by the Act with integrating accounting and budget information into a form consistent with those used to make budgets, put together a uniform financial management system for their agency, and—perhaps most importantly—make sure that the system they put together allowed for actual useful measurement of the financial performance of the CFO's agency.

However, the CFO Act was light on the details, and after the Act passed in 1990, there was a need to determine the actual details of the accounting standards required. Therefore, the Treasury, OMB, and Comptroller General signed a Memorandum jointly establishing the FASAB to "consider and recommend the appropriate accounting standards for the federal government" (see *History of FASAB*, available at **http://www.fasab.gov/the-history-of-fasab/**). Until 1999, FASAB simply gave recommendations to those three sponsoring entities. Then, in 1999, FASAB was approved to set final generally acceptable accounting practices (GAAP) for the federal government, with only a 90 day review period by the sponsoring entities. In 2002, the Treasury was removed as a sponsoring entity, leaving the OMB and GAO as the only entities able to object to FASAB set standards (see id.).

III. FASAB and Standard 56

As mentioned above, since 1999, FASAB sets the final GAAP for the federal government. These practices are then used throughout the federal government to determine the content and structure of the financial reports the CFO Act requires federal government agencies, departments, and the like to prepare. While the GAAP are not themselves literally binding law, they do show what the federal government considers to be compliance with the law. As long as an agency follows GAAP, there will generally be a presumption that it is also complying with the federal financial accounting requirements. Therefore, unless the underlying legislation is amended by Congress, FASAB essentially determines the extent of the federal government's financial transparency (see id.). With the official adoption of Standard 56 as of October 4, 2018—completely unchanged from the pre-comment period version from July 2018—FASAB has determined that national security concerns essentially trump the need for financial transparency to the public. So how does Standard 56 do this?

A. What Does Standard 56 Do?

In the absolute most simple terms, Standard 56 allows federal entities to shift amounts from line item to line item and sometimes even omit spending altogether when reporting their financials in order to avoid the potential of revealing classified information.[1] However, as with all laws, nearly every word in that sentence is a complicated concept to unpack. Who counts as a federal reporting entity? When and how can these entities conceal or remove financial information from their reports? What information can be removed? When does something count as confidential, and who makes that determination? All of these questions have enormous bodies of writing in FASAB memorandums addressing, and sometimes failing to address, their answers.

The simplest place to start with understanding Standard 56 is its scope. It applies to federal entities that issue unclassified general purpose federal financial reports (GPFFR), including where one entity is consolidated with another. This means it only applies to otherwise unclassified financial reports where there is a risk of revealing classified information; classified financial reports are their own can of worms. (See generally, FASAB *Statement of Federal Financial Accounting Standards 56*, available at **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**). Standard 56 also doesn't remove the actual requirement to report, it just allows these entities to change their reports in ways that don't reflect their actual spending (see id.). However, for the purposes of government transparency, determining who is responsible for classifying information, and/or removing that information from unclassified reports, is quite opaque for the average interested citizen.

B. Reporting Entities Within the Scope of Standard 56

The actual reporting entities empowered by the standards of Standard 56 include organizations which are included in the government wide GPFFR (see id.). This includes any entities that are "(1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits" (FASAB *Statement of Federal Financial Accounting Standards 47*, p. 1, available at **http://files.fasab.gov/pdffiles/handbook_sffas_47.pdf**).

However, many different departments, bureaus, and agencies prepare their own GPFFRs as well. The various entities that both prepare their own GPFFR and are within a larger reporting entity are called Component Reporting Entities. This includes executive departments, independent agencies, government corporations, legislative agencies, and federal courts (id at 7). Their GPFFRs are then consolidated into the government wide GPFFR.

Under the Component Reporting Entities and included in their GPFFRs are various other organizations, from smaller departments to government contractors, which are split into two categories: disclosure entities and consolidation entities (see id.).

Consolidation entities are entities like agencies and departments. A consolidation entity generally (1) is financed through taxes and other non-exchange revenues, (2) is governed by the Congress and/or the President, (3) imposes or may impose risks and rewards to the federal government, and (4) provides goods and services on a non-market basis (see id. at 16). For instance, a department or corporation established by Congress to perform a government function is a classic example of a consolidation entity. Consolidated entities are reported by a larger entity as part and parcel of their financial reporting—as if they were one economic entity. We will discuss this type of entity later in great depth, as it constitutes one of the largest potential loopholes of Standard 56 (see id.).

Disclosure entities are financially independent organizations. These organizations still need to be included in the government wide GPFFR, but do not fully meet the four characteristics of consolidated entities above. They include quasi-governmental entities, organizations in receiverships and conservatorships, and organizations owned or controlled through federal government intervention actions (see id. at 16). A good example would be government-established non-profits that have a significant portion of their board appointed by the President but are entirely funded by their own activities.

Additionally, there are "related parties," which are organizations where at least one of the parties involved has the ability to exercise significant influence over the policy decisions of the other party. This significant influence does not need to amount to control, but can include things such as representation on a board of directors, participation in policy making procedures, shared managerial personnel, and things along those lines. The existence of significant influence is generally determined through a full analysis of the particulars of each situation. This classification is usually applied to organizations that do not even rise to the level of a disclosure entity, but nonetheless would be misleading to exclude. Some common examples of related parties are some government-sponsored enterprises and organizations governed by representatives from each of the governments that created the organization, including the United States, wherein the federal government has agreed to ongoing or contingent financial support to accomplish shared objectives. Related entities generally do not include government contractors, government vendors, some non-profits, organizations created by treaty, or special interest groups—although they can in the right circumstances (see id. at 7 and 31-33).

However, there are also certain entities that would probably be consolidation or disclosure entities, but are expressly excluded from the government wide GPFFR: the Federal Reserve System and bailout entities (see *Financial Report of the United States Government 2016*, p. 227, available at **https://fiscal.treasury.gov/files/reports-statements/financial-report/01112017FR-(Final).pdf**). In particular, this includes entities like Freddie Mac and Fannie Mae (see id.). If the government obtains rights in another entity which would give them the sort of control that normally makes a disclosure entity, but gains those rights when it "guarantee[s] or pay[s] debt for a privately owned entity whose failure could have an adverse impact on the nation's economy, commerce, national security, etc. . ." those rights don't count for determining a reporting entity (id).

This means that in addition to consolidation and disclosure entities, the scope of Standard 56 stretches to any organization which it would be misleading to exclude but isn't otherwise incorporated into their list of covered entities. Because of this, although there is not an exhaustive list of whose financial reporting is impacted by Standard 56, if you can think of an entity related to the government, it is a safe bet they count as a covered reporting entity. This can include publicly traded corporations with significant funding and/or control from the federal government.

C. Changes to Disclosure Standards Under Standard 56

For these covered entities, Standard 56 offers financial reporting exceptions in a few situations for national security purposes. These reporting exceptions are the meat of Standard 56, three rules substantially modifying the reporting requirements of the above discussed entities to varying degrees (see FASAB *Statement of Federal Financial Accounting Standards 56*, p. 6, available at **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**).

In general, disclosure entities are required to provide their financial reporting in a manner which is clear, concise, meaningful, and transparent (see FASAB *Statement of Federal Financial Accounting Standards 47*, para 71-73, available at **http://files.fasab.gov/pdffiles/handbook_sffas_47.pdf**). This is done through a single, integrated report of finances disclosing the relationship of the organization to the government and related entities, the nature and magnitude of their activity and their financial balances, and a description of financial and non-financial risks, potential benefits, and, if possible, the amount of the federal government's exposure to gains and losses from the past or future operations of the disclosure entity or entities (see id. at para 74). This generally includes how much control or influence over the entity is exercised, key terms in their contractual agreements, percentage ownership and voting rights, a summary of assets, liabilities, revenues, expenses, gains and losses, key financial indicators, information on how their reports are stored and can be obtained, and quite a bit more (see id.). Essentially what is required is a transparent summary of how money is spent to provide accountability to the public. Standard 56 creates three loopholes to this disclosure standard.

D. Modifications to Avoid Disclosure of Classified Information

The first new loophole allows disclosure entities to modify their financial reports to "prevent the disclosure of classified information in an unclassified GPFFR" so long as these modifications do not change the net results of operations and net position. (See FASAB *Statement of Federal Financial Accounting Standards 56*, p. 6, available at **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**.)

This ultimately means that, when done to conceal confidential information, entities can—and are essentially required to under the terms of Standard 56—shift money from one line item to another so long as the totals stay consistent. The rule also allows entities to omit the line item entirely while retaining the amounts so as to maintain the same net results. This means that readers of these reports will never know if the amounts reported spent on specific projects or things are an accurate representation (see id.). As you might expect given the rationale of this being a national security precaution, there will not be any narrative in these reports explaining or revealing where a modification has taken place (see id.). If they can maintain net position in their reports, an entity can even omit a project entirely by folding it into another department or project within the same entity.

While it could obviously be worse for transparency purposes, the alternative would be that the amounts would just be omitted entirely. That brings us to the next two changes to accounting standards created by Standard 56.

E. Reporting on Consolidation Entities

We briefly discussed consolidation entities above as one of the larger loopholes to reporting within Standard 56. This is because the second change to reporting requirements of Standard 56 allows the reporting entity which the consolidation entity is consolidated with to modify reports to avoid disclosure of confidential information even if that modification changes net results of operations or net position. The reporting entity can move the financials of the consolidation entity or even choose not to include it in its report; full stop. (See FASAB *Statement of Federal Financial Accounting Standards 56*, pp. 6-7, available at **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**.)

The concept of consolidation entities being incorporated into the reports of a larger reporting entity is far from new. FASAB has memorandums detailing the rules regarding consolidation from as far back as 2012 (see FASAB Federal Reporting Entity Memorandum, November 29, 2012, available at **http://files.fasab.gov/pdffiles/tab_a1_concepts_federal_2012dec.pdf**). By itself, it is not a particularly problematic issue. Under FASAB rules, consolidation in financial reporting is appropriate for those organizations financed by the taxpayer, governed by elected or appointed officials, imposing risks and rewards on the taxpayer, and providing goods and services on a non-market basis. However, consolidation is not appropriate for organizations operating with a high degree of autonomy (see id. At 7).

In general, where an organization is controlled by the federal government and stands to make or lose money, but doesn't have enough independence for a disclosure entity, it is included somewhere as a consolidation entity (see FASAB *Statement of Federal Financial Accounting Standards 47*, pp. 14-15, available at **http://files.fasab.gov/pdffiles/handbook_sffas_47.pdf**). As you've seen, the determination of what sort of entity something is hinges a great deal on the level of autonomy of the entity—the greater the control the government has, the more likely something will be classified as a consolidation entity. This control doesn't mean the government has to actively manage on the day-to-day, but does require an examination of—among other things—whether the government can do things like appoint a majority of board members, dissolve the organization, authorize or deny action within the organization on some or all issues, or direct the policies or use of assets within the organization, and/or direct investment decisions.

Consolidation entities are only assigned to one component entity and, in general, where that sort of control exists for a consolidated entity, the public would rely on the larger reporting entity for information on the consolidation entity's financials (see id.). Under the second accounting standard change within Standard 56, the public can't even count on these financials being reported in the first place (see FASAB *Statement of Federal Financial Accounting Standards 56*, pp. 6-7).

F. Interpretations Modifying Reporting Standards in the Future

The final change to accounting standards within Standard 56 doesn't do much at the moment, but has the greatest potential to undermine financial transparency in the future. It allows FASAB to issue Interpretations of Standard 56 in the future which would allow other modifications to financial reports for the purpose of avoiding disclosure of classified information. FASAB can, and likely will, release these Interpretations over time. These Interpretations can allow modifications to reporting without regard for maintaining an entity's net results or net position in their reporting. Those interpretations may even be classified themselves (Appendix A, A16), resulting in a portion of the federal government's accountability standards being concealed from the public (see *FASAB Statement of Federal Financial Accounting Standards 56*, pp. 6-7).

Looked at in the most optimistic light, this will allow FASAB to ensure that Standard 56 isn't abused and issue rulings of when disclosure is necessary in situations not yet considered. Looked at in a less optimistic light, this means that the ability of the government to obfuscate financial records will continue to grow in the coming months and years, without public oversight, as Interpretations add to or clarify these existing loopholes.

IV. Administrative History of Statement 56

Statement 56, and its reporting exceptions, have been in the works within FASAB for months. When an issue is identified, FASAB performs preliminary deliberations, prepares the initial documents, and then releases a review version to the public for comment and public hearings. After the comment period, FASAB enters further deliberations to consider the comments and make revisions. Then, the Board approves the proposed statement by a two-thirds majority vote, and submits it to the principals (the OMB and the GAO) for review. If neither principal objects to the proposal after 90 days, it is published by FASAB and is added to the GAAP for federal entities (Definition: FASAB (Federal Accounting Standards Advisory Board), available at **https://searchcompliance.techtarget.com/definition/FASAB-Federal-Accounting-Standards-Advisory-Board**).

For Standard 56, the exposure draft was published on July 12, 2018, with comments due by August 13, 2018. Seventeen comments were submitted by various departments, agencies, and accounting firms (see *FASAB Classified Activities*, available at **http://fasab.gov/ca/**). The final Statement 56 was published on October 4, 2018, with little if any change from the exposure draft. However, the comments on Statement 56 are themselves interesting and somewhat enlightening.

A. Commentary on Required Disclaimers

FASAB proposed two possible alternatives for disclosure/disclaimer requirements under Standard 56. Either reporting entities could be given a choice in whether or not to consistently disclose that certain presentations may have been modified, or all reporting entities must disclose the possibility that certain presentations may have been modified, regardless of actual modification (see FASAB *Exposure Draft Interpretation of Federal Financial Accounting Standards 56: Classified Activities*, available at **https://fas.org/sgp/news/2018/07/fasab-review.pdf**).

The SEC gave a fairly entertaining comment on Standard 56. After answering "No Comment" to literally every preceding question, the SEC gave its thoughts on FASAB's proposal for how component entities should disclose that they have modified their reports. The SEC, the nation's foremost agency in the fight against financial fraud, doesn't think that every component entity should have to disclose that modifications may have occurred, and especially the SEC shouldn't have to. The reasoning the SEC gave for this position was that they "believe that this would be misleading and likely to cause confusion for financial statement readers, by implying that SEC is involved in classified activities. It's likely that SEC, as well as other agencies, would receive numerous inquiries from the public and from the media by including such an unexpected disclaimer in its financial statements." In other words, they're worried it would look strange to the public if they disclosed that they had modified their financial reporting, despite no such modification. The public may think it odd that component entities such as the SEC would make such a, in their own words, "unexpected disclaimer" (*FASAB Exposure Draft: Classified Activities*, SEC Comment, available at **http://files.fasab.gov/pdffiles/CA_13_SEC.PDF**).

Veterans Affairs and the Association of Government Accountants had a similar stance, and while they commented on other aspects of Standard 56 as well, they joined the SEC in criticizing a mandatory disclaimer, and suggested disclaimers would only be appropriate when GPFFRs were actually modified (see FASAB Classified Activities, available at **http://fasab.gov/ca/**).

Several other commenting parties had a different take on the required disclaimers. For instance, the Department of Defense's Office of The Chief Financial Officer and the Department of the Interior wanted agencies to have the option to give a disclaimer or not, irregardless of whether or not they made changes to classified information under the new standard (id.). The Department of Energy's Office of The Chief Financial Officer even felt it would be appropriate to have no disclaimers whatsoever, even if GPFFRs were materially modified (id.).

B. Federal Commentary on Standard 56 Generally

Various government agencies commented on the "meat" of Standard 56, and most were in favor[2] of FASAB's proposals in general. For instance, Housing and Urban Development had fairly positive comments across the board, and deferred greatly to the need to classify information. The organization agreed with all of FASAB's methodology and conclusions, and stated the new standards would strike a correct balance between protecting classified information and a commitment to open government.

However, oddly enough, the Department of Defense Office of the Inspector General was particularly concerned with the proposed Statement. They wrote "[t]his proposed guidance is a major shift in Federal accounting guidance and, in our view, the potential impact is so expansive that it represents another comprehensive basis of accounting" (*FASAB Exposure Draft: Classified Activities*, Department of Defense Office of the Inspector General Comment, available at **http://files.fasab.gov/pdffiles/CA_8_DoD_OIG.PDF**). They suggested already existing methods like redaction are sufficient to protect classified information, and stated the FASAB "should clarify whether this proposed standard, or subsequent Interpretations, could permit entities to record misstated amounts in the financial statements to mislead readers with the stated purpose of protecting classified information. We believe that no accounting guidance should allow this type of accounting entry" (id.).

Additionally, while not quite as critical as the Inspector General, the Treasury expressed concerns about the modification of net results of operations and net position.

C. Concerns From Accounting Firms

The accounting firm Kearney & Company had a more critical take on the proposed standard as well. They worried that "[t]he FASAB's proposed approach could result in material omissions in GPFFR. . . If GPFFR can be modified so material activity is no longer accurately presented to the reader of financial statements, its usefulness to public users is limited and subject to misinterpretation" (*FASAB Exposure Draft: Classified Activities*, Kearney & Company Comment, available at:
http://files.fasab.gov/pdffiles/CA_14_Kearney_&_CO_.PDF).

The accounting firm KPMG was more concerned with clarity and consistency, stating that because of potential classified interpretations, only some people with clearance will be able to understand the complete set of GAAP. Because of this, "[i]t is not clear how management of each federal entity will be able to assert that their GPFFR have been prepared in accordance with GAAP when management does not have access to all of GAAP" (*FASAB Exposure Draft: Classified Activities*, KPMG Comment, available at
http://files.fasab.gov/pdffiles/CA_2_KPMG.PDF).

V. The Results of Statement 56 for the Public

There is a legitimate existing tension between the need to protect confidential government information and the public's interest in financial transparency and accountability. Standard 56 isn't without possible justification. That being said, the concerns of both the accounting world and many within the federal government itself are extremely valid.

Statement 56 undercuts the reliability of government accounting standards and financial statements to such a degree as to render an already questionably valuable reporting tool virtually useless to the public. The possibility of false or omitted information renders the reports largely unreliable as to actual amounts, as does the fact that even an accurate report is rendered questionable by the very existence of modifications that are not necessarily exposed. Classifying portions of the federal GAAP mystifies the process even further, and the fuzzy definitions of reporting entities leaves the potential for this to touch not only direct government entities, but government contractors and other private (but federally entangled) entities. The general disclosure of the government—requiring all reporting entities to report the potential of modifications whether or not they actually exist in their report while simultaneously forbidding the actual disclosure of the actual existence of any modifications—is essentially a worst case in terms of transparency for the public.

December 29, 2018

Sources

FASAB

- **http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf**
- **http://www.fasab.gov/documents-for-comment/**
- About: **http://www.fasab.gov/mission-objectives/**
- History: **http://www.fasab.gov/the-history-of-fasab/**
- General info: **https://searchcompliance.techtarget.com/definition/FASAB-Federal-Accounting-Standards-Advisory-Board**

Reporting Entities

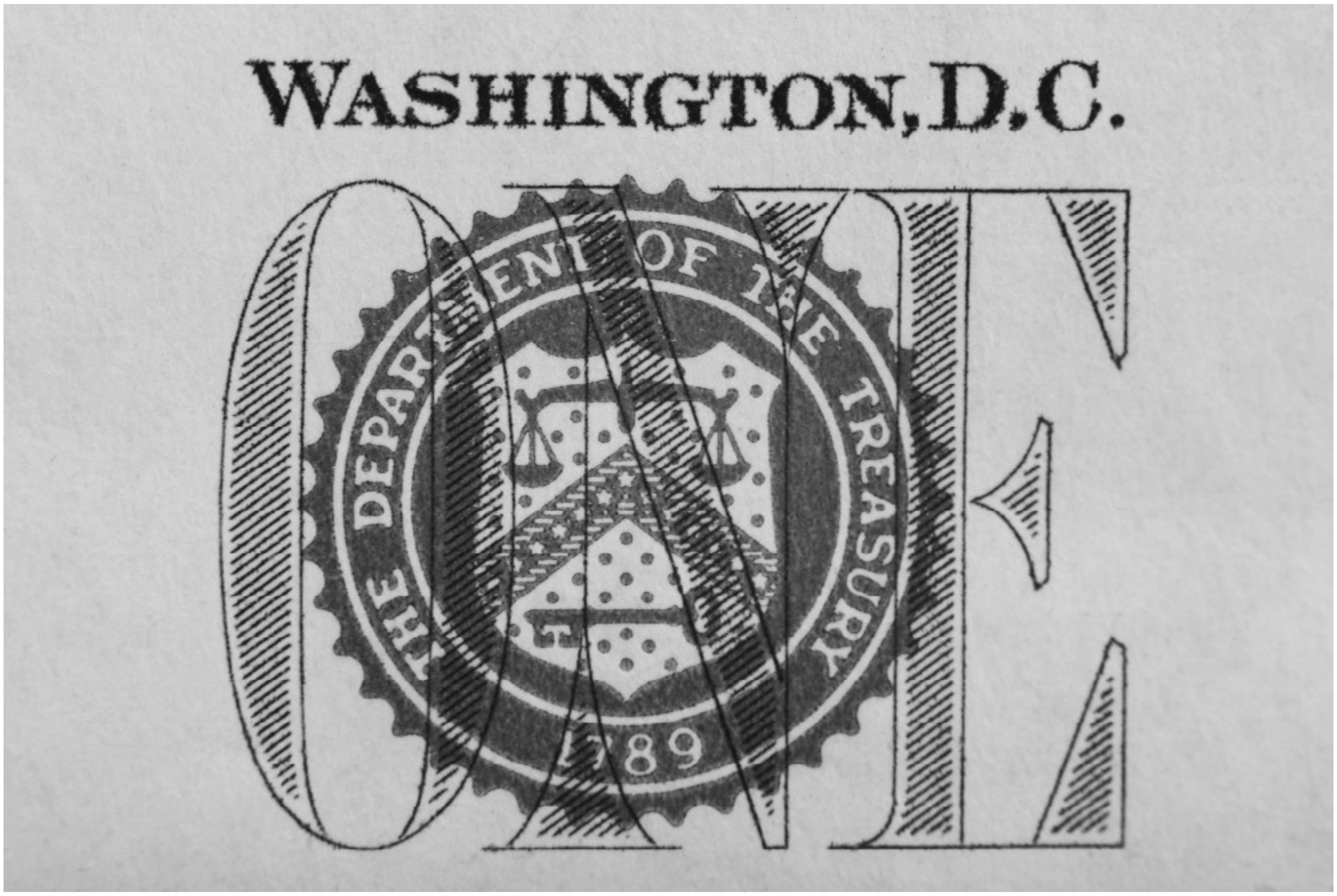
- **http://www.fasab.gov/concepts-federal-entity/**
- **http://files.fasab.gov/pdffiles/handbook_sffas_47.pdf**

Endnotes

1. The extent of what qualifies as classified or confidential information is determined by Executive Order 13526 (the most recent standard set back in 2009), changes over time, and could fill a book by itself. https://www.archives.gov/isoo/policy-documents/cnsi-eo.html.

2. The Departments of Veterans Affairs, Housing and Urban Development, Energy, and The Interior, all had agreement with the proposed standard more or less across the board, with a few exceptions for disagreements about the disclaimers.

6. National Security Exemptions and SEC Rule 10b-5



"Well, we are against fraud, aren't we?"

~ Then-Commissioner of the SEC, Sumner Pike, in the only comment made before approving Rule 10b-5

Table of Contents

I. Introduction

The creation of the Securities and Exchange Commission (SEC), and its various powers to protect against financial fraud, are among the least debated bits of law created of all time. The creation of SEC's most sweeping regulatory power of all, Rule 10b-5, was approved with no debate or comment whatsoever except one: the then-Commissioner of the SEC, Sumner Pike, said "Well, we are against fraud, aren't we?" (See "The Interest of the Securities and Exchange Commission in Private Civil Actions Under the Securities Acts," **https://www.sec.gov/news/speech/1968/011268smith.pdf**.)

The exact contours of 10b-5 are something we'll discuss a fair bit over the course of this article. However, it can simply be summarized as a rule against omissions or misrepresentations connected to the sale or purchase of a security. It, and the SEC as a whole, arguably exist with the primary purpose of ensuring investors are both not deceived and are as informed as possible about their investments. So how does this come into play when, as we wrote previously, the government is sometimes required to alter or omit financial statements behind government issued securities, and requires the same of their publicly traded contractors, for the purpose of national security and maintaining confidentiality? (See **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**.)

The government, both federal, state and local, can all be subject to the rules of the SEC. How does the law make national security exemptions and 10b-5 disclosure requirements play nice when it comes to the disclosure documents for government issued securities? In order to explore and understand this question, let's take a look at exactly how the SEC and 10b-5 work, some of the various national security reporting exemptions at play, and how these national security exemptions would be taken into account when it comes to 10b-5. Then, at the end, we will wrap up by taking a look at some hypothetical situations, and how the laws we've discussed—both 10b-5 and national security exemptions—might apply to those situations.

II. What Is SEC Rule 10b-5?

All federal agencies get their power to create enforceable regulations from a delegation of power from Congress, offering them the ability to essentially act as Congress would within a particularized scope. For the SEC, this grant of power came in Section 10 of the Securities Exchange Act of 1934 (the '34 Act) with the goal of enforcing the Securities Act of 1933 (the '33 Act). Agencies such as the SEC can then create regulations within the scope of their power grant and, generally, enforce them with the power of law (see *The Laws That Govern the Securities Industry*, available at **https://www.sec.gov/answers/about-lawsshtml.html#secexact1934**). The SEC's regulations can be found in Code of Federal Regulations Title 17 (see 17 CFR, available at **https://www.law.cornell.edu/cfr/text/17**).

The 1934 Act included 10b to provide the SEC a general power to enact rules combatting manipulative and deceptive practices in securities trading. The regulations the SEC came up with to combat this are all listed as subsections to the initial 10b grant of power. These regulations evolved, and continue to evolve, over time as new rules are added or existing rules amended (see 17 CFR 240, Subpart A, Subject Group 66, available at **https://www.law.cornell.edu/cfr/text/17/part-240/subpart-A**).

As a few examples, Rule 10b-1 provides that the SEC's fraud regulations be applied even to normally exempt securities such as federal securities or the municipal securities issued by state and local governments (see 17 CFR 240.10b-1). Rule 10b-3 forbids securities brokers and dealers from directly or indirectly engaging in securities fraud (see 17 CFR 240.10b-3). Rule 10b-10 requires certain disclosures in writing by brokers and dealers before completing a securities transaction (see 17 CFR 240.10b-10). However, the broadest of these rules, generally considered a bit of a catch-all for the SEC to prevent financial fraud otherwise not considered and the source of the majority of lawsuits brought both by the SEC and the public, is 10b-5.

10b-5, codified in the Code of Federal Regulations at 17 C.F.R. 240.10b-5, can be very quickly summarized as a rule prohibiting acts or omissions which result in fraud or deceit in connection with purchase or sale of any security. It's perhaps best known as the rule forbidding insider trading, but is extremely broad in scope and can cover any number of financial evils. As with most law, although it can be simply put, the actual application of 10b-5 is far from simple.

10b-5 makes it unlawful for any "person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange," to:

> *"(a) …employ any device, scheme, or artifice to defraud, (b)…make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c)…engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."*

This means that a 10b-5 violation requires showing that: (1) the accused party counts as a person under the scope of 10b-5; (2) manipulation or deception has occurred through misrepresentation or omission; (3) the deception or omission was important enough to be considered "material"; (4) the deception or omission was made in connection with the sale or purchase of securities; (5) the deception or omission was done recklessly or intentionally; and, although this can sometimes be presumed as we'll discuss later, (6) the accusing party relied on the misrepresentation. From there, the analysis shifts depending on whether action is being brought by the SEC itself or a private party. Let's take a deeper look at these elements.

III. The Elements of a Rule 10b-5 Claim

Rule 10b-5 can be enforced against makers of a deceptive statement by both the SEC, and by private citizens through a private lawsuit. However, private lawsuits have several additional elements plaintiffs need to prove, and it requires a plaintiff to have both bought the relevant securities, and to have suffered a loss as a result. SEC and private actions do share a few basic elements, though (see id.).

A private party suing for a 10b-5 violation needs to establish that they relied and acted on the deception or omission, have standing[1] to sue in the first place, and finally that they suffered losses caused by the deception or omission.

What's more, whether brought by a private party or the SEC itself, these legal actions are somewhat limited in who they are brought against. The proper defendant of a 10b-5 lawsuit or enforcement action is the direct maker of the relevant misleading statement (see *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011)). Aiders and abettors, like lawyers, accountants, and other employees of an entity, are not liable. Instead, it is the direct source of a statement, and often the legal entity itself, that are held liable if these elements are proven (see id.).

These issues of standing and finding a proper defendant are important. However, the focus here is on where a person would have committed a 10b-5 violation as opposed to suing under the rule, so we will mostly be focusing more on the shared elements of who is a person under 10b-5, material misrepresentation, scienter (intent), and reliance.

A. Is the Government a "Person" Falling Under the Scope of 10b-5?

To a reasonable person, the question of who constitutes a person would likely be a very simple one. However, lucky you, you've wandered into the realm of ridiculous complexity that is law. For purposes of 10b-5, a "person" is far from limited to natural persons. It certainly includes businesses, corporations, and more. However, perhaps surprisingly, one of the most complicated and disputed issues for 10b-5 purposes is whether the federal government—as well as state and local governments—count as a person. This is further complicated by greater issues as to when and where state and local governments can properly have a 10b-5 claim brought against them.

The initial '34 Act has drawn a great deal of debate as to whether the government was meant to be a person. The version of the '33 Act passed through the House included the government as a person. However, the version ultimately passed by the Senate removed this. Then, in a 1934 House-Senate conference, it was determined that the government did in fact count as a person. That being said, at the same conference which made all the provisions under the '33 and '34 Acts applicable to fraud involving state and local government securities—no matter whether the defendant was a private person, a corporation, or the government—the ability for a private person to seek a remedy for fraud involving state and local governments was removed. This conflict in the government's intent to let itself, or state and local governments, be subject to 10b-5 was deepened by the fact that 1975 amendments to the '34 Act explicitly include a "government, or political subdivision, agency, or instrument of a government" as a person subject to SEC rules like 10b-5. However, those amendments still didn't change the fact that state and local government securities have their own registration process, as discussed later in the article. Instead, the current law specifically exempts most government securities from the majority of regulations regarding most domestic securities (see Local Government Liability Under Rule 10b-5, Margaret v. Sachs, pp. 35-42, available at **https://openscholarship.wustl.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1824&context=law_lawreview**).

However, as you've seen above in our discussion of Rule 10b-1, SEC regulations apply to even these usually exempted securities. Once traded, the government entity which issued the security is generally subject to SEC scrutiny. For instance, SEC rules require offerings of state and local government securities exceeding $1M (a relatively paltry sum in the scheme of government securities) to include disclosure documents for investors and have found these state and local governments to be proper 10b-5 fraud defendants based on the contents or lack of contents of these disclosure documents (see Rule 15c2-12, 17 C.F.R. § 240.15c2-12 (1991) [hereinafter rule 15c2-12]). Rule 15c2-12 became effective on January 1, 1990 (see Municipal Securities Disclosure, Securities Exchange Act Release No. 26985, 3 Fed. Sec. L. Rep. (CCH) 25,098, at 18,190 (June 28, 1989)). However, even this rule has a number of exemptions. Most notably, literally any security can be exempted by written request if the SEC determines that this exemption is consistent with a public interest (such as confidentiality and national security) and the investors are sufficiently protected (see

Rule 15c2-12(e)). If exempted, the security, and the reporting of that security, would be unlikely to create a 10b-5 issue. This concept of exempted municipal securities and the liability associated with them is something we'll get into much more depth with later in this article.

It's also worth noting that the government—both federal, state and local—can be liable under 10b-5 for participating in fraud involving corporate securities as opposed to simply the municipal securities they themselves issue (see, e.g., In re Citisource, Inc. Sec. Litig., 694 F. Supp. 1069, 1072 (S.D.N.Y. 1988) (claim made against New York City)). For instance, New York City was found to count as a person for purposes of 10b-5 liability where they had issued and sold corporate stock of CitiSource (see In re Citisource, Inc. Securities Litig., 694 F. Supp. 1069 (S.D.N.Y. 1988)). The SEC has also successfully brought a financial fraud suit—although not a 10b-5 suit—against a city Mayor, the city, and other city administrators over selling bonds as part of a public-private venture to fund a movie project but failing to disclose that the partnership backing the project had disintegrated before any bonds were issued (see *SEC Secures Federal Judge Order Against Mayor Based on Control Person Liability*, Paul Maco, Katharine D'Ambrosio, Britt Cass Steckman, Bracewell & Giuliani LLP, Feb 5, 2015, available at **https://casetext.com/analysis/sec-secures-federal-judge-order-against-mayor-based-on-control-person-liability?sort=relevance&resultsNav=false**).

These rulings, and several other rulings, have highlighted a trend in case law towards finding municipal governments to be 10b-5 persons while being more reticent when it comes to state governments. The crux of the courts' distinction here, especially when it comes to suing for damages as opposed to an injunction to make a state or local government do or stop doing something, is a larger constitutional issue–the Eleventh Amendment. The Eleventh Amendment generally prevents a citizen from suing their own state in federal court (see *Hans v. Louisiana*, 134 U.S. 1 (1890), *Bair v. Krug*, 853 F.2d 672 (9th Cir. 1988)). This has seen state governments and their representatives frequently dismissed as defendants from 10b-5 suits, even though they count as a person for 10b-5 purposes (see *Bair v. Krug*, 853 F.2d 672 (9th Cir. 1988); *Charter Oak Fed. Say. Bank v. Ohio*, 666 F. Supp. 1040 (S.D. Ohio 1987); *Finkielstain v. Seidel*, 857 F.2d 893 (2d Cir. 1988)). It should be noted that this doesn't prevent suits brought by the SEC itself based on reports from private citizens.

Courts are much less reluctant to move forward when the target of a 10b-5 suit is a local government or its representative as opposed to a state government or representatives. They've moved forward with suits against New York City, South Bend, and quite a few more cities/city representatives. (See In re Citisource, Inc. Sec. Litig., 694 F. Supp. 1069, 1072-78 (S.D.N.Y. 1988); and *Gorsey v. I.M. Simon & Co.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) 1 93,173 (D. Mass. Feb. 23, 1987). See also *Gorsey v. I.M. Simon & Co.*, [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) % 94,996 (D. Mass. March 6, 1990); *Ross v. Bank South, N.A.*, 837 F.2d 980, 1003 (11th Cir. 1988), aff'd on other grounds, 885 F.2d 723, 728 n.6 (11 th Cir. 1989) (en bane) (appeal dismissed as to Vestavia Hills), cert. denied, 110 S. Ct. 1924 (1990); see In re Washington Pub. Power Supply Sys. Sec. Litig., 623 F. Supp. 1466, 1476 n.4, 1478-80 (W.D. Wash. 1985), aff'd on other grounds, 823 F.2d 1349 (9th Cir. 1987).)

So does the government count as a person for purposes of 10b-5? Almost certainly yes. However, the unhelpful caveat here is that while government counts as a person under 10b-5, the actual answer to whether they fall under the scope of 10b-5 requires a lot deeper analysis that unfortunately doesn't always have a strict yes or no answer under existing case law. Part of the problem is that 10b-5 deals with publicly traded securities; any government security that is publicly traded has a slew of regulations and exemptions that impact the 10b-5 scope analysis. We'll discuss some of these later to hopefully better understand this relationship. While it is uncertain (legally speaking) how liable the different parts of government are under 10b-5, the private entities trading government securities downwind of the government are liable.

B. Material Misrepresentations

Next, for both SEC and private lawsuits, there must be some form of manipulation or deception made in connection with the purchase or sale of securities, and that manipulation or deception must be material. Materiality is a bit of a legal buzzword that changes based on context, but for a 10b-5 violation, it occurs where "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (*Caiola v. Citibank, N.A.*, New York, 295 F.3d 312, 329 (2d Cir. 2002) (quoting *Inc. v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988)). In other words, there must be "a substantial likelihood that a reasonable shareholder would consider it important" in making his investment decision (Section 10(b) Litigation: The Current Landscape, American Bar Association, **https://www.americanbar.org/groups/business_law/publications/blt/2014/10/03_kasner/**). This investment decision can be as clear-cut as a decision to buy a certain security or not, or can boil down to the exact price an investor would be willing to pay for a given security. For instance, if they overpaid for a certain security, or would have sold a security off if they had known the truth, both are examples of investor decisions that might change given a piece of material information.

There obviously isn't a particular reasonable shareholder that the courts can call up and ask for their opinion whenever there's a 10b-5 case, so this analysis of materiality is a highly fact-specific one and changes depending on the industry norms and standards. This is intentional; the courts—and even the Supreme Court—have specifically eschewed any bright-line rules for materiality, arguing:

> *A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive. In TSC Industries this Court explained: "The determination [of materiality] requires delicate assessments of the inferences a `reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him . . . ." (426 U.S., at 450). After much study, the Advisory Committee on Corporate Disclosure cautioned the SEC against administratively confining materiality to a rigid formula. Courts also would do well to heed this advice. (Basic Inc. v. Levinson, 485 U.S. 224, 235 (1988))*

The thought process here is that materiality of information related to securities is too diverse and fact-specific a topic to apply a bright-line rule for when something is properly material (see *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 30-31 (2011)).

Materiality itself is intentionally a fairly high evidentiary bar. The Supreme Court has stated that this is intentional to avoid an "overabundance of information… 'simply to bury [investors] in an avalanche of trivial information—a result that is hardly conducive to informed decision making'" (see *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

That being said, there are some notable factors that can come into play when determining materiality, even if it is impossible to pin down any one factor as independently dispositive on the issue. For example, an omission or deception can be material if it misstates the risk involved in an investment. In *Caiola v. Citibank*, Citibank misstated the risk of Caiola's portfolio when it agreed to perform synthetic trades for the investor, with delta hedging on Citibank's side, but stopped performing delta hedging on Caiola's behalf, without informing Caiola. Caiola's complaint alleged "Citibank thereby exposed Mr. Caiola to precisely the risks that Citibank advised he could and should avoid through the use of synthetic trading" (id. at 329). The court determined "These misrepresentations are clearly sufficient under Rule 10b-5 because they are the sort that 'a reasonable person would consider important in deciding whether to buy or sell shares'" (id., citing *Azrielli v. Cohen Law Offices*, 21 F.3d 512, 518 (2d Cir. 1994)).

It's notable that just because information adversely affects the value of a security, that does not by itself guarantee materiality. The adverse information has to be substantial enough to alter the total mix of information available to the person buying or selling the security such that it would change the decision of a reasonable investor. This can require a statistically likely negative impact of the adverse information, but courts have found on a number of occasions that just because something obviously bad was misrepresented there isn't necessarily materiality. (See *Matrixx*, 131 S.Ct. at 1321., *In re Merck Co., Inc. Securities*, MDL No. 1658 (SRC), Civil Action No. 05-1151 (SRC), Civil Action No. 05-2367 (SRC), at *1 (D.N.J. Aug. 8, 2011).)

Another common way courts help determine whether something is material is to look to changes in the actual value of the security in question after the allegedly material statement is made. Essentially, materiality can be partially determined by looking at the movement in value—for good or for bad—after the statement is made (see *Oran v. Stafford*, 226 F.3d 275, 281 (3d Cir. 2000)). However, in practice, it is usually used by courts to prove that the statement was not material (looking to a lack of movement in the value of the security beyond the norm) as opposed to determining that a statement actually was material (see id.). What's more, the factor is much more difficult to use with omissions, and generally only is used in situations where an allegedly materially misleading statement has been actively made.

Disclaimers can also impact materiality; courts occasionally say that a disclaimer to a representation–saying that an investment is highly risky or that research on a topic was limited and partially inconclusive and more research is needed—is sufficient to negate the materiality of some misrepresentations (see id.). This does not mean that a disclaimer removes the possibility of 10b-5 liability, far from it. Instead, it means that such a disclaimer can mitigate the impact on a reasonable investor's choice to buy or sell a security while still looking at the totality of the circumstances.

Omissions also work slightly differently from misrepresentations when it comes to materiality. They are only material and actionable when the omission necessarily renders another affirmative statement made by the defendant false or misleading, or there is some sort of existing statutory duty to disclose the omitted information. (See *Basic, Inc. v. Levinson*, 485 U.S. 224, 239 n. 17 (1988); *Oran v. Stafford*, 226 F.3d 275, 285 (3d Cir. 2000); *Glazer v. Formica Corp.*, 964 F.2d 149, 157 (2d Cir. 1992); *Backman v. Polaroid Corp.*, 910 F.2d 10, 12 (1st Cir. 1990) (en banc); In re General Motors Class E Stock Buyout Sec. Litig., 694 F. Supp. 1119, 1129 (D.Del. 1988).) Speculative situations are difficult to establish materiality for, specifically because the fluid nature of a speculative situation makes it difficult to reasonably rely on as an investor (see *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988)).

However, the courts have found this especially true in the case of 10b-5 actions involving omissions (see id.).

All this being said, the goal of 10b-5 is:

> *"To substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry" (SEC v. Capital Gains Research Bureau, Inc., 375 U.S., at 186; Accord, Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Santa Fe Industries, Inc. v. Green, 430 U.S., at 477). The role of the materiality requirement is not to "attribute to investors a child-like simplicity, and inability to grasp the probabilistic significance of negotiations" (Flamm v. Eberstadt, 814 F.2d, at 1175), but to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger "mix" of factors to consider in making his investment decision. (See Basic Inc. v. Levinson, 485 U.S. 224, 234 (1988).)*

The intent of the law here is to make sure investors get everything that is important to their decision. Materiality is a high bar, but it's there to filter out less impactful information as opposed to provide a shield for dishonest brokers. That being said, in practice, materiality can be a hard hurdle for a 10b-5 case to clear and often requires substantial expert testimony from both sides.

C. Scienter or Intent

Plaintiffs must additionally show scienter (intent), standing, reliance, causation, and damages. To establish scienter, a plaintiff must show more than mere negligence, but instead some form of recklessness or actual knowledge of a manipulation or deception, on the part of a specific agent or agents of an entity (see *Matrix Cap. Mgmt. Fund, L.P. v. BearingPoint, Inc.*, 576 F.3d 172, 182 (4th Cir. 2009) (quoting *Teachers' Ret. Sys. of La. v. Hunter*, 477 F.3d 162, 184 (4th Cir. 2007)). In other words, being unreasonable or careless with regards to the information in question isn't enough. The rule requires a conscious disregard for the truth and the risks being inaccurate would impose on others. Of course, being willfully misleading, or having actual knowledge of deception or manipulation works as well, but can often be much harder to prove (see *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1301 n.20 (2d Cir. 1973)). This can be done with "facts showing either that the defendant had both motive and opportunity to commit fraud, or strong circumstantial evidence of conscious misbehavior or recklessness" (see *Section 10(b) Litigation: The Current Landscape*, American Bar Association, **https://www.americanbar.org/groups/business_law/publications/blt/2014/10/03_kasner**, citing *Novak v. Kasaks*, 216 F.3d 300, 307 (2d Cir. 2000)).

D. Reliance

A private plaintiff must also show they relied on the deception. In the case of omissions of fact, reliance is often presumed, and in the case of affirmative statements, "the most direct way to demonstrate reliance is to show that the plaintiff was aware of a company's statement and engaged in the relevant transaction based on that specific misrepresentation" (*Section 10(b) Litigation: The Current Landscape*, American Bar Association, **https://www.americanbar.org/groups/business_law/publications/blt/2014/10/03_kasner/**). If the plaintiff suffered a loss caused by relying on that misrepresentation (such as if the price of stocks the plaintiff bought in reliance drops), they can usually recover damages equal to the benefit they would have received had the misrepresentation been the correct information.

For example, if a CEO lies about a large government contract their company was granted, and you invest based on this statement, you have relied on their misrepresentation. If that same CEO concealed a project which suffered substantial losses and you would not have invested—or even if you would have sold off your stock in the company—had you known then you have reliance on his omission.

In addition, there are some cases where reliance can presumed if the plaintiff was buying from a public market. The Supreme Court has held that the typical investor presumes the price set by the market for a public security is a representation of all public information about that company, and there is a rebuttable presumption that there is a reliance on all publicly available misrepresentations issued by that company (see *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2414 (2014)).

IV. How Does 10b-5 Apply to Reporting and Accounting Exemptions?

Now that you know how 10b-5 works in general, we can take a look at how government securities are specifically regulated within the confines of both 10b-5 and a broader level. In general, rule 10b-5 fully applies to any private entities, as we discussed above. However, there are some exemptions to SEC reporting requirements which can result in omissions in both internal accounting and SEC filings. These come in two forms: national security exemptions, and government securities exemptions.

A. Government Securities Exemptions

The Government Securities Act of 1986 authorizes the Secretary of the Treasury to regulate brokers and dealers of government securities in conjunction with the SEC. Specifically, the SEC shares authority with the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (see *The History and Organization of the Federal Reserve: The What and Why of the United States' Most Powerful Banking Organization*, available at **https://constitution.solari.com/the-history-and-organization-of-the-federal-reserve-the-what-and-why-of-the-united-states-most-powerful-banking-organization/**), and the Federal Deposit Insurance Corporation, depending on the type of entity (see 15 USC 78c(a)(34) "appropriate regulatory agency").

These securities follow rules promulgated by both the SEC and the Treasury, and have a separate registration and reporting process (see *SEC Guide to Broker/Dealer Registration*, available at **https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html**). However, the underlying statute also grants the Secretary of Treasury the ability to "conditionally or unconditionally exempt any government securities broker or government securities dealer, or class of government securities brokers or government securities dealers" from most of the requirements (see 15 USC 78o-5(a)(5)). This means that while this division of authority still involves the SEC and rule 10b-5, the regulations are fluid and subject to change.

For instance, the Office of the Comptroller of the Currency handbook advises that "[b]anks' transactions in government securities are subject to the anti-fraud provisions of section 10(b) of the Exchange Act and SEC Exchange Act Rule 10b-5, as well as section 17(a) of the Securities Act of 1933" (see *Comptroller's Handbook, Government Securities Act*, p. 16, available at **https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/government-securities-act/pub-ch-government-securities-act.pdf**). However, it also holds banks to other standards determined by the Comptroller, such as "[i]n recommending to a customer . . . a government security, a bank that is a government securities broker or dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer" (id. at 15). The Board of Governors of the Federal Reserve System has similar provisions for state member banks (see *Federal Reserve System Government Securities Sales Practices*, available at **https://www.federalreserve.gov/boarddocs/press/boardacts/1997/199703122/R-0921.pdf**).

B. Private Entity National Security Exemptions

There are also two processes by which a private entity can (and in most cases must) refrain from disclosing classified information regarding any securities; government or private. First, as we discussed in *The Black Budget: The Crossroads of (Un)Constitutional Appropriations and Reporting* (available at **https://constitution.solari.com/the-black-budget-the-crossroads-of-unconstitutional-appropriations-and-reporting/**), certain internal accounting and external reporting requirements can be waived for private entities by the Director of National Intelligence. Normally, issuers of securities need to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer"; and maintain internal accounting according to generally accepted accounting principles (GAAP) (see 15 USC 78m(b)(2)). Failing to do so can result in criminal liability (see 15 USC 78m(b)(5)). A waiver from the Director of National Intelligence can remove some of those requirements, allowing private entities to deviate from GAAP and even alter their books if the waiver allows.

Second, any documents filed with the SEC are subject to a general national security exemption under 17 CFR 240.0-6, which requires no ". . . document filed with the Commission or any securities exchange shall contain any document or information which . . . has been classified." However, the SEC still requires the filing of "a statement from an appropriate department or agency of the United States to the effect that such document or information has been classified or that the status thereof is awaiting determination" (see 17 CFR 240.0-6(b)). This statement must be in writing and must be obtained prior to reporting (or in lieu of reporting) any classified information to the SEC. This second requirement, in theory, creates a paper trail both on the classifying agency's side, and on the SEC report, which should contain statements that certain information has been omitted. Such a paper trail probably qualifies as compliance with Rule 10b-5.

C. Federal Entity National Security Exemptions

The Federal Government and its associated reporting entities have quite a few situations where they can, and often are required to, omit or alter their financial statements. A notable example of this is the Federal Accounting Standards Advisory Board's (FASAB's) recent Statement of Federal Financial Accounting Standards 56 (SFFAS 56). SFFAS 56 allows federal agencies, and an enormous number of entities associated with the government, to alter and outright omit spending information where it is necessary to protect classified information. For a more complete understanding of SFFAS 56, see our previous article on the topic (*FASAB Statement 56: Understanding New Government Financial Accounting Loopholes*, available at **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**).

V. Conclusion

The SEC's Rule 10b-5 is one of many laws and regulations protecting against omissions or misrepresentations regarding securities, and is one of the most commonly used and widely applicable of those regulations. However, Rule 10b-5 itself is highly fact-specific, and courts have explicitly stated that is intended. There is no bright-line rule on what sort of exact behavior is required. Often, Rule 10b-5 violations are proven in hindsight, after the losses of tremendous amounts of money (or equivalent opportunity costs). The various national security exemptions, like the FASAB's new SFFAS 56, or the longstanding SEC national security exemption, make things even more complex regarding applying Rule 10b-5 to situations where lack of disclosure is expressly allowed (or even required, and we've put together a few hypotheticals to illustrate this complexity in Appendix A, if you want some additional examples).

The takeaway here is, when it comes to the legal duties regarding disclosure, don't take it for granted. Do your own due diligence, and consult with experts you trust before engaging in a large investment, even if the investment is something as ostensibly safe as Treasury bonds. You're free to simply trust in disclosure laws, but their fact-specific nature often results in violations that need to be fully argued and proven in court, which can cost you substantial legal fees for a coin-flip chance of prevailing.

January 24, 2019

Appendix A. Hypotheticals

These national security exemptions, such as SFFAS 56, raise the question of how much about the government's accounting practices a broker of government securities—and especially a primary dealer—would have to disclose to avoid a 10b-5 issue. To help you understand this question, let's take a look at a few hypothetical situations and how the law would be analyzed here.

Hypothetical A:

Prime-Time Bills, Inc. (PTB) is a newly incorporated and approved primary dealer **https://en.wikipedia.org/wiki/Primary_dealer**, who intends to run a business of buying U.S. Treasury securities from the Federal Reserve System to sell those securities to investors. What disclosures does PTB need to make about the government securities it's trading in order to be safe from an SEC 10b-5 enforcement action? What sort of information is "material" when it comes to government securities?

Hypothetical B:

Shadow Aeronautics, LLC ("SA") is a private government contractor that designs and builds stealth aircraft for the military. While they do subcontract some non-classified work for major airlines, the majority of their profits come from government contracts that are classified. What can SA do in order to comply with SEC Rule 10b-5 and avoid an enforcement action, without revealing classified information?

Elements of Rule 10b-5

Person: PTB is a corporation, a private entity, which qualifies as a person under securities laws. They only buy and sell government securities, so they need to register with the SEC as a broker/dealer of government securities. Because they aren't a bank or savings association, they are regulated by the SEC directly.

SA is an LLC, a private entity, which also qualifies as a person under securities laws. They don't trade in government securities at all, so they register with and are regulated by the SEC like any other private entity.

Deception or Omission: Neither PTB nor SA are allowed to make any affirmative statement or omit information, subject to the materiality requirements below.

However, SA deals with classified projects, which cannot be disclosed to the public. Therefore, SA has to get a waiver from the agency that classified whatever project they're working on, and file that waiver with the SEC instead of information on that project. If SA does this, they are allowed to omit information that may be material to a potential shareholder, although they still can't lie (like say they won contracts they instead lost).

Material: For a misrepresentation or omission to be material, it has to be substantial enough to affect the "total mix" of the information available to a investor, such that it would change the mind of a reasonable investor. This can be done by misstating the risk involved in an investment. For instance, if PTB sells a low risk government security, but knows the security has details that result in a higher risk than PTB states, that may be a material misrepresentation. Then, the information being disclosed, and the information being omitted, is considered in the context of the "total mix" of available information. For instance, in the case of PTB's government securities, a recession, a bankruptcy (in the case of municipal securities), or a new piece of legislation/regulation that concerns Treasury securities, could all change the risk level of the securities PTB trades in. That underlying change then needs to be examined in the context of other available information, and the more speculative the change, the less likely it is to be material.

For example, if government accounting can be classified under the new accounting standards set by FASAB (see **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**), whether those accounting changes also alter the risk level of government securities needs to take into account the fiscal stability of the government as a whole, the amount of money allocated to paying such securities back, as well as other factors a reasonable investor would consider in determining the risk levels and creditworthiness of a government security. If any information like that is omitted, would that omission be so significant as to change how a reasonable investor would approach that security?

If the misrepresentation results in a negative impact value on the value of the securities (for instance, by artificially inflating the value, then dropping the value once the deception becomes known), the misrepresentation is considered material. For instance, if SA represents that they won several government contracts, but they didn't (or the contracts were worth far less than SA said), their stock prices will probably fall when the information comes out. That would result in a negative impact on stock value, and the information would be considered material.

Scienter: The misrepresentations or omissions need to be done either knowingly, or with a conscious reckless disregard for the truth and consequences of the statement. If the agent making the statement for either entity knows the information to be false, misleading, or its omission would misrepresent the investment, that qualifies for scienter. If they make a conscious effort to disregard and stay uniformed of information they need to know, that might qualify as scienter, depending on the specific facts involved.

Reliance, Causation, and Loss: If a private plaintiff is suing PTB or SA, the plaintiff will need to prove they suffered a loss in connection with the purchase or sale of a security (which may include opportunity loss, depending on the damages portion of the lawsuit) that was actually caused when they relied on a material misrepresentation. Since SA and PTB are more concerned with SEC enforcement action here, we won't go down this rabbit hole too much.

Endnotes

1. Standing can be a complex issue unto itself, but generally, plaintiffs need to show they have the right to sue over the issue. For Rule 10b-5, the plaintiff must have bought or sold the security at issue; potential buyers who avoided buying stock because of deception do not qualify for standing.

7. Classification for Investors 101

Table of Contents

I. Introduction

Investing is a field fraught with risk and has a long and sometimes less than savory history. As a result, there are a myriad of laws and regulations meant to protect and inform investors, and ensure material information about potential investments is not concealed or fabricated. However, there is a substantial subsection of investment opportunities that collides with perhaps the most famous category of concealed information, that which is classified for national security purposes. As the private sector becomes more and more involved in military and intelligence projects, it is natural that the allure of investment in such contractor entities grows. This creates a collision between the requirements for transparency that are usually imposed on corporate entities and the opposite requirements for secrecy in the name of national security.

Over this article, we hope to outline how classification works and what classification-related exemptions investors should be aware of. Even if an investor might not be able to get access to the classified information, understanding the rules surrounding it might be helpful to an investor looking to invest in the securities of private government contractors (e.g., defense and intelligence contractors or most financial institutions[1]), or even the securities offered by the federal government itself. To this end, we'll be covering how classification works and providing a resource for investors summarizing our past discussions in previous articles of relevant reporting exemptions created by national security exemptions.

One thing to keep in mind is, colloquially, the term "confidentiality" can be applied in a variety of circumstances, from trade secrets and non-disclosure agreements to keeping a friend's personal secret, secret. There's a large body of law on general confidentiality, which we won't be discussing here. For the purposes of this article, we'll be referring to confidentiality as one of the levels of classification, discussed below.

A. Why Does Classification Matter to the Average Investor?

Information is critical to investors. The more you have, the more certain your investments become, and large swaths of law protect an investor's right to the information they need to make informed decisions. Classification, however, runs counter to this principle, and it is often difficult to determine if a particular classified fact even exists. This can prove problematic for an investor looking to invest in companies undertaking military or intelligence contracts, or basing their investment decisions on government accounting data.

A.1. Private Entity Reporting Exemptions

Normally, the SEC requires a great deal of information to be disclosed in their filings, and filing entities have to comply with internal accounting regulations. SEC Rule 10b-5 prohibits acts or omissions that result in fraud or deceit in connection with purchase or sale of any security. It is a violation to make any untrue statement of a material fact or to omit to state a material fact in connection to the purchase or sale of a security. However, if the entity of concern is dealing with a classified project, there is a great swath of information that they cannot share with investors, material or not, and they can get a waiver to allow them to depart from accounting practices and legally "cook the books." Understanding what sort of information an entity can (and often must) conceal is nowhere near as useful as knowing any hidden material facts, but it nonetheless serves some purpose in the risk assessment of said securities.

A.2. Government Accounting Exemptions

Federal entities are also required to obfuscate classified information in their accounting practices, under new rules by FASAB. While investors don't exactly buy stock directly in the government (that's what taxes and campaign contributions are for), the money spent on different programs, or on the enforcement of regulations for different industries, can prove informative for an investor. If portions of the government's books are classified (and in some cases shifted around among federal entities), this can have an effect on an investor's analysis of investment prospects in virtually any field. In addition to this, investors are able to purchase government-backed securities, such as Treasury bonds, which have a more direct connection to the financial state of the federal government. If an investor can't see the actual underlying information, understanding the framework by which the information is hidden is the next best thing.

A.3. Government Investment in Varied Industries

While the federal term for "investment" doesn't quite mean the same thing as for private investors, a great deal of federal "investment" makes its way to the private sector.
https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/44974-federalinvestment.pdf For instance, federal R&D investment often comes in the form of grants to private entities, who can then tout that funding as part of a market prospectus. If you base your investment decision on the availability of government investment funds, then it is valuable to understand the underlying rules of classification and the resulting exemptions in the federal financial statements.

II. How Does Classification Work? The Quick and Dirty Summary

The how and why of classification is currently covered by Executive Order (EO) 13526, which we'll explain in this article. Basically, the classification of information is largely a purview of the executive branch. While the power to classify information is delegated down a chain of bureaucracy, it starts with the President, Vice President, and agency heads. Then, once the information is classified, it's a tangle of classification levels, standards, and restrictions, which determines everything from who can view the information to when its classification expires. However, none of that will be open to the public, so the closest an investor can get is by understanding how the system works, and where it touches their interests.

If you're interested in more information on classification, beyond this article, each agency with original classification authority prepares a classification guide. These guides are supposed to facilitate proper and uniform classification and should be reviewed and updated according to the executive order. While those guides themselves are often classified, the Office of the Director of National Intelligence approved the release of a 2014 version of their guide in a FOIA request.
https://www.dni.gov/files/documents/FOIA/DF-2015-00044%20(Doc1).pdf

A. What Is Executive Order 13526?

Over the history of the U.S., classification standards and rules have generally been an issue addressed via executive order. While there have been laws protecting classified information, such as the Espionage Act of 1917 and the Intelligence Identities Protection Act of 1982, today classified information is essentially entirely covered by a 2009 executive order issued by former President Barack Obama. Executive Order 13526 revoked and supplanted previous executive orders on the issue and modified the existing regulations codified in 32 C.F.R. 2001. Its rules, focused a bit more on the declassification process than its predecessors, provide the framework for modern classification in the U.S. The order, not surprisingly a bit on the byzantine side of things, covers who is authorized to classify information, when and how it can be classified, the various levels of classification, and when classified info ceases to be classified. There's an enormous amount of other regulatory issues here from various agencies and laws that impact this, but Executive Order 13526 (EO 13526, or "the Order", available at **https://www.archives.gov/isoo/policy-documents/cnsi-eo.html**) is certainly the best place to start when it comes to understanding classification.

B. Classification Authorities

The actual parties with original classification authority (unconditioned power to classify information) are: the President or Vice President in the performance of their official duties, agency heads and officials designated by the President in the Federal Register, and U.S. government officials delegated authority to do so (EO 13526 Section 1.3). This delegation and authorization likely represents the largest portion of people who are actually doing the classification on a day-to-day basis. However, there are limitations on this type of delegation.

It's generally the agency heads doing the delegation when it comes to classification authority. However, any delegation of classification authority has to be limited to the absolute minimum possible to execute the necessary duties. What's more, as soon as their need for this delegation of authority ends, the agency heads are required to revoke the authority grant.

There are different levels of classification available that have different effects (EO 13526 Section 1.2). We will discuss the actual differences in these classifications later in this article. However, not every grant of authority is created equal when it comes to these different types of classification. The "Top Secret" level of classification cannot be delegated at all and is restricted to the President, Vice President, and named agency heads. The "Secret" or "Confidential" level of classification can be done more broadly, even beyond the initial three groups discussed above. The authority can be delegated by a senior agency official who had previously had the authority delegated to them by their agency head. These delegations all have to be made in writing and identify the official delegating the delegee by name and position title. Delegating a certain level of authority also grants the delegee authority to classify information at all levels below their authority grant.

The original classification authorities (the President, Vice President, and agency heads) are required by EO 13526 to receive a certain amount of training. The training includes instruction on the proper safeguarding of classified information and of the criminal, civil, and administrative sanctions that may be brought against an individual who fails to protect classified information from unauthorized disclosure.

Despite these restrictions, there are provisions for exceptional cases where an employee, government contractor, licensee, certificate holder, or grantee of an agency produces information they believe to require classification and does not have the authority to implement that classification (EO 13526 Section 1.3(e)). In this case, they can treat the information as if it were classified and give it the same level of protection actual classified information would have. However, the information must be promptly sent to the agency officer or employee who could appropriately determine the classification status of the information. The agency then has 30 days to decide whether to classify the information; during this time the information is treated as classified. If the entity creating the information isn't sure which agency they should send the request to, they can send it up the ladder to the Director of the Information Security Oversight Office who will make a determination as to classification level and/or which agency should have jurisdiction over the subject matter. For instance, if a defense contractor or a financial institution is handling information they believe requires classification, like a new invention or money for intelligence operations, they can treat it as such and immediately notify the relevant agency, and that agency has 30 days to decide what to do.

C. Classification Standards, Categories, and Levels

In order to be classified at all, information needs to meet certain standards (EO 13526 Section 1.1). From there, it can be further separated into different levels of classification as discussed above. The base classification standards of EO 13526 require, before any bit of information can be classified: (1) somebody with authority sufficient to classify the information; (2) the information must be owned by, produced by or for, or is under the control of the U.S. (a moderately complicated topic we will not be going into great depth on here for interests of length); (3) the information falls within one of the approved classification categories—something we will get into below; and (4) a person of sufficient authority determines that "unauthorized disclosure of the information reasonably could be expected to result in damage to the national security, which includes defense against transnational terrorism, and the original classification authority is able to identify or describe the damage."

The first of the elements, sufficient authority, is discussed above. The second obviously covers any information produced by the government itself or its agencies. It also covers, among other things, information created by government contractors—including many financial institutions—to a large extent. However, as mentioned, the exact breadth of what this element encompasses is a source of some debate. This debate is somewhat stymied by the fact that courts take a general position where they do not question whether something has been properly made classified, providing great deference to the government on this issue. (See "Challenging classification: a third option," by Stephen Aftergood, available at **https://www.rcfp.org/journals/news-media-and-law-fall-2015/challenging-classification-th/**).

The third element, proper classification categories, is much easier to explain as they are more or less explicitly described in EO 13526. In order to qualify for classification, information must address one of the following categories: (1) military plans, weapons systems, or operations; (2) foreign government information; (3) intelligence activities (including special activities), intelligence sources or methods, or cryptology; (4) foreign relations or foreign activities of the United States, including confidential sources; (5) scientific, technological, or economic matters relating to the national security, which includes defense against transnational terrorism; (6) United States Government programs for safeguarding nuclear materials or facilities; (7) vulnerabilities or capabilities of systems, installations, infrastructures, projects, plans, or protection services relating to the national security, which includes defense against transnational terrorism; or (8) weapons of mass destruction. These fairly specific categories, taken together, cover an enormous amount of information. However, these kinds of restrictions are crucially important to limiting a tool as potentially damaging to government transparency as classification.

The final element, damage to national security, is not one that's often questioned in the courts due to the deference shown. Some things, like unauthorized disclosure of foreign government information, are presumed to damage national security. However, it's a fully factual analysis, and the classification's justification is usually not something that can itself be revealed. That being said, the level of damage that can potentially be caused by disclosure of the information is the key to the different classification of information.

There are three levels of classification, addressed to some degree above (EO 13526 Section 1.2). First, "Top Secret" information must be reasonably expected to cause articulable grave damage to the national security were it disclosed. "Secret" classified information has a similar standard but must only cause "serious" damage. "Confidential" information must only be reasonably expected to cause damage to national security—full stop. The actual distinctions here are incredibly vague on their face. From a scholarly standpoint, there are some instructional guidelines as to what qualifies for each level. For instance, "grave damage" includes but is not limited to information where disclosure could cause "armed hostilities against the United States or its allies; disruption of foreign relations vitally affecting the national security; the compromise of vital defense plans or complex cryptologic and communications intelligence systems; the revelation of sensitive intelligence operations; and the disclosure of scientific or technical developments vital to national security" (EO 111652, Section 1(A)). However, on a practical level, it is hard to clearly delineate what goes where as the courts generally presume information to be properly classified. This means there's very little in the way of practical examples to go off of.

C.1. Brief Summary of Derivative Classification

There is one more form of classification that is fairly commonly used—derivative classification (EO 13526 Section 2.1-2.2). This is the classification information generally created using already classified information—incorporating it into something else, paraphrasing or restating it, etc. It doesn't include duplication or reproduction of classified information as that's automatically considered classified at the same level as the origin information.

Derivative classification is unique in that it does not require the person classifying it to have classification authority. Basically, it's assumed that it is proper that such information should be classified at the same level as the source information. What's more, all derivatives of already derivative information also carry forward the classification level of the highest classification level contained within the product.

D. Restrictions on Classification and Corner Cases

Under EO 13526, not all information is appropriate for classification. Obviously the majority of policing of this would be internal, but there are many enumerated situations in which information cannot be classified. Information cannot be made classified to: "(1) conceal violations of law, inefficiency, or administrative error; (2) prevent embarrassment to a person, organization, or agency; (3) restrain competition; or (4) prevent or delay the release of information that does not require protection in the interest of the national security" (EO 13526 Section 1.7). In other words, confidentiality is not supposed to be used as a tool for a cover-up, to gain economic advantage, or really for any purpose other than protecting national security. Scientific research is an especially questionable subject when it comes to classification and needs to be clearly related to national security before it can qualify.

Once something has initially been declassified, a topic we will discuss below, it can be reclassified, but there are some limitations that wouldn't apply when it first received classified status. First, there needs to be a reclassification action commenced by an agency head who determines, in writing, that national security requires reclassification. After that, it must be determined that the information can be reasonably recovered, and there must be a report to the Director of the Information Security Oversight Office. This is also the process used to classify or reclassify information in response to a Freedom of Information Act (FOIA) request or a request under the Privacy Act of 1974. However, in order to limit the potential for abuse of the classification system in the face of a FOIA request or other similar request, classification or reclassification determinations where there is already a request for the information must be considered on a document-by-document basis with the personal participation—or at a minimum under the direction of—an agency head, deputy agency head, or senior agency official.

There is also a bit of an odd situation for classification when it comes to large compilations of information where only part of it could reasonably be classified. This is because sometimes the holes in information within such compilations can say nearly as much as the actual information. In these scenarios, the government is allowed to classify the entire compilation if the information revealed by what is excluded would independently meet the requirements of classification discussed above (EO 13526 Section 1.7(e)).

E. Duration

EO 13526 also implements requirements on the duration of applied classification (EO 13526 Section 1.5). In general, it is up to the original classification authority to determine when something is declassified, subject to certain restrictions in the order. There is a maximum classification duration of 10 years, or 25 years for particularly sensitive information. If the authority does set a date, the information is automatically declassified on that date. If the agency declines to pick a specific date, the information is presumed to declassify 10 years from the date of the original decision, unless the agency determines the information's sensitivity is such that it merits a 25-year duration. Authorities can extend the duration of classification by following the procedures of this order (in essence, starting from scratch to show the information should still be classified). Information that was previously marked for some form of an indefinite duration of classification under previous executive orders also needs to comply with these rules on duration.

F. Declassification

Once the duration on classification has expired, or an authority otherwise feels information shouldn't be classified, the order lays out rules on how to go about declassifying information. There are three main categories of declassification: Automatic Declassification, Systematic Review, and Mandatory Review (EO 13526 Part 3).

F.1. Authority to Declassify

First, the original authority that classified the information, or their successor, can authorize declassification (EO 13526 Section 3.1). This authority can also be delegated, or exercised by a supervisory authority. Second, the Director of National Intelligence (DNI) always has authority over information or intelligence relating to intelligence sources, methods, or activities. The agency head or the senior agency official can also determine if and when a piece of information that still meets classification requirements nonetheless should be declassified in the public's interest.

Additionally, one of the core developments of this new executive order was the creation of a National Declassification Center in the National Archives (EO 13526 Section 3.7). Its purpose is "to streamline declassification processes, facilitate quality-assurance measures, and implement standardized training regarding the declassification of records determined to have permanent historical value." Their purview extends to storing records, dealing with historical records, interagency declassification, and developing measures and guidelines for dealing with classified information. As a result, they enjoy broad authority over declassification efforts.

F.2. Automatic Declassification

Records over 25 years old that have permanent historical value under title 44 of the U.S. Code (USC) were automatically declassified without review in 2006. This process is set to repeat every December 31st, subject to a few exceptions (EO 13526 Section 3.3).

For instance, an agency head may exempt information from automatic declassification if it would reveal a confidential source, assist in the development of a WMD, impair U.S. cryptologic systems or activities, impair state-of-the-art weapons systems, reveal actual war plans that remain in effect, reveal information that would seriously and demonstrably impair relations between the U.S. and a foreign government, impair the protection of the President and Vice President, impair national security or reveal vulnerabilities, or violate any other statute, treaty, or international agreement. If an agency head wants to authorize such an exemption, they must notify the President, who may direct that agency head to not exempt the file, or declassify it at an earlier date. Information exempted from automatic declassification is still subject to mandatory and systematic declassification review.

There are also a few situations where the 25-year deadline is extended. Files in an integral file block are declassified as a block, dependent on the most recent record in that block. A delay of 5 years can be applied to classified information contained in microforms, motion pictures, audiotapes, videotapes, or comparable media that make a review for possible declassification exemptions more difficult or costly. A delay of 3 years may be applied to files that were transferred from another agency, or if it is discovered that files were inadvertently passed over for review.

F.3. Declassification by Review

Agencies also have to establish their own programs for mandatory and systematic declassification review, for records exempted from automatic declassification, to ensure information that no longer meets the order's requirements is declassified (EO 13526 Sections 3.4-3.6). Additionally, the National Declassification Center conducts its own review program for records in their custody (EO 13526 Section 3.7). The Secretary of Defense may establish procedures regarding cryptologic information, and the Director of Central Intelligence may do so for information pertaining to intelligence activities.

For systematic programs, records of interest to researchers, or likely to be declassified, should be prioritized in such programs (EO 13526 Section 3.4). For mandatory review programs, information is subject to review if there is a request with sufficient specificity for the agency to locate the information with a reasonable amount of effort, that information has not been subject to such a request in the last 2 years, and that information is not otherwise exempt (like information originating from the incumbent President or Vice President) (EO 13526 Section 3.5-3.6). A mandatory review request can be made by a member of the public, but the specificity requirements limit the success of such actions. (See "Challenging classification: a third option," by Stephen Aftergood, available at **https://www.rcfp.org/journals/news-media-and-law-fall-2015/challenging-classification-th/** very interesting surface-level analysis of the declassification options available to the public.) Decisions on declassification can be appealed by the requestor or the classifying agency.

G. Access and Distribution

Obviously, the primary purpose of classification is to prevent access to, or distribution of, information that is classified. With that in mind, it should come as little surprise that a great deal of EO 13526 is dedicated to the limited circumstances in which somebody can access classified information (EO 13526 Part 4).

In order to be allowed access to classified information, a person must be OK'd for access by an agency head or their designee, sign a non-disclosure agreement, and have a demonstrable need to know the information (EO 13526 Section 4.1). Once you meet these criteria, you still are required to receive some level of training on how to safeguard the secrecy of the classified information. What's more, you're still not allowed to take the classified information anywhere beyond the control of the originating agency. You can't even take it off the premises where it's located without authorization from a suitable agency official. The agencies themselves are required to go to great lengths to ensure they implement policies to maintain these rules and limit access to classified information. The information can't even travel beyond the agency it originates in without following a series of procedures.

So, lo and behold, the most secretive information in the country has rules to keep it secret. Access and distribution are limited to need-to-know and emergencies where there is an imminent threat to life or the country. Even then, agencies are required to reveal the absolute minimum necessary, and the information disclosed in this way is not considered declassified after the fact.

There are a few special access programs that can break these usual rules (EO 13526 Section 4.3). The Secretaries of State, Defense, and Energy, and the Director of Central Intelligence, or the principal deputy of each, may create a special access program as necessary as long as they are kept to an absolute minimum. These special access programs can only be made pursuant to a statute or where there is an exceptional vulnerability or threat and the normal way of determining who can access the information won't work. The programs must be kept as small as possible.

Surprisingly, there are also some exceptions for historical research (EO 13526 Section 4.4). The EO allows for the usual need-to-know rules to be waived to some degree when a person is conducting historical research. Similar exceptions are provided to past Presidents and Vice Presidents, as well as those previously occupying certain policy-making positions where they were appointed by a President.

Specific waivers to access rules can be granted by the head of the agency where the classified information originated if they do so in writing and take additional steps to make sure the information is safeguarded consistent with the rules of the EO (EO 13526 Section 4.3).

H. Challenging Classification and Requesting Declassification of Information

What happens if you want to challenge the classification status of information? Let's say you made a FOIA request and are told the information is classified and get nothing for your efforts, or perhaps you are barred from viewing financials of a government contractor and think they are improperly classified. Well, the unfortunate news is that you're usually going to be out of luck, but there are some ways to challenge the appropriateness of the classification status of information and to request that it be declassified and made available to the public. However, those challenges are primarily available to those who already have access to the information and are authorized holders of the information (See EO 13526 Section 1.8). The primary methods for a private citizen to challenge classification are the MDR process discussed above or through the Freedom of Information Act; both require fairly specific knowledge of the classified information.

This is a frustrating state of affairs to many in the public, but it makes at least some sense in that there's no way to know whether something is properly classified without knowing what the information is in the first place. Under the EO, authorized holders of information are expected to challenge classification on their own initiative where they believe something should either not have been classified in the first place or is due for declassification. (See id.) How often does that happen? It's classified.

However, there are genuine protections for those in government who would ensure maximum government transparency by making sure the tool of classification is used appropriately. They are ostensibly protected from retaliation by the language of the EO. What's more, the EO requires that these concerns be addressed by an actual impartial panel. The classification then undergoes an internal review and even an internal appeals process through the Interagency Security Classification Appeals Panel.

To the public, challenging classification is mostly out of reach beyond the very narrow scope of the mandatory declassification proceedings discussed above. As mentioned above, the Courts give great deference to classification and generally consider it improper to consider whether information should classified in a court setting. (See "Challenging classification: a third option," Stephen Aftergood).

There are some rules on how classified information is handled in criminal cases, mostly outlined in the Classified Information Procedures Act, but even then, those rules are mostly focused on maintaining the secrecy of the information. (See Synopsis of Classified Information Procedures Act, available at **https://www.justice.gov/jm/criminal-resource-manual-2054-synopsis-classified-information-procedures-act-cipa**).

III. Classification and Government Accounting, a Summary of Federal Accounting Exemptions for Classified Information

Once a piece of information has been classified, it can have a snowball effect on every government agency even tangentially involved with it. For instance, federal government entities have quite a few situations where they can, and often are required to, omit or alter their financial statements to protect classified information. The Federal Accounting Standards Advisory Board (FASAB) created an accounting standard for this purpose: Statement of Federal Financial Accounting Standards 56 ("SFFAS 56" or "Standard 56"). SFFAS 56 allows federal agencies, and an enormous number of entities associated with the government, to alter and outright omit spending information where it is necessary to protect classified information. For a more detailed explanation of SFFAS 56, you can read *FASAB Statement 56: Understanding New Government Financial Accounting Loopholes*, available at **https://constitution.solari.com/fasab-statement-56-understanding-new-government-financial-accounting-loopholes/**.

A. Covered Entities

The actual reporting entities empowered by the standards of SFFAS 56 include organizations that are included in the government-wide General Purpose Federal Financial Report (GPFFR). This includes any entities that are (1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits. These entities, and the entities that fall under their purview, are separated into several categories: component reporting entities, consolidated entities, and disclosure entities.

Component reporting entities are the various entities that both prepare their own GPFFR, and are within a larger reporting entity. This includes executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Their GPFFRs are then consolidated into the government-wide GPFFR. Under the component reporting entities and included in their GPFFRs are various other organizations, from smaller departments to government contractors, which are split into two further categories: disclosure entities and consolidation entities.

Consolidation entities are entities like agencies and departments, and are reported by a larger entity as part and parcel of their financial reporting, as if they were one economic entity. Generally, a consolidation entity (1) is financed through taxes and other non-exchange revenues, (2) is governed by the Congress and/or the President, (3) imposes or may impose risks and rewards to the federal government, and (4) provides goods and services on a non-market basis. For instance, a department or corporation established by Congress to perform a government function is a classic example of a consolidation entity.

Disclosure entities, on the other hand, are financially independent organizations. These organizations still need to be included in the government-wide GPFFR but do not fully meet the four characteristics of consolidated entities. They include quasi-governmental entities, organizations in receiverships and conservatorships, and organizations owned or controlled through federal government intervention actions. A good example would be government-established non-profits that have a significant portion of their board appointed by the President but are entirely funded by their own activities.

However, despite all appearances, the Federal Reserve System and bailout entities are expressly excluded from the government-wide GPFFR. In particular, this includes entities like Freddie Mac and Fannie Mae. If the government obtains rights in another entity that would give them the sort of control that normally makes a disclosure entity, but it gains those rights when it guarantees or pays a debt, those rights don't count for determining a reporting entity.

B. Reporting Exceptions

In general, disclosure entities are required to provide their financial reporting in a manner which is clear, concise, meaningful, and transparent. There are, however, a few new exceptions.

The first exception allows disclosure entities to modify their financial reports to prevent the disclosure of classified information in an unclassified GPFFR so long as these modifications do not change the net results of operations and net position.

This means that, when done to conceal confidential information, entities can, and are essentially required to, shift money from one line item to another so long as the totals stay consistent. The rule also allows entities to omit the line item entirely while retaining the amounts so as to maintain the same net results. This means that readers of these reports will never know if the amounts reported spent on specific projects or things are an accurate representation. Further, given the rationale of this being a national security precaution, there will not be any narrative in these reports explaining or revealing where a modification has taken place. If they can maintain net position in their reports, an entity can even omit a project entirely by folding it into another department or project within the same entity.

The second exception to reporting requirements of Standard 56 allows the reporting entity which the consolidation entity is consolidated with to modify reports to avoid disclosure of confidential information even if that modification changes net results of operations or net position. The reporting entity can move the financials of the consolidation entity or even choose not to include them in its report; full stop.

The final exception to accounting standards within Standard 56 doesn't do much at the moment but has the greatest potential to undermine financial transparency in the future. It allows FASAB to issue Interpretations of Standard 56 in the future, which would allow other modifications to financial reports for the purpose of avoiding disclosure of classified information. FASAB can, and likely will, release these Interpretations over time. These Interpretations can allow modifications to reporting without regard for maintaining an entity's net results or net position in their reporting. Those Interpretations may even be classified themselves, resulting in a portion of the federal government's accountability standards being concealed from the public.

IV. Classification and Private Entities, a Summary of Classification Exemptions for Private Entities

As a threshold matter, any documents filed with the SEC are subject to a general national security exemption under 17 CFR 240.0-6, which requires that no ". . . document filed with the Commission or any securities exchange shall contain any document or information which . . . has been classified." However, the SEC still requires the filing of "a statement from an appropriate department or agency of the United States to the effect that such document or information has been classified or that the status thereof is awaiting determination." This statement must be in writing and must be obtained prior to reporting (or in lieu of reporting) any classified information to the SEC.

Second, certain internal accounting and external reporting requirements can be waived for private entities by the Director of National Intelligence. Normally, issuers of securities need to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer" and maintain internal accounting according to generally accepted accounting principles (GAAP) (see 15 USC 78m(b)(2)). Failing to do so can result in criminal liability. A waiver from the Director of National Intelligence (DNI) can remove some of those requirements, allowing private entities to deviate from GAAP and even alter their books if the waiver allows.

The waiver can be issued to:

> *". . . any person acting in cooperation with the head of any Federal department or agency responsible for such [classified] matters if such act in cooperation with such head of a department or agency was*

> *done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance."* (15 U.S. Code § 78m(b)(3)(A), available at **https://www.law.cornell.edu/uscode/text/15/78m**)

The use of this particular exemption was always allowed by statute, but the power was delegated to the DNI in an obtusely named presidential memo by President G.W. Bush to the Director of National Intelligence, "Memorandum on Assignment of Function Relating to Granting of Authority for Issuance of Certain Directives," stating:

> *"I hereby assign to you [the Director of National Intelligence] the function of the President under . . . [15 U.S.C. 78m(b)(3)(A)]. In performing such function, you should consult the heads of departments and agencies, as appropriate."* (Memorandum for the Director of National Intelligence (May 5, 2006, available at **https://www.gpo.gov/fdsys/pkg/FR-2006-05-12/html/06-4538.htm**).

Presidential memos have no legal requirements in order to be used. They simply direct an agency to act in a certain manner. This particular memo granted the required "Presidential authority" of section 78m(b)(3)(A) to the Director of National Intelligence, enabling the Director to exempt private contractors from SEC reporting requirements.

V. How Does Classification Impact You as an Investor?

As we've discussed, information is key to making prudent investment decisions, and securities regulation is focused on ensuring investors get that information. On the other hand, the laws surrounding classified information are the exact opposite, and are concerned with ensuring some information sees the light of day just in time to graduate from college and get a law degree.

If that information only mattered to the government and potential enemies, that wouldn't be a problem. However, the federal government is deeply entangled with the private sector, especially when it comes to private military and intelligence contractors, and various government grants. Even more, the government itself issues securities, like Treasury bonds, whose value is dependent in some part on the government's own finances (which are now classified).

There is obviously a push and pull between transparency and security. Classification isn't just a tool of obfuscation; it has genuine value in protecting the interests of the country. Classified information is virtually essential to operating the U.S. government. However, it still creates a closed system where the existing oversight is also classified and is almost completely opaque to an outside observer or investor. There is no independent auditor outside the classification system to ensure that all use of classification is compliant with the executive order. This lack of information is an issue when analyzing an investment with some relationship to classified information—just like it would be for any other security. Especially when dealing with government contractors, it's important to understand what information will be available to you and what material information cannot be relied on in making an informed decision in moving forward on your investments. The rule here is the rule for all investment: be informed, determine what sources you can trust, and then weigh your risks.

February 10, 2019

Endnotes

1. Financial institutions are considered federal contractors for legal purposes if they: (1) are FDIC insured or insured by the National Credit Union Association; (2) serve as a federal fund depository; or (3) hold a federal contract exceeding $10,000.

Chapter V. The Missing Money Chronology

"Tempus Fugit (Time flies)" ~ Virgil

DATE	EVENT	CATEGORY
19340131	Gold Reserve Act creates the Exchange Stabilization Fund (ESF). "The fund began operations as of April 27, 1934, financed by $2 billion of the $2.8 billion paper profit that the government realized from devaluation, that is, from raising the price of gold to $35 an ounce from $20.67. This sum was deposited to its account with the Treasurer of the United States (Treasury AR 1935, Exhibit 40, p. 265). The fund was authorized to deal in gold and foreign exchange in order to stabilize the exchange value of the dollar, to invest any portion of the fund not currently required for stabilization purposes in direct obligations of the United States." [Source: Anna J. Schwartz, "From Obscurity to Notoriety: A Biography of the Exchange Stabilization Fund."] The ESF is excluded from the Congressional appropriations process and Treasury is not required to justify its expenditures or investments to Congress.	law
19410000	The War Powers Act authorizes the U.S. Treasury's Exchange Stabilization Fund to serve as a holding pool for captured Nazi valuables—currency, gold, precious metals, and even stocks and bonds—seized as the Germans or other Axis governments attempt to smuggle them out of Europe.	law
19470000	The U.S. National Security Act of 1947 approves the "black budget." This legislation also creates the Central Intelligence Agency and the National Security Council.	law
19490527	CIA Act passes into law. permitting the Central Intelligence Agency to use confidential fiscal and administrative procedures and exempting it from many of the usual limitations on the use of federal funds. The Act (Section 6) also exempts the CIA from having to disclose its "organization, functions, officials, titles, salaries or numbers of personnel employed." It also creates a program called PL-110 to handle defectors and other "essential aliens" outside normal immigration procedures, as well as give those persons cover stories and economic support.	law
19620213	The Federal Open Market Committee (FOMC) authorizes open market transactions in foreign	Event law

	currencies for the account of the Federal Reserve System. Before this, the Federal Reserve Bank of New York served as the agent only of the ESF in executing its limited foreign currency transactions. Since that date, it has served both the ESF and the Federal Reserve System.	
19680524	The Securities and Exchange Commission (SEC) promulgates Rule 240.0-6 shielding classified information and documents from disclosure requirements under federal securities laws and providing for the disclosure of such information privately to the SEC: “Any requirement to the contrary notwithstanding, no registration statement, report, proxy statement or other document filed with the Commission or any securities exchange shall contain any document or information which, pursuant to Executive order, has been classified by an appropriate department or agency of the United States for protection in the interests of national defense or foreign policy.”	law
19700000	An amendment to the Gold Reserve Act of 1934 allows the Secretary of the Treasury, with authorization of the President, to use ESF funds to “deal in gold, foreign exchange, and other instruments of credit and securities.”	law
19720000	The Financial Accounting Foundation (FAF) is organized as a non-stock Delaware corporation with the goal of ensuring objectivity and integrity in financial reporting standards. The foundation is responsible for: Establishing and improving financial accounting and reporting standards; Educating constituents about those standards; Overseeing the administration, and finances of its standard-setting Boards, the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB), and their advisory councils; Selecting the members of the standard-setting boards and advisory councils; and Protecting the independence and integrity of the standard-setting process. The FAF is funded from the accounting support fees paid by public-company issuers of securities, subscription and publication revenues, and investment income. It oversees the FASB and GASB and selects their members. The Board of Trustees of the FAF is selected by a nomination process that involves several organizations from investing, accounting, business, financial, and governmental sectors, but new members are ultimately selected by the existing Board. The selection process was amended in 2008 to reduce private sector influence on the Board of Trustees and its oversight of the FASB and GASB. [Source: Wikipedia]	Corporate law
19730701	Formation of the Financial Accounting Standards Board (FASB), the independent, private-sector non-profit standards- setting organization the primary purpose of which is to establish and improve Generally Accepted Accounting Principles (GAAP) within the United States in the public's interest. The Securities and Exchange Commission (SEC) designates the FASB as the organization responsible for setting accounting standards for public companies in the U.S. The FASB replaces the American Institute of Certified Public Accountants' (AICPA) Accounting Principles Board (APB). The FASB is funded by the Financial Accounting Foundation, which also oversees its operations. The FASB was conceived as a full-time body to ensure that Board member deliberations encourage broad participation, objectively consider all stakeholder views, and are not influenced or directed by political/private interests. [Source: Wikipedia]	Corporate law
19731220	The SEC, in Accounting Series Release No. 150 (ASR 150), states that FASB pronouncements will be considered by the SEC as having “substantial authoritative support.” In that release, the Commission reaffirms an earlier policy statement contained in Accounting Series Release No. 42 (ASR 4) that financial statements, prepared in accordance with accounting principles for which there is no substantial authoritative support, will be presumed misleading, and that footnotes or other disclosures will not avoid this presumption.	law
19780000	An amendment to the Gold Reserve Act (31 U.S.C.§ 5302 (c) (1)) provides for a monthly statement to the House and Senate Banking Committees by the Treasury "on all agreements made or renewed, all transactions occurring during the month, and all projected liabilities" of the ESF, but the status of the decisions of the Secretary of Treasury as final remains in place. A later amendment provides that Congress, in addition to the President, receives reports on ESF operations. [Source: Schwartz]	Law Treasury
19810000	President Reagan issues Executive Order 12333 to allow the outsourcing of classified projects to private contractors. The order states: “Agencies within the Intelligence Community are authorized to enter into contracts or arrangements for the provision of goods or services with private companies or institutions in the United States and need not reveal the sponsorship of such contracts or arrangements for authorized intelligence purposes. Contracts or arrangements with academic institutions may be undertaken only with the consent of appropriate officials of the institution.” (Section 2.7)	law

19811204	Issuance of Executive Order 12333, “United States Intelligence Activities” by President Ronald Reagan, which, among other things, prohibits GAO from auditing classified activities.	law
19820402	Issuance of Executive Order 12356, “National Security Information,” containing U.S. classification policy. Information is considered classified if it concerns: (1) Military plans, weapons, or operations; (2) The vulnerabilities or capabilities of systems, installations, projects, or plans relating to the national security; (3) Foreign government information; (4) Intelligence activities (including special activities) or intelligence sources or methods; (5) Foreign relations or foreign activities of the United States; (6) Scientific, technological, or economic matters relating to the national security; (7) United States Government programs for safeguarding nuclear materials or facilities; (8) Cryptology; (9) A confidential source; or (10) Other categories of information that are related to the national security and that require protection against unauthorized disclosure as determined by the President or by agency heads or other officials who have been delegated original classification authority by the President. Any determination made under this subsection shall be reported promptly to the Director of the Information Security Oversight Office.	law
19820908	The Federal Managers’ Financial Integrity Act (FMFIA) amends the Accounting and Auditing Act of 1950 to require ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency. It requires agencies to establish internal control and financial systems that provide reasonable assurance of achieving the three objectives of internal control, which are: Effectiveness and efficiency of operations; Compliance with regulations and applicable laws; and Reliability of financial reporting. In addition to requiring federal agencies to establish internal control over their programs, financial reporting, and financial management systems, the FMFIA requires the agency head to provide an annual Statement of Assurance on whether the agency has met these requirements.	HUD
19840000	The Government Accounting Standards Board (GASB), an independent, non-political organization formed for the purpose of performing functions like the FASB for state and local governments, establishes rules that require state and local governments to report clear, consistent, and transparent financial information to their constituents. The GASB is one component of a non-profit standard-setting group that is autonomous of any corporate or government body. This group includes the Financial Accounting Foundation (FAF), the Financial Accounting Standards Board (FASB), the Financial Accounting Standards Advisory Council (FASAC), and the Governmental Accounting Standards Advisory Council (GASAC). GASB standards are recognized by governments and the accounting profession as the official source of U.S. Generally Accepted Accounting Principles (U.S. GAAP) for state and local governments.	Event Law
19860000	The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) begins, lasting until 1993.	law
19861028	The Government Securities Act of 1986 authorizes the Secretary of the Treasury to regulate brokers and dealers of government securities in conjunction with the SEC.	Treasury
19820908	Enactment of the Federal Managers’ Financial Integrity Act, requiring agencies to establish internal control and financial systems that provide reasonable assurance that the three objectives of internal control are achieved: Effectiveness and efficiency of operations; Compliance with regulations and applicable laws; and Reliability of financial reporting.	law
19880106	A series of unsuccessful federal efforts to assist the Farm Credit System eventually leads to the enactment of the Agriculture Credit Act (P.L. 100-233) on this date. This act provides federal financial assistance to prevent the Farm Credit System from defaulting on its debt.	law
19901115	The Federal Credit Reform Act of 1990 requires Federal agencies to set aside the subsidy cost of new credit assistance provided in the form of direct loans or loan guarantees. The subsidy cost will be the estimated long-term cost to the government of the loan or loan guarantee. The subsidy	law

	cost associated with each direct loan or loan guarantee, which the Administrator must set aside, may be funded by Federal appropriations, direct payment of a credit risk premium by the applicant, or a non-Federal infrastructure partner on behalf of the Applicant, or any combination thereof.	
19901115	President George H.W. Bush signs the Chief Financial Officers (CFO) Act into law. According to the Government Accountability Office (GAO), this is the most comprehensive and far-reaching financial management improvement legislation since the passage of the Budget and Accounting Procedures Act of 1950. The CFO Act lays a foundation for comprehensive reform of federal financial management, establishing a leadership structure, providing for long-range planning, requiring audited financial statements, and strengthening accountability reporting.	law
19901126	Adoption of Federal Credit Reform Act of 1990.	law
19930120	Lloyd Bentsen becomes Secretary of the Treasury and serves until September, 1994.	Treasury
19930808	Enactment of Government Performance and Results Act (GPRA)—one of a series of laws designed to improve government performance management. The GPRA requires agencies to engage in performance management tasks such as setting goals, measuring results, and reporting their progress. To comply with the GPRA, agencies produce strategic and performance plans and conduct gap analyses of projects. The GPRA establishes project and strategic planning and sets up a reporting framework for agencies to show the progress they make toward achieving their goals. [Source: Wikipedia]	law
19940900	Sir James Goldsmith is interviewed by Charlie Rose. Goldsmith lobbies Congress not to pass the latest round of GATT or create the World Trade Organization (WTO).	media
19941013	Government Management Reform Act (GMRA) enacted. The CFO Act of 1990 mandated the preparation of audited annual financial statements for certain funds and accounts from a number of executive branch agencies, with 10 agencies selected to provide audited annual financial statements for all agency accounts. In the GMRA, the latter provision expands to every agency covered under the CFO Act (commonly referred to as "CFO agencies") and later to every executive agency in the Accountability of Tax Dollars Act of 2002. GMRA requires the Secretary of the Treasury to provide government-wide annual consolidated financial statements to be audited by the GAO. [Source: GAO]	law
19950100	The U.S. Treasury loans Mexico $12 billion from the ESF as part of a rescue package. What makes the loan notorious is that it does not require Congressional authorization but is made at the discretion of the Secretary of the Treasury, with the approval of the President.	Treasury
19950101	Creation of the World Trade Organization (WTO), replacing GATT (although GATT still exists as a treaty within WTO).	event
19950111	Robert E. Rubin becomes Secretary of the Treasury and serves until July 2, 1999.	Treasury
19950129	*The Washington Post* pulls from publication “The Crimes of Mena” by Sally Denton and Roger Morris. The article illuminates the arms trafficking operation run by Barry Seal at the Intermountain Regional Airport at Mena, Arkansas, while Clinton was governor and George H.W. Bush was Vice President and in charge of the National Security Council (NSC) run by Oliver North during Iran-Contra. Seal, who was assassinated in Feb. 1986, was carrying a personal phone book that included George H.W. Bush’s private phone number. Allegations are supported by IRS Agent Bill Duncan, Arkansas State Policy Investigator Russell Welch, and numerous documents, witnesses, and investigations. Duncan testifies before Congress that the IRS “withdrew support for the operations" (i.e., his investigations) and directed him to withhold information from Congress and perjure himself. Daniel Hopsicker is later to report in “Barry and the Boys” that Seal's operation at Mena grosses as much as $5 billion. The article is later published in *Penthouse*—reporting that western Arkansas had been a center of international drug smuggling during the 1980s and the headquarters of perhaps the biggest drug smuggling operation in history.	Media, enforcement
19950419	Oklahoma City bombing takes place, destroying HUD loan files for Region 6 (Arkansas and Texas included).	event, HUD
19960200	Treasury Department announces that it is suspending payment of interest on government securities in the Exchange Stabilization Fund’s portfolio in order to create additional borrowing	Treasury

	power for the government under the debt ceiling that Congress is refusing to raise. This action, together with the use of the Fund for the Mexican rescue, brings the Fund to public notice after it had remained so long in obscurity. [Source: Anna Schwartz]	
19960606	The “Dark Alliance” series by Gary Webb starts running in the *San Jose Mercury News*, exposing the role of the CIA in cocaine trade through Mena, Arkansas into South Central Los Angeles. The Hamilton Securities Community Wizard geocoded software program includes maps showing a high concentration of HUD mortgage defaults in South Central LA.	Media, enforcement
19960930	The Federal Financial Management Improvement Act (FFMIA) builds on the CFO Act by emphasizing the need for agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions and ensure accountability on an ongoing basis. FFMIA requires the 24 major departments and agencies covered by the CFO Act to implement and maintain financial management systems that comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the U.S. Standard General Ledger (SGL) at the transaction level. FFMIA also requires auditors to report in their CFO Act financial statement audit reports whether the agencies’ financial management systems comply with FFMIA’s requirements. [Source: GAO]	law
19961019	Enactment of Government Accountability Act of 1996.	law
19961105	Re-election of Bill Clinton.	event
19970000	William J. Clinton Foundation is founded. The Clinton Foundation (founded as the William J. Clinton Foundation and, from 2013 to 2015, briefly renamed the Bill, Hillary & Chelsea Clinton Foundation) is a non-profit organization under section 501(c)(3) of the U.S. tax code. Former President of the United States Bill Clinton establishes the foundation with the stated mission to "strengthen the capacity of people in the United States and throughout the world to meet the challenges of global interdependence.” [Source: Wikipedia]	event
19970000	An amendment to the Gold Reserve Act (31 U.S.C.§ 5302(b)) provides that an ESF loan or credit to a foreign entity or government for more than six months in any twelve-month period requires the President to give Congress "a written statement that unique or emergency circumstances require the loan or credit for more than six months." [Source: Schwartz]	Law
19970400	Hamilton Securities Group holds an Advisory Board meeting at Safeguard Scientific. While there, President (Bill Crist) of the CalPERS pension fund—the largest in the country—says, “You don’t understand. It’s too late. They have given up on the country. They are moving all the money out in the fall [of 1997]. They are moving it to Asia.” He does not say who “they” are but indicates that it is urgent that Catherine Austin Fitts see Nick Brady (Chairman of Dillon Read, where Catherine was a partner, and Secretary of Treasury under Reagan and George H.W. Bush and her former supervisor at Dillon Read), as Hamilton Security Group’s data indicating that there is hope for the country might make a difference. (Catherine Austin Fitts thought at the time that he meant that the pension funds and other institutional investors would be shifting a much higher portion of their investment portfolios to emerging markets.)	Event, Hamilton
19971014	Hamilton Securities receives letters from HUD (1) canceling, (2) seizing funds owed to Hamilton for work performed, and (3) demanding the return of all HUD portfolio data. Although HUD’s letter states that the contract cancellation is “for convenience of the government,” newspaper accounts relate it to bid issues. Hamilton had reported to HUD in 1996 that the AT&T/Bell Labs error had been addressed by the appropriate HUD staff and dismissed as not material. There are intimations that Hamilton proprietary software programs like Community Wizard belong to HUD and that HUD should receive a free copy. All work, including Community Wizard and community databanks, comes to a halt; all efforts to encourage Congress to pass requirements for place-based disclosure stop. Shortly thereafter, Nicolas Retsinas (FHA Commissioner) falsely alleges to the press that Hamilton is under criminal investigation.	Hamilton
19980121	Stories on Monica Lewinsky proliferate in the general news. *The Washington Post* "postpones" its front-page investigative story about Hamilton Securities, which never runs.	media
19980308	Judge Stanley Sporkin approves seizure of the Hamilton Securities offices by the Department of Justice.	Hamilton
19980309	Counsel for Inspector General of HUD, Judith Hetherton, attempts to obstruct justice by throwing Hamilton’s paper copies of its accounting records into the building trash bin.	Hamilton

19980309	Hamilton files suit against HUD in Court of Federal Claims in an effort to recover amounts withheld for services rendered under its HUD contract represented by Claude Goddard. [Hamilton Securities Advisory Services, Inc. v. The United States (98-CV-169), U.S. District Court, United States Court of Federal Claims, Judge Marion Blank Horn] **Hamilton Sec Advisory Serv Inc. v. the US**	Hamilton
19980422	Hamilton files an affidavit in the pending case before Judge Sporkin, signed by Hamilton's building property manager, stating that Judith Hetherton had moved paper copies of Hamilton's accounting records into the building trash and taken photographs of it with her camera.	Hamilton, enforcement
19980600	*Dark Alliance*, by Gary Webb, is published by St. Martin's Press.	Media, enforcement
19980930	1998 FY end. $17.6B in undocumentable adjustments against Treasury at HUD and $1.7T at DOD.	event, Treasury DOD HUD
19981218	S.C. Gwynne, with reporting by Adam Zagorin, report in "Just Hide Me the Money" (*Time* Magazine) regarding the October, 1998 Citicorp/Travelers merger and the world of offshore banking: "Citibank's private-banking unit holds more than $100 billion, which makes it about the same size as the entire bank was in 1982. These funds are in turn part of a $17 trillion global pool of money belonging to what bankers euphemistically call 'high-net-worth-individuals'—a pool that generates more than $150 billion a year in banking revenue. The numbers are impressive when you consider that except at a few sleepy British and Swiss institutions, the private-banking industry didn't exist until the 1980s. Citibank predicted early this year that it would reach $1 trillion—that's trillion with a T—in private-banking assets by the year 2010. And it faces some 4,000 competitors, from global dreadnoughts like Switzerland's UBS to secretive banks in the tiny principality of Andorra to brokerages in Miami and accountancy firms in the Channel Islands."	media, corporate
19990000	Richard Grasso, Chairman of the New York Stock Exchange, travels to a rebel-held village in Colombia to meet with a Revolutionary Armed Forces of Colombia (FARC) commander. At that time, the GAO reported that FARC had assumed control of a majority market share of the Colombian cocaine trade.	Event
19990625	Hamilton Securities files complaint against Ervin & Associates in District of Columbia Superior Court.	Hamilton
19990629	DC Superior Court case by Hamilton Securities against Ervin & Associates is removed to U.S. District Court for the District of Columbia (1:99-cv-01698-LFO), Judge Stanley Sporkin, who later turns down Hamilton's motion to remand the case to DC Superior Court.	Hamilton
19990702	Lawrence H. Summers becomes Secretary of the Treasury and serves until January 20, 2001.	Treasury
19990812	Daniel Hawke withdraws as counsel to Ervin & Associates to later take a position with the enforcement division of the Securities and Exchange Commission formerly run by Stanley Sporkin and is replaced by attorneys Craig Stephen Brodsky and Mark Polston.	Hamilton
19990930	1999 FY end. $59.6B in undocumentable adjustments against Treasury at HUD and $2.3T at DOD.	event, Treasury DOD HUD
20000322	HUD Inspector General (IG) Gaffney testifies before House Committee on Government Reform, Subcommittee on Government Management, Information and Technology regarding $59B in undocumentable adjustments against Treasury: "HUD used a financial statement report consolidation software called Hyperion Enterprise to prepare the financial statements. Reconciliation processes to identify discrepancies with Treasury fell behind schedule, and HUD had to make numerous adjustments to the general ledger fund balance with Treasury balances to make them agree with Treasury records. These adjustments were not made via the normal general ledger posting process. Rather, they were made directly to Hyperion Enterprise. At the time we discontinued our audit work, a total of 42 adjustments totaling about $17.6 billion had been processed in this manner to adjust fiscal year 1998 ending balances. An additional 242 adjustments totaling about $59.6 billion were made to adjust fiscal year 1999 activity."	HUD

20000500	Testimony of the HUD Inspector General House Government Reform Committee: **Statement**	
20000510	Hamilton's case against Ervin & Associates is reassigned to Judge Louis F. Oberdorfer.	Hamilton
20000721	Judge Oberdorfer grants Hamilton's motion to unseal the qui tam case, revealing Ervin & Associates as relator.	Hamilton
20000930	2000 FY end. $320B in undocumentable adjustments against Treasury at the Air Force and $161.6B at Navy and $1.1T (includes $320.8 billion from Air Force).	Event, Treasury
20001100	Kelly O'Meara story in *Insight* Magazine: "Why Is 59 Billion Missing from HUD?"	Media, HUD
20001130	Hamilton's case against Ervin & Associates and its qui tam case are consolidated.	Hamilton
20001231	During the Clinton Administration, the Harvard Endowment grew from $4B to nearly $20B. After serving as Secretary of Treasury during the Clinton Administration, Bob Rubin returns to the Board of Harvard Corporation/Harvard Management. After serving as Secretary of Treasury during the Clinton Administration, Lawrence Summer returns to Harvard as President. After serving as Assistant Secretary of Housing-Federal Housing Commissioner, Nicholas Retsinas becomes head of the Harvard Center for Housing Studies.	corporate
20010000	William J. Clinton Foundation begins work when Clinton leaves the presidency, primarily to raise funds for the Clinton Library. David Resnick, formerly an accountant with Resnick, Fedder and Silverman specializing in HUD matters and a HUD and Hamilton contractor, serves as the Foundation's CPA.	corporate
20010120	Paul H. O'Neil becomes Secretary of the Treasury and serves until December 31, 2002.	Treasury
20010120	George W. Bush becomes 43rd President of the United States after defeating Al Gore.	event
20010223	Qui tam case discovery assigned to Magistrate Alan Kay.	Hamilton
20010300	Kelly O'Meara story in *Insight* Magazine: "Cuomo Leaves HUD in Shambles."	Media, HUD
20010600	Kelly O'Meara story in *Insight* Magazine: "Inside HUD's Financial Fiasco."	media, HUD
20010700	Kelly O'Meara story in *Insight* Magazine: "A Financial Fiasco Is in the Making."	Media, DoD
20010900	Kelly O'Meara story in *Insight* Magazine: "Rumsfeld Inherits Financial Mess."	DoD, media
20010910	Secretary of Defense Donald Rumsfeld delivers remarks on Monday, September 10, 2001, at the Pentagon: "According to some estimates, we cannot track $2.3 trillion in transactions. We cannot share information from floor to floor in this building because it's stored on dozens of technological systems that are inaccessible or incompatible."	Media, DoD
20010911	World Trade Center (WTC) buildings collapse and Pentagon is hit. Among the offices at the Pentagon that are hit are the Office of Naval Intelligence (ONI) office that was investigating the $3.3T in undocumentable adjustments at DOD. Among the losses at the WTC are the largest Treasury dealer Cantor Fitzgerald: 658 employees; Marsh & McLennan: 295 employees; Aon Corporation: 175 employees; and Fiduciary Trust International: 87 employees. Large Treasury and mortgage securities dealer Solomon's offices are destroyed in destruction of WTC Building 7.	Media, Treasury
20010930	Independent Auditors' Report on FY 2001 DOD Annual Financial Report and Report on Internal Controls and Compliance with Laws and Regulations "DoD eliminated billions of dollars of intradepartmental expenses, revenue, accounts payable and other liabilities and accounts receivable and other assets that could not be verified. For FY 2001, DoD acknowledged that, for the most part, the DoD accounting systems did not capture trading partner information at the transactional level. Therefore, current systems could not produce the data necessary for reconciliations between buyers and sellers." DOD processed $1.1T in unsupported accounting	Treasury, DoD

	entries. Accountants identified $17.3B in inconsistencies that affected the Fund Balance with Treasury, including $12.4B in disbursement disparities.	
20011013	President George H.W. Bush signs the USA PATRIOT Act into law.	law
20011100	Chris Sanders and Catherine Austin Fitts publish “The Myth of the Rule of Law,” Sanders Research Associates.	media
20011128	Enron collapses after Dynegy backs out of contract to purchase it for $6B after finding accounting problems.	Event
20011200	Kelly O’Meara story in *Insight* Magazine: “Bureaucrats Circle Their Wagons.”	Media
20020108	Dan Briody writes in “Carlyle’s way: making a mint inside 'the iron triangle' of defense, government, and industry” (*Red Herring*, 2002): “Among those associated with Carlyle are former U.S. president George Bush Sr., former U.K. prime minister John Major, and former president of the Philippines Fidel Ramos. And Carlyle has counted George Soros, Prince Alwaleed bin Talal bin Abdul Aziz Alsaud of Saudi Arabia, and Osama bin Laden's estranged family among its high-profile clientele. The group has been able to parlay its political clout into a lucrative buyout practice (in other words, purchasing struggling companies, turning them around, and selling them for huge profits)—everything from defense contractors to telecommunications and aerospace companies. It is a kind of ruthless investing made popular by the movie *Wall Street*, and any industry that relies heavily on government regulation is fair game for Carlyle's brand of access capitalism. Carlyle has established itself as the gatekeeper between private business interests and U.S. defense spending. And as the Carlyle investors watched the World Trade towers go down, the group's prospects went up.”	Media
20020131	“Trading Truth: A Report on Harvard’s Enron Entanglements: A HarvardWatch Report” reports that Herbert “Pug” Winokur, then a member of the Harvard Corporation (the University’s 7-member governing committee) and longtime member of the board of directors and chairman of the Finance Committee of Enron, approved the creation of more than 3,000 partnerships and subsidiaries allegedly illegally used by Enron to hide debt and avoid taxation. During the period when company executives touted Enron’s stock to employees, Harvard’s main private investment fund (Highfields Capital) short-sold several million shares of Enron stock for an estimated profit of $50MM.	Media
20020300	Kelly O’Meara story in *Insight* Magazine: “What Does It Take to Lose a Contract?”	Media, DoD
20020325	Congresswoman Cynthia McKinney appears on KPFA radio after asking for federal contracting budgets and the DOD contracts and payment systems, but her request is refused.	Media, DoD
20020409	Comptroller General/Director of General Accounting Office (GAO) testifies before the House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform: “For fiscal year 2001, 18 of the 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions on their financial statements, which is the same number of agencies as last year and up from 6 agencies for fiscal year 1996 ” and that “for fiscal year 2001, reports of inspectors general and their contract auditors indicated that 20 of the CFO Act agencies’ financial management systems were not in substantial compliance with at least one of FFMIA’s three federal financial management systems requirements, compared to 19 such agencies for fiscal year 2000.” His testimony also states: "The President’s Management Agenda frames the problem this way: 'A clean financial audit is a basic prescription for any well-managed organization, yet the federal government has failed all four [now five] audits since 1997. Moreover, most federal agencies that obtain clean audits only do so after making extraordinary labor-intensive assaults on financial records. Without accurate and timely financial information, it is not possible to accomplish the president’s agenda to secure the best performance and high measure of accountability for the American people.'”	event
20020429	Kelly O’Meara story in *Insight* Magazine, “Government Fails Fiscal Fitness Test.” (This article cites both the $1.1 trillion at DOD and the $59 billion… at HUD.)	Media, Treasury
20020522	Catherine Austin Fitts questions Congressman Van Hilleary of Tennessee (who was then running for Governor) regarding the missing money in the Federal government. In response, he says there is nothing he can do about it. Catherine Austin Fitts writes a letter to Van Hilleary published by Scoop Media (**link**) and as an article in The Solari Report (“The Real Deal”). It addresses the	Media, DoD, HUD

	failure of federal agencies to produce Independent annual certified financial statements and reliable financial systems; $3.3 trillion of undocumented adjustments at HUD and DOD for fiscal 1998-2000.	
20020522	Catherine Austin Fitts, Solari Report, “Letter to Congressman Van Hilleary.”	Media
20020702	Sarbanes-Oxley Act signed into law to protect stakeholders and investors by improving the dependability and precision of corporate financial disclosures. The legislation also creates the Public Company Accounting Oversight Board (PCAOB) and includes a mandate that public companies pay accounting support fees that operate as one of the funding sources for the Financial Accounting Standards Board (FASB).	law
20020828	Sealed transcripts filed in qui tam case from period before the case was unsealed. Transcripts for several hearings are missing.	Hamilton
20020930	2002 FY end. $500.1B in undocumentable adjustments against Treasury at Army.	DoD, Treasury
20021101	HBO's *The Sopranos*, episode 46: “Watching Too Much Television” (Scamming the Feds); Brian lays out a way to use bogus real estate deals to con money out of HUD.	Media, HUD
20021107	Enactment of the Accountability of Tax Dollars Act, which expands the types of federal agencies that are required to prepare audited financial statements.	law
20021200	Paul O'Neill is fired as Secretary of Treasury for his public disagreement with the Administration regarding costs and mechanisms of starting the Iraq War. The controversy relates to a report commissioned in 2002 by O'Neill while Treasury Secretary documenting total outstanding debt and liabilities of the U.S. federal government. The report suggests the United States faces future U.S. federal budget deficits of more than $500BB and that sharp tax increases, massive spending cuts, or both will be unavoidable if the United States is to meet benefit promises to its future generations.	Treasury
20030203	John W. Snow becomes Secretary of the Treasury and serves until June 30, 2006.	Treasury
20030210	Rudolf Contreras replaced as opposing counsel in the qui tam case by attorney Brian J. Sonfield in representing the U.S. Government.	Hamilton
20030418	Kelly O’Meara story in *Insight* Magazine: “HUD’s Financial Woes Continue.”	Media, HUD
20030501	Judge Oberdorfer denies Hamilton’s motion to dismiss claims related to the optimization error by Hamilton’s contractor, AT&T/Bell Labs in the qui tam case.	Hamilton
20030526	Scoop Media article, “US’ Missing Trillions Make Mainstream At Last.” For the original missing trillions stories, see, "Government Fails Fiscal-Fitness Test" posted on April 29, 2002 (**link**). The elevation of this blockbuster story into the mainstream comes after the *San Francisco Chronicle* runs a front-page investigative piece a week before. The full text of this article is included below for archival and educational purposes. After publication of the *Chronicle* article, several more mainstream mentions are made of the story in other media, including *CBS News* (see below) and *The Guardian* in the United Kingdom.	Media
20030821	Kelly O’Meara story in *Insight* Magazine: “‘High Risk Finance at the Federal Level: The US Government Reports That Its Financial Management Systems Are Seriously Unreliable….”	Media, Treasury
20030928	2003 FY end. $268.3B in undocumentable adjustments against Treasury at Army.	Media, DoD Treasury
20030930	Kelly O’Meara story in *Insight* Magazine: “Treasury Checks and Unbalances: The 2003 Financial Statements Mark the Seventh Year in a Row That the Federal Government Could not Audit, Let Alone Balance, Its Books.”	Media, Treasury
20031001	Hamilton files a motion for summary judgment in the Court of Federal Claims case.	Hamilton

20031028	Chris Sanders, “Where Is the Collateral?” Sanders Research Associates, republished from Scoop Media.	Media
20040324	The Court of Federal Claims enters a memorandum opinion denying Hamilton's motion for summary judgment and denying the government's motion for summary judgment because the Court determines that Hamilton did not breach its contracts. The Court invites the government to amend is counterclaim.	Hamilton
20040330	The government declines to amend its counterclaim in the Court of Federal Claims case.	Hamilton
20040409	Catherine Austin Fitts sends a letter to National Security Advisor Condoleezza Rice (cc to Bush and Cheney) regarding comments on Rice's testimony under oath before the National Commission on Terrorist Attacks on the United States. After the letter goes viral, Halliburton is the largest user on the Solari website for several days, and then Catherine is seriously poisoned, taking years to recover.	Media, Hamilton
20040419	Final judgment entered in favor of Hamilton Securities (subsequently merged into Solari, Inc.) in the amount of $1.505MM plus interest in the Court of Federal Claims case and, thus, there is no need for trial previously scheduled for April 22, 2004.	Hamilton
20040604	Request to John Hawke, Comptroller of the Currency, to help get Hamilton paid Court of Federal Claims case, with copies to Congress. No replies.	Hamilton
20040705	Chris Sanders, “So Where Is the Collateral?” Sanders Research Associates on the extent of the corruption at HUD and the mortgage markets.	Media
20040816	Partial judgment against Hamilton Securities on Count IX (North and Central sale) in the amount of $1.5MM and in favor of Hamilton on Counts II (single-family offering), XIII and XIV (re: Williams Adley contract), XV and XVI (re: cross-cutting contract) entered in qui tam case.	Hamilton
20040819	2004 FY end. $258.1B in undocumentable adjustments against Treasury at the Department of the Army.	DoD Treasury
20041016	MSNBC: “US Probes $100 Million Missing in Iraq.”	Media, DoD
20041102	George W. Bush is re-elected President of the United States, defeating John Kerry.	Event
20050301	Hamilton files an appeal of the qui tam case order.	Hamilton
20050310	Before House of Representative hearings on the FY 2006 defense budget, Congresswoman Cynthia McKinney questions Donald Rumsfeld and Joint Chiefs of Staff Chairman Richard Myers on DynCorp and 9/11 War Games, revealing answers about lack of oversight over DynCorp's practice of sex slave trafficking and lack of accuracy and missing money regarding DOD finances. McKinney demands a list of contractors and payments related to DOD transaction, payment, and accounting systems.	DoD
20050500	Ed Harriman writes in “So, Mr. Bremer, Where Did All the Money Go?” (*The Guardian*): ‘’At the end of the Iraq war, vast sums of money were made available to the US-led provisional authorities, headed by Paul Bremer, to spend on rebuilding the country. By the time Bremer left the post eight months later, $8.8bn of that money had disappeared.”	Media, DoD
20060100	Hamilton Securities Group enters into a global settlement with DOJ (on behalf of HUD in the Court of Claims) and Ervin (with respect to civil pursuit of qui tam case after DOJ declined to Adopt), resolving the qui tam case (in which, after 10 years, there was no finding of wrongdoing by anyone other than the mistake by Hamilton’s sub-contractor, AT&T/Bell Labs) and Hamilton’s lawsuit against HUD for payment of contracting fees owed by HUD to Hamilton for work completed in 1996 (in which the judge found in favor of Hamilton) and Hamilton’s lawsuit against Ervin for tortious interference of contract (Ervin’s insurance firm has to pay). Department of Justice insists that settlement does not waive the rights to pursue Hamilton regarding taxes. Tax filings require 4 years and $150,000 of accounting and attorneys fees to file after Hamilton’s accountant reports that Hamilton’s files have disappeared. Hamilton owes $0 in taxes.	Hamilton

20060209	Kai Ryssdal, *Marketplace*, “Negroponte (Director of National Intelligence) Given Power to Waive SEC Rules.” The federal government provides waivers to private companies so they do not have to comply with SEC rules as more money goes missing from the U.S. government and immediately before the Financial Crisis begins.	Media, Corporation
20060400	The Solari Report publishes *Dillon Read and Co., Inc. and the Aristocracy of Stock Profits* by Catherine Austin Fitts explaining how the federal government engineered the housing bubble and that trillions are being transferred out of government accounts.	Media, HUD
20060505	In the Memorandum on Assignment of Function Relating to Granting of Authority for Issuance of Certain Directives, President G.W. Bush waives the SEC reporting requirements for contractors. The SEC Act itself grants the authority to any president to exempt contractors from reporting via 15 U.S. Code § 78m(b)(3)(A), which states: “With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance.” [Source: Wikipedia]	Law, Corporate
20060614	Daniel Gros, “Discrepancies in America’s Accounts Hide a Black Hole” (*Financial Times* article).	Media, DoD
20060700	DOD Inspector General reports on $6.5MM of Army spending allocated by Pentagon with no paper trail, and no DOD audit for past two decades to resolve this; says Pentagon “money pit” goes back to 1991.	DoD
20060710	Henry M. Paulson, Jr. becomes Secretary of the Treasury and serves until January 20, 2009.	Treasury
20060926	Enactment of the Federal Funding Accountability and Transparency Act requiring information about Federal awards to be posted on a single, searchable website that is open for public access.	law
20060929	The Credit Rating Agency Reform Act of 2006 is enacted. This law requires the SEC to establish clear guidelines for determining which credit rating agencies qualify as nationally recognized statistical rating organizations (NRSROs). It also gives the SEC the power to regulate NRSRO internal processes regarding record-keeping and how they guard against conflicts of interest and makes the NRSRO determination subject to a Commission vote (rather than an SEC staff determination). Notably, however, the law specifically prohibits the SEC from regulating an NRSRO's rating methodologies.	law
20061210	Goldman Sachs meets to determine how to short the market in mortgage-backed securities—the start of triggering the Financial Crisis.	Corporate
20070320	In GAO testimony before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives, U.S. Comptroller General David Walker testifies: “For the 10th consecutive year, certain material weaknesses in financial reporting and other limitations on the scope of our work resulted in conditions that continued to prevent us from being able to provide the Congress and the American people an opinion as to whether the consolidated financial statements of the U.S. government were fairly stated in conformity with U.S. generally accepted accounting principles (GAAP).”	event
20070825	2007 FY end. $1.1T in undocumentable adjustments against Treasury at Department of the Army.	DoD Treasury
20070930	Donald L. Barlett and James B. Steele, “Billions over Baghdad,” (*Vanity Fair*): “Between April 2003 and June 2004, $12 billion in U.S. currency—much of it belonging to the Iraqi people—was shipped from the Federal Reserve to Baghdad, where it was dispensed by the Coalition Provisional Authority. Some of the cash went to pay for projects and keep ministries afloat, but, incredibly, at least $9 billion has gone missing, unaccounted for, in a frenzy of mismanagement and greed.”	Media, DoD

20070930	Goldman reports $11B income during FY 1997, $4B of which is from shorting of the subprime mortgage-backed securities market.	Corporate
20080000	Bear Stearns collapses, kicking off the 2008 Financial Crisis, a housing crisis that results in a 31.8% drop in housing prices and the Great Recession.	Event, Corporate
20080300	Tony Blair Faith Foundation is formed.	Corporate
20080500	Lehman Brothers files for bankruptcy protection after Treasury Secretary Paulson announces there will be no more bailouts. Lehman's becomes the largest bankruptcy in U.S. history.	Corporate Event, Treasury
20080725	Catherine Austin Fitts is thrown off of KPFA radio in Berkeley, California on a pretext, shortly before the Freddie Mac and Fannie Mae takeover and as the Bohemian Grove starts their annual meeting. Shortly thereafter, a large San Francisco money manager announces it has lost the $1 billion it invested in Fannie Mae that April, saying it had "no idea" there was a problem. Catherine Austin Fitts had been on KPFA radio at 5pm for years explaining the problem to the entire San Francisco Bay Area audience.	Media
20080906	Takeover of Fannie and Freddie, when the director of the Federal Housing Finance Agency (FHFA), James B. Lockhart III, announces his decision to place the two government-sponsored enterprises (GSEs) into a conservatorship run by the FHFA.	Corporate, HUD, event
20080915	2008 FY end. $595.8B in undocumentable adjustments against Treasury at Army.	DoD
20080916	AIG is bailed out when the Federal Reserve provides an $85 billion two-year loan to prevent its bankruptcy and further stress on the global economy. In return, the Fed takes ownership of 79.9 percent of AIG's equity. In the end, the government turns a $23B profit on the sale of its AIG shares acquired in the bailout. Bernanke is quoted as saying AIG took risks with unregulated products like hedge funds while using cash from people's insurance policies. "AIG had become a major seller of credit default swaps in an attempt to boost its profit margin. These swaps insured the assets that supported corporate debt and mortgages. If AIG went bankrupt, it would trigger the bankruptcy of many of the financial institutions that had bought these swaps." The AIG bailout occurs one day after U.S. Treasury Secretary Henry Paulson says there will be no further Wall Street bailouts. That move forced investment bank Lehman Brothers into bankruptcy. [Kimberly Amadeo, "AIG Bailout, Cost, Timeline, Bonuses, Causes, Effects: Why It Made Bernanke Angrier Than Anything Else in the Recession," *The Balance*, updated November 5, 2018]	Corporate, Treasury, Media
20080930	Enactment of Emergency Economic Stabilization Act of 2008 (the "bailout" of the U.S. financial system)—Establishes the Troubled Asset Relief Program (TARP) for funding most U.S. banks through the purchase of toxic assets and equity from financial institutions to strengthen the financial sector. Passed by a Democratic-controlled Congress and signed into law by President George W. Bush.	Law
20081003	Bernard Madoff, the former NASDAQ Chairman and founder of the Wall Street firm Bernard L. Madoff Investment Securities LLC, admits that the wealth management arm of his business was an elaborate Ponzi scheme.	Event, Corporate
20090120	Barack Obama becomes 44th President of the United States after defeating John McCain.	Event
20090126	Timothy F. Geithner becomes Secretary of the Treasury and serves until January 25, 2013.	Treasury
20090200	The SEC promulgates amended regulations designed to address concerns about the integrity of the process by which NRSROs rate structured finance products, particularly mortgage-related securities.	law
20090500	Congressman Alan Grayson at a Congressional hearing questions Federal Reserve Chairman Ben Bernanke on $550B of loans to foreigners (or "central liquidity swaps" in Federal Reserve-ese). Which financial institutions received this money? Bernanke's answer: I don't know. As the Fed was lending this money, the dollar increased by 30% in value. Grayson asks, was this a coincidence? Bernanke's answer: yes. Bernanke says Congress approved this in 1913 in the Federal Reserve Act, and this facility has been used repeatedly over the years.	Event

20090629	Paul Tharp, "US Official Sees $23.7 Trillion Rescue Tab" (*New York Post*). TARP IG Neal Barofsky reports that $23.7T will need to be expended on TARP.	Media, Treasury
20090709	2009 FY end. $311.3B in undocumentable adjustments against Treasury at Army.	DoD Treasury
20091229	President Barack Obama issues Executive Order 13526, "Classified National Security Information," which redefines the procedures for classified information.	law
20100308	2010 FY end. $874.8B in undocumentable adjustments against Treasury at Army.	DoD Treasury
20100416	SEC charges Goldman Sachs with fraud in structuring and marketing of a collateralized debt obligation (CDO) tied to subprime mortgages. "The Securities and Exchange Commission today charged Goldman, Sachs & Co. and one of its vice presidents for defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the U.S. housing market was beginning to falter. The SEC alleges that Goldman Sachs structured and marketed a synthetic collateralized debt obligation (CDO) that hinged on the performance of subprime residential mortgage-backed securities (RMBS). Goldman Sachs failed to disclose to investors vital information about the CDO, in particular the role that a major hedge fund played in the portfolio selection process and the fact that the hedge fund had taken a short position against the CDO." [Source: SEC website]	Corporate, Enforcement
20110806	Zachary A. Goldfarb, "S&P downgrades U.S. credit rating for first time" (to AA+), *Washington Post*. The downgrade to AA+ occurs four days after Congress votes to raise the debt ceiling of the federal government by means of the Budget Control Act. Later, the U.S. government commences an investigation into S&P's role in the rating of several mortgage-backed securities that played a role in the 2008 Financial Crisis. To mend its relationship with the U.S. government, S&P asks its then-CEO [Devin Sharma] to step down, 18 days after the U.S. was downgraded. [Source: Wikipedia]	Media, Treasury
20110911	2011 FY end. $14.6B in undocumentable adjustments against Treasury at the Department of the Army.	DoD Treasury
20120719	2012 FY end. $110.9B in undocumentable adjustments against Treasury at the Department of the Army.	DoD Treasury
20120721	"£13tn hoard hidden from taxman by global elite": *The Guardian* reports that a global super-rich elite has exploited gaps in cross-border tax rules to hide an extraordinary £13 trillion ($21tn) of wealth offshore—as much as the American and Japanese GDPs put together—according to research commissioned by the campaign group Tax Justice Network.	Corporate, Media
20120930	2014 FY end. $1.9B in undocumentable adjustments against Treasury at HUD.	HUD
20121106	Barack Obama is re-elected President of the United States, defeating Mitt Romney.	Event
20130205	DOJ files a lawsuit against S&P.	Enforcement, Corporate
20130228	Jacob J. Lew becomes Secretary of the Treasury and serves until January 20, 2017.	Treasury
20130426	Catherine Austin Fitts and John Rappoport discuss Hamilton Securities, its Community Wizard database, and the Hamilton Securities litigation in a special Solari Report on the relationship between the Oklahoma City bombing and West of the Mississippi (Region 6 defaulted loans) HUD loan sale documents.	Media, Hamilton, HUD,
20130927	SAIC changes its name to Leidos and spins off a new and independent $4 billion government services and information technology company that retains the Science Applications International Corporation name. [Source: Wikipedia]	Corporate
20140509	Enactment of the Digital Accountability and Transparency (DATA) Act. The DATA Act's goals are to: (1) Expand the Federal Funding Accountability and Transparency Act of 2006 (31 U.S.C. 6101	law

	note) by disclosing direct Federal agency expenditures and linking Federal contract, loan, and grant spending information to programs of Federal agencies to enable taxpayers and policy-makers to track Federal spending more effectively; (2) Establish government-wide data standards for financial data and provide consistent, reliable, and searchable government-wide spending data that are displayed accurately for taxpayers and policy-makers on USASpending.gov (or a successor system that displays the data); (3) Simplify reporting for entities receiving Federal funds by streamlining reporting requirements and reducing compliance costs while improving transparency; (4) Improve the quality of data submitted to USASpending.gov by holding Federal agencies accountable for the completeness and accuracy of the data submitted; (5) Apply approaches developed by the Recovery Accountability and Transparency Board to spending across the Federal Government.	
20140930	2014 FY end. $1.9B in undocumentable adjustments against Treasury at HUD.	HUD Treasury
20141223	Financial Improvement and Audit Readiness (FIAR) Plan Status Report issued by the Comptroller of DOD prepared in accordance with section 1003 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2010. The Report addresses issues impeding the reliability of the Department of Defense financial statements. Among findings: • "Moving from audit readiness into audit is a tremendous accomplishment for the Department. Going under audit will highlight remaining deficiencies through an auditor's lens so that corrective actions can be implemented and full audit readiness achieved by FY 2018." • DOD OIG rescinds a clean audit opinion on USMC (United States Marine Corps) on March 23, 2015, after learning of USMC transactions in U.S. Treasury suspense accounts that had not been previously reported and included in the audit. There will not be an SBA (General Fund schedules of budgetary activity) audit in FY 2015. • Department does not achieve the September 30, 2014, SBR (statement of budgetary resources) deadline but "progress has been made." • Nearly 90 percent of the total DOD General Fund appropriations are under audit. The remainder of General Fund appropriations not under audit are undergoing examinations or audit readiness activities. • Most legacy systems were originally designed to address operational or mission requirements. Additionally, many were built prior to the Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208), which requires financial systems to comply with the U.S. Standard General Ledger (USSGL) and Treasury Financial Manual. As a result, these systems were not designed to meet federal standards for financial systems. Attracting and retaining qualified personnel to help the Department achieve audit readiness and sustain an audit ready state has been an ongoing challenge.	DoD
20150203	S&P settles the lawsuit by the Department of Justice and nineteen states' attorneys general and the District of Columbia for $1.375B.	Corporate, Enforcement
20150500	015 FY end. $6.5T in undocumentable adjustments against Treasury at Army.	DoD Treasury
20150930	The Inspector General's report for the Army in fiscal year 2015 reports $6.5 trillion in unsupported journal voucher adjustments. Unsupported journal voucher entries and adjustments, as the result of agencies' failure to correct system deficiencies, are considered red flags for potential fraud. Of note, on the asset side of the Army General Fund is an increase of $794B in Fund Balance with Treasury and, on the liabilities side, an increase of $929 billion in Accounts Payable. There is a net $1T increase in assets resulting from unsupported journal voucher adjustments and a $1T increase in net liabilities due to unsupported journal voucher adjustments. More than 16,000 records that might reveal either the source or the destination of some of that $6.5 trillion have been "removed."	DoD
20150930	HUD "material errors" in reporting are $278.5 billion, nearly eight times the size of HUD's $36 billion budget. The explanation given in the report is as follows (see https://www.hudoig.gov/sites/default/files/3-16-2017-HouseHearing-Wriien-Tes[monyPDF.pdf, page 4): Of the $278.5 billion in errors, $159.4 billion was due primarily to (1) incorrect data entry, (2) omission of restated balances, or (3) incorrect data provided by HUD's component entities (FHA and Ginnie Mae). The remaining $119.1 billion were due to inappropriate rounding adjustments. We found several instances in which rounding was performed to the nearest billion and hundred billion instead of the nearest million as required.	DoD
20160116	Leidos Holdings Inc. announces it has entered into a definitive agreement with Lockheed Martin pursuant to which Leidos would combine with Lockheed Martin's realigned Information Systems & Global Solutions business in a Reverse Morris Trust transaction.	Coporate, DoD
20160700	Thomas Hedges, "The Pentagon Has Never Been Audited, That's Astonishing" (*The Guardian*).	Media, DoD

20160815	"Lockheed Cuts and Runs" [Solari Report]—Lockheed Martin spins out its Information Systems & Global Solutions division to Leidos for $4.6B. The merger deal closes and is implemented immediately prior to the latest DOD Inspector General audit. With Lockheed having been the largest provider of information systems, including accounting and payments systems, to DOD and U.S. government agencies, this merger now makes Leidos the largest IT provider in the federal market.	Media, Corporate, DoD
20170120	Donald Trump becomes 45th President of the United States after defeating Hillary Clinton.	Event
20170213	Steven T. Mnuchin becomes Secretary of the Treasury.	Treasury
20170309	Catherine Austin Fitts and Rob Kirby present a Solari Report interview on the Exchange Stabilization Fund.	Media
20170320	Senator Charles Grassley of Iowa, a frequent critic of the DOD's financial practices, says on the Senate floor that the Pentagon's longstanding failure to conduct a proper audit reflects "twenty-six years of hard-core foot-dragging" on the part of the DOD, where "internal resistance to auditing the books runs deep."	DoD
20170900	Deadline set in 2009 by Congress for Pentagon to subject itself to full audit.	DoD
20170928	Interview with Dr. Mark Skidmore on The Solari Report, "Summary Report on 'Unsupported Journal Voucher Adjustments' in the Financial Statements of the Office of the Inspector General for the Department of Defense and the Department of Housing and Urban Development."	Media, DoD, HUD
20170928	Launch of website at missingmoney.solari.com to make public DOD and HUD financial statements and documentation.	Media
20170930	Although OIG audit reports in previous years were always made available online without restriction or censorship, a DOD OIG report on a U.S. Navy financial statement for FY 2017 suddenly appears in heavily redacted form—not just the numbers it contains, but even its title! Only bureaucratic sloppiness enable one to see that the report concerns Navy finances: Censors missed some of the references to the Navy in the body of the report. A request to the Office of Inspector General to have the document uncensored is met with the response: "It was the Navy's decision to censor it, and we can't do anything about that." At the request of *The Nation*, Senator Grassley's office also asks the OIG to uncensor the report. Again, the OIG refuses. [See David Lindorff article, 11/27/18]	DoD
20171005	The Solari team discovers that the Solari Report link to the report "Army General Fund Adjustments Not Adequately Documented or Supported" has been disabled by the DOD and HUD Offices of Inspectors General.	DoD, HUD
20171005	DOD News, "DOD Announces Agency Wide Audit" [Spoiler alert: DOD's independent accountants were not able to produce a clean audit of 2018 financial statements]	Media, DoD
20171008	The Solari team learns that key documents have been reposted on the OIG website, but with different URLs.	Enforcement, Media
20171008	Fire at the New York Federal Reserve.	Event
20171211	United Press International, "Trump Signs $700 Billion Defense Budget" (*Defense News*).	Media, DoD
20171212	In late May 2018, a graduate student at Michigan State University finds on the OIG website the most recent report for the DOD, which summarizes unsupported adjustments for fiscal year 2017. However, this document differs from all previous reports in that all the numbers relating to unsupported adjustments are redacted.	DoD,
20180112	Special Solari Report article published: "The Black Budget: The Crossroads of (Un)Constitutional Appropriations and Reporting."	Media
20180112	Special Solari Report article published: "The Appropriations Clause: A History of the Constitution's	Media

	(As of Yet) Underutilized Clause.”	
20180123	Special Solari Report article published: “The U.S. Statutes Creating Modern Constitutional Financial Management and Reporting Requirements and the Government’s Failure to Follow Them.”	Media
20180314	Comments due on the exposure draft of FASAB Statement 56.	law
20180330	Special Solari Report article published: “The History and Organization of the Federal Reserve: The What and Why of the United States’ Most Powerful Banking Organization.”	Media
20180500	Dr. Mark Skidmore publishes “Update on the $21 Trillion in Unsupported Adjustments at the Department of Housing and Urban Development and the Department of Defense” [Solari Report], reporting that over the past several months, he has repeatedly tried to contact the Office of the Inspector General (OIG) in an effort to obtain additional information regarding the nature of the unsupportable adjustments at DOD, but the OIG is no longer responding to inquiries.	Media, HUD, DoD, enforcement
20180606	FASAB proposes two possible alternatives for disclosure/disclaimer requirements under Standard 56.	Law
20180712	FASAB issues a classified exposure draft of the first Statement 56 Interpretation: “Interpretation of Federal Financial Accounting Standards 56: Classified Activities with comments due by August 13, 2018."	law
20180712	Dr. Lawrence Kotlikoff and Dr. Mark Skidmore, “Is Our Government Hiding $21 Trillion in Spending?” (*Forbes*).	Media, DoD, HUD
20180721	Comments due on disclosure/disclaimer requirements under FASAB Standard 56.	law
20180726	Federation of American Scientists, “Bid to Rectify the ‘Black Budget’ Fails“: A bill in the Senate to remove “pass-through” funds from the Air Force budget and include them in Defense-wide appropriations fails. “In fiscal year 2018, the Air Force pass-through budget amounted to approximately $22.0 billion, or just less than half of the total Air Force procurement budget. The committee believes that the current Air Force pass-through budgeting process provides a misleading picture of the Air Force’s actual investment budget.”	law
20180904	First round of Kavanaugh confirmation hearings begins.	Event media
20180904	FBI report on Kavanaugh is sent to Senate Judiciary Committee.	Event media
20180927	Ford testimony is added to the Kavanaugh confirmation hearings.	Event media
20180930	Deadline DOD gave itself for producing auditable financial statements.	DoD
20181004	Final Statement 56 is published, with little if any change from the exposure draft.	Law
20181004	Several months after beginning the promised FY 2018 DOD audit, the government accepts the recommendations of the Federal Accounting Standards Advisory Board: https://fas.org/sgp/news/2018/07/fasab-review.pdf (see page 3 for a summary). The statement allows government officials to misstate and move funds around to hide expenditures if it is deemed necessary for national security purposes, and the rule applies to all agencies, not just the black budget. Here is an excerpt from the report: "This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position." From this statement, it seems that only a few people with high-level security clearances have the authority to determine what is a national security issue, and these same people will now be allowed to restate budgets to hide activity. No one but those few people would ever know that	DoD

	expenditures on a given activity are hidden in completely different area of government.	
20181006	Kavanaugh is confirmed as Justice of the Supreme Court by the U.S. Senate.	Event media
20181010	Hurricane Michael, the third-most intense Atlantic hurricane to make landfall in the contiguous United States in terms of pressure, behind the 1935 Labor Day hurricane and Hurricane Camille of 1969, hits the East Coast of the U.S., distracting news watchers from the finalization of FASAB Statement 56 on October 4, 2018.	event
20181027	Ernst & Young and other private accounting firms announce they cannot complete DOD 2018 FY audit. “The firms concluded...that the DoD’s financial records were riddled with so many bookkeeping deficiencies, irregularities, and errors that a reliable audit was simply impossible.”	DoD
20181127	“Exclusive: The Pentagon’s Massive Accounting Fraud Exposed: How US military spending keeps rising even as the Pentagon flunks its audit” (*The Nation*). The reporter, Dave Lindorff, notes that Ernst & Young and other accounting firms have given up on trying to perform a 2018 FY audit: “The firms concluded . . . that the DoD’s financial records were riddled with so many bookkeeping deficiencies, irregularities, and errors that a reliable audit was simply impossible.” The tab for the attempted audit reportedly was $900MM. According to Lindorff, “1,200 auditors went through Pentagon books for a year and they came up with nothing. The only things they were able to audit well—and this is significant—is the retirement plan and the payroll.” *The Nation* further states: "For decades, the DoD’s leaders and accountants have been perpetrating a gigantic, unconstitutional accounting fraud, deliberately cooking the books to mislead the Congress and drive the DoD’s budgets ever higher, regardless of military necessity. DoD has literally been making up numbers in its annual financial reports to Congress—representing trillions of dollars’ worth of seemingly nonexistent transactions—knowing that Congress would rely on those misleading reports when deciding how much money to give the DoD the following year, according to government records and interviews with current and former DoD officials, congressional sources, and independent experts." The author then proceeds to misrepresent Dr. Skidmore on national radio, promoting the $21 trillion as not real money, just a “plug.”	Media, DoD
20181127	“Green New Deal” proposed by Alexandria Ocasio-Cortez, creating a non-accountable 15-member Congressional Committee to manage enormous amounts of money and assets dedicated to “green” enterprises with little accountability.	Law
20190100	Laurence Kotlikoff publishes, “Holding U.S. Treasurys? Beware: Uncle Sam Can't Account For $21 Trillion” (*Forbes*, January 9, 2019). Kotlikoff (Dr. Mark Skidmore's coauthor on other missing money articles) writes, “Typically, undocumentable transactions are a just small fraction of authorized spending. How could a $122 billion Army financial statement generate undocumentable adjustments that were 54 times authorized spending?” Kotlikoff also writes, “. . . both Skidmore and Lindorff requested that the OIG provide more detailed information about the nature of 170 transactions that generated $2.1 trillion in undocumentable transactions (see page 6 of the OIG report). Why would the Army make up such huge phony numbers, as Lindorff and his sources assert? And yet is difficult to imagine that such huge sums could flow in and/or out of the Army financial statement in a way that was unauthorized. It is impossible to verify without greater transparency.”	Media, DoD

Links

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Testimony of the HUD Inspector General before the House Government Reform Committee, May 2000. **https://www.whereisthemoney.org/59billion.htm**

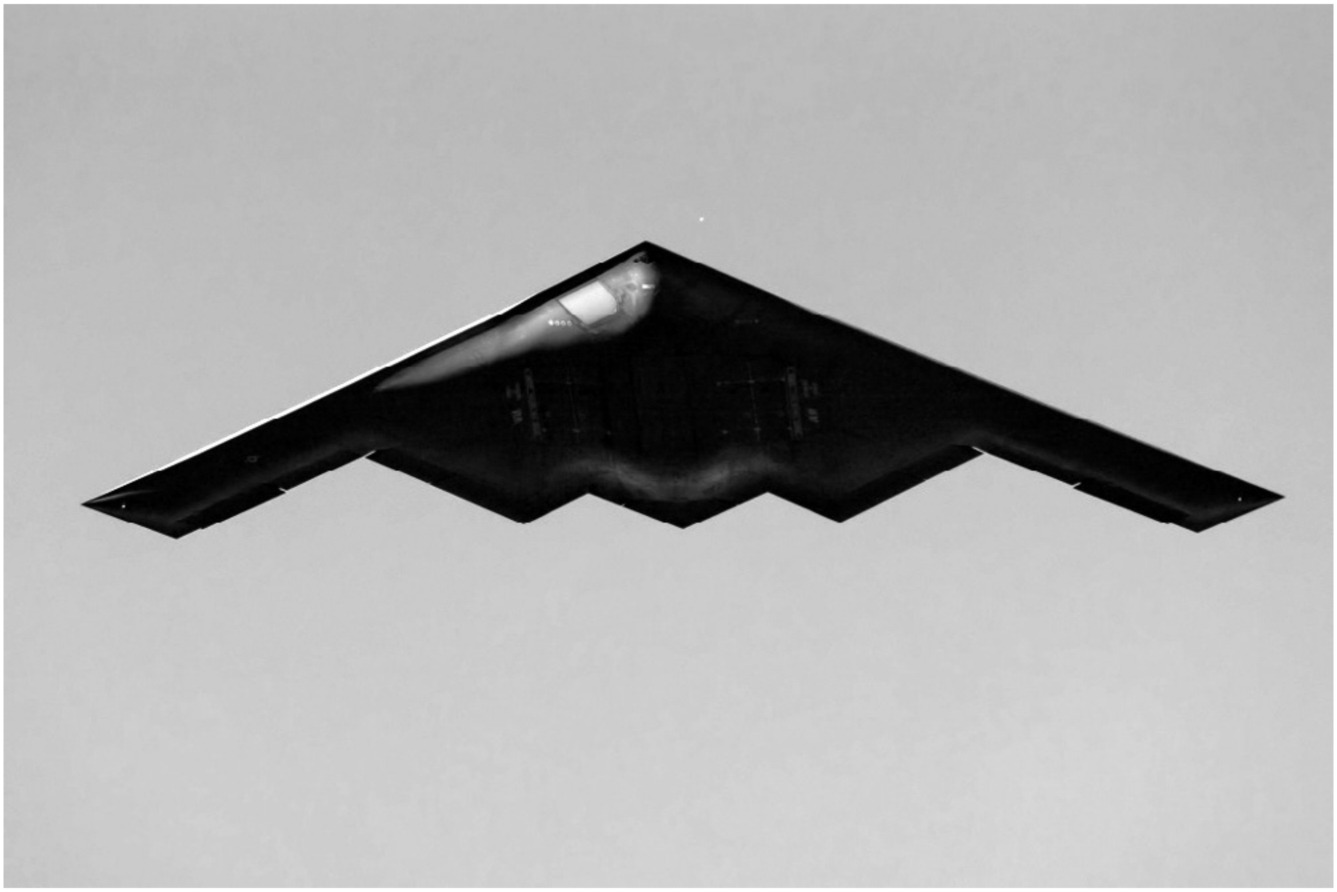
Chapter VI. Contractors, Investors & Dealers

The ten largest government contractors in 2017 were issued $50.7 billion in contract awards. These ten contractors had a combined 356 instances of misconduct since 1995 involving fines of $7.2 billion.
~ Project on Government Oversight (POGO), Federal Misconduct Database
https://www.contractormisconduct.org/

By Jason Worth

Numerous corporations, banks, and financial institutions are involved in the federal finances—from running information, accounting, servicing, and payment systems or serving as depository to the U.S. government or managing the trading operations of the Exchange Stabilization Fund. Private financial institutions are primary and secondary dealers of the U.S. Treasury debt as well as dealers and market makers in bonds and mortgage securities directly or indirectly guaranteed by the U.S. government. Many of these enterprises have outstanding stocks and bonds. Changes in the federal credit also have an impact on their credit and value. The tables and charts below provide a listing of some of the companies directly involved in the U.S. federal credit as contractors and dealers as well as an overview of investors in official U.S. debt.

Top 100 U.S. Government Contractors



The following table shows the top contractors to the United States Government as published by the U.S. General Services Administration. Dollar amounts are in USD millions. Companies with "N/A" listed under market cap are not publicly traded (or are subsidiaries of publicly traded parent companies.)

Company	Headquarters	Industry	2017 Contract Value	Market Cap	LTM Revenue	Trailing P/E
Lockheed Martin Corp	USA-MD-Bethesda	Aerospace & Defense	$50,696,000,000	$78,994,000,000	$54,280,000,000	26.3x
The Boeing Company	USA-IL-Chicago	Aerospace & Defense	$23,362,000,000	$200,407,000,000	$96,940,000,000	21.1x
General Dynamics Corp	USA-VA-Falls Church	Aerospace & Defense	$15,337,000,000	$48,512,000,000	$34,090,000,000	16.0x
Raytheon Company	USA-MA-Waltham	Aerospace & Defense	$14,658,000,000	$45,296,000,000	$26,480,000,000	18.6x
Northrop Grumman Corp	USA-VA-Falls Church	Aerospace & Defense	$11,195,000,000	$44,455,000,000	$28,290,000,000	16.4x
McKesson Corp	USA-CA-San Francisco	Medical Distribution	$8,796,000,000	$23,867,000,000	$210,930,000,000	13.3x

Huntington Ingalls Industries	USA-VA-Newport News	Aerospace & Defense	$7,245,000,000	$8,356,000,000	$7,970,000,000	12.5x
Bechtel Group	USA-CA-San Francisco	Construction & Engineering	$5,530,000,000		$32,900,000,000	
BAE Systems plc	UK-Hampshire	Aerospace & Defense	$5,288,000,000	$20,134,000,000	$17,570,000,000	20.9x
L3 Technologies	USA-NY-New York	Aerospace & Defense	$5,151,000,000	$13,818,000,000	$10,050,000,000	16.1x
Leidos Holdings	USA-VA-Reston	Info Tech Services	$4,788,000,000	$8,300,000,000	$10,060,000,000	14.3x
AECOM	USA-CA-Los Angeles	Construction & Engineering	$4,108,000,000	$4,564,000,000	$20,160,000,000	16.4x
Booz Allen Hamilton Holding Corp	USA-VA-McLean	Business Services	$4,090,000,000	$6,647,000,000	$6,370,000,000	19.1x
Humana Inc.	USA-KY-Louisville	Health Care Plans	$3,715,000,000	$38,888,000,000	$55,930,000,000	18.9x
Science Applications International Corp	USA-VA-Reston	Info Tech Services	$3,456,000,000	$2,755,000,000	$4,600,000,000	14.4x
Harris Corporation	USA-FL-Melbourne	Communication Equipment	$3,194,000,000	$16,440,000,000	$6,310,000,000	21.5x
UnitedHealth Group	USA-MN-Minnetonka	Health Care Plans	$3,050,000,000	$238,257,000,000	$219,890,000,000	19.4x
CSRA Inc (sub. of General Dynamics)	USA-VA-Fairfax	Info Tech Services	$2,945,000,000			
General Atomic Technologies Corporation	USA-CA-San Diego	Aerospace & Defense	$2,663,000,000			
Centene Corporation	USA-MO-St. Louis	Health Care Plans	$2,604,000,000	$24,738,000,000	$56,360,000,000	32.1x
Alliant Techsystems (sub. of ATK Orbital)	USA-VA-Arlington	Aerospace & Defense	$2,549,000,000			
National Technology & Engineering Solutions of Sandia LLC (sub. of Honeywell)	USA-NM-Albuquerque	Research & Development	$2,527,000,000			
Bell Boeing Joint Project Office (Bell & Boeing Partnership)	USA-MO-St. Louis	Aerospace & Defense	$2,510,000,000			
General Electric Company	USA-MA-Boston	Diversified Industrials	$2,473,000,000	$77,761,000,000	$122,170,000,000	17.1x
Los Alamos National Security LLC	USA-CA-Los Alamos	Research Firm	$2,470,000,000			

United Technologies Corporation	USA-CT-Farmington	Aerospace & Defense	$2,458,000,000	$94,929,000,000	$64,140,000,000	17.7x
Triwest Healthcare Alliance Corp.	USA-AZ-Phoenix	Healthcare Benefits Administration	$2,444,000,000			
CACI International	USA-VA-Arlington	Info Tech Services	$2,437,000,000	$37,179,000,000	$4,550,000,000	11.2x
Honeywell International Inc	USA-NJ-Morris Plains	Diversified Industrials	$2,381,000,000	$101,743,000,000	$42,920,000,000	36.5x
California Institute of Technology	USA-CA-Pasadena	Research University	$2,361,000,000			
Consolidated Nuclear Security LLC (Bechtel, Leidos, ATK Orbital, SOS & Booz)	USA-TN-Oak Ridge	Uranium Processing	$2,342,000,000			
Battelle Memorial Institute	USA-OH-Columbus	Research Firm	$2,337,000,000		$6,200,000,000	
United Launch Alliance LLC (Lockheed & Boeing JV)	USA-CO-Centennial	Aerospace & Defense	$2,249,000,000			
AmerisourceBergen Corp	USA-PA-Chesterbrook	Medical Distribution	$2,220,000,000	$16,226,000,000	$167,940,000,000	09.6x
Health Net Inc. (sub. of Centene)	USA-CA-Woodland Hills	Health Care Plans	$2,109,000,000			
Merck & Co. Inc.	USA-NJ-Kenilworth	Drug Manufacturing	$1,768,000,000	$194,768,000,000	$41,730,000,000	50.1x
Lawrence Livermore National Security (Bechtel, BWX, AECOM, Battelle, Texas A&M)	USA-CA-Livermore	Research & Development	$1,740,000,000			
Accenture Inc.	Ireland-Dublin	Info Tech Services	$1,693,000,000	$97,417,000,000	$42,320,000,000	22.5x
B.L. Harbert Holdings LLC	USA-AL-Birmingham	Construction & Engineering	$1,679,000,000		$1,250,000,000	
Fluor Corporation	USA-TX-Irving	Construction & Engineering	$1,672,000,000	$5,154,000,000	$19,390,000,000	22.1x
Cerberus Capital Management LP (DynCorp Int'l)	USA-NY-New York	Security & Training	$1,664,000,000			
Atlantic Diving Supply (aka ADS Inc)	USA-VA-Virginia Beach	Equipment and Procument	$1,638,000,000			
Chemonics International Inc	USA-DC-Washington	International Trade & Development	$1,638,000,000			

Oshkosh Corporation	USA-WI-Oshkosh	Truck Manufacturing	$1,526,000,000	$4,827,000,000	$7,710,000,000	10.9x
KBR Inc	USA-TX-Houston	Construction & Engineering	$1,516,000,000	$2,427,000,000	$4,520,000,000	05.6x
The Mitre Corporation	USA-MA-Bedford	Research & Development	$1,501,000,000			
UT–Battelle (Univ of TN & Battelle Partnership)	USA-TN-Oak Ridge	Research & Development	$1,482,000,000			
Textron Inc	USA-RI-Providence	Aerospace & Defense	$1,463,000,000	$11,665,000,000	$14,240,000,000	19.8x
Deloitte LLP	UK-London	Professional Services	$1,453,000,000		$43,200,000,000	
State Of California	USA-CA	Research & Development	$1,285,000,000			
Sierra Nevada Corporation	USA-NV-Sparks	Aerospace & Defense	$1,223,000,000			
Caddell Construction Co. Inc.	USA-AL-Montgomery	Construction & Engineering	$1,202,000,000			
Jacobs Engineering Group Inc.	USA-TX-Dallas	Construction & Engineering	$1,189,000,000	$8,607,000,000	$14,980,000,000	47.2x
International Business Machines Corp	USA-NY-Armonk	Info Tech Services	$1,156,000,000	$110,382,000,000	$80,370,000,000	19.3x
Pfizer Inc.	USA-NY-New York	Drug Manufacturing	$1,133,000,000	$247,867,000,000	$53,370,000,000	10.4x
Space Exploration Technologies Corp (aka SpaceX)	USA-CA-Hawthorne	Aerospace & Defense	$1,123,000,000			
Hewlett Packard Enterprise Company	USA-CA-Palo Alto	Communication Equipment	$1,094,000,000	$19,917,000,000	$30,850,000,000	09.2x
PAE Holding Corp	USA-VA-Arlington	International Trade & Development	$1,075,000,000			
Massachusetts Institute Of Technology	USA-MA-Cambridge	Research & Development	$1,073,000,000			
Johns Hopkins University	USA-MD-Baltimore	Research & Development	$1,031,000,000			
CH2M Hill (sub. of Jacobs Engineering)	USA-CO-Meridian	Construction & Engineering	$1,011,000,000		$5,240,000,000	
Vectrus Systems Corp (sub. of Vectrus Inc)	USA-CO-Colorado Springs	Business Services	$1,010,000,000	$265,000,000	$1,250,000,000	04.0x
BP Products North	UK-London	Oil & Gas	$1,006,000,000			

America (sub. of British Petroleum)						
Savannah River Nuclear Solutions LLC	USA-SC-Aiken	Research & Development	$974,000,000			
The Aerospace Corporation	USA-CA-El Seguno	Aerospace & Defense	$949,000,000			
Leonardo Spa	EU-Italy-Rome	Aerospace & Defense	$943,000,000	$5,306,000,000	$11,610,000,000	12.3x
Rockwell Collins (sub. of United Technologies)	USA-IA-Cedar Rapids	Aerospace & Defense	$932,000,000			
Glaxosmithkline plc	UK-Middlesex	Drug Manufacturing	$921,000,000	$97,750,000,000	$30,260,000,000	27.5x
Enterprise Services LLC (sub. of DXC Technology)	USA-TX-Plano	Info Tech Services	$921,000,000			
Arctic Slope Regional Corporation	USA-AK-Barrow	Professional Services	$920,000,000			
MacAndrews & Forbes Holdings	USA-NY-New York	Undetermined	$865,000,000			
CDW Corporation	USA-IL-Chicago	Info Tech Services	$848,000,000	$12,087,000,000	$16,280,000,000	18.4x
Denali Holding (Dell Technologies)	USA-TX-Round Rock	Info Tech Services	$846,000,000			
AT&T	USA-TX-Dallas	Telecom Services	$803,000,000	$224,672,000,000	$164,440,000,000	05.9x
Engility Holdings	USA-VA-Chantilly	Staffing & Outsourcing Services	$791,000,000	$1,076,000,000	$1,930,000,000	31.5x
Nana Regional Corporation	USA-AK-Kotzebue	Info Tech Services	$786,000,000			
Alion Science And Technology Corporation	USA-VA-McLean	Aerospace & Defense	$783,000,000			
Rolls-Royce Holdings plc	UK-London	Aerospace & Defense	$776,000,000	$21,355,000,000	$17,140,000,000	28.7x
The Parsons Corporation	USA-CA-Pasadena	Defense, Security & Infrastructure	$766,000,000		$3,000,000,000	
Mantech International Corp	USA-VA-Fairfax	Software Applications	$755,000,000	$2,161,000,000	$1,920,000,000	16.5x
Royal Dutch Shell plc	EU-Netherlands-The Hague	Oil & Gas	$736,000,000	$249,144,000,000	$371,570,000,000	11.8x
Cardinal Health Inc	USA-OH-Dublin	Medical Distribution	$734,000,000	$14,179,000,000	$139,380,000,000	09.5x

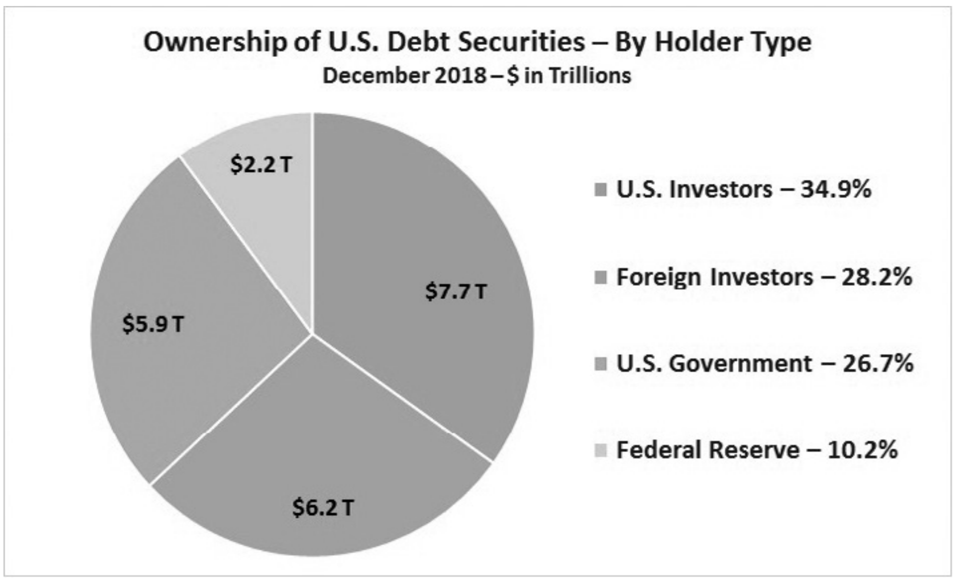
Sanofi SA	EU-France-Paris	Pharmaceuticals	$705,000,000	$105,284,000,000	$34,970,000,000	20.1x
Insight Enterprises	USA-AZ-Tempe	Info Tech Services	$692,000,000	$1,533,000,000	$7,120,000,000	11.6x
Verizon Communications	USA-NY-New York	Telecom Services	$689,000,000	$239,740,000,000	$130,540,000,000	07.4x
Carahsoft Technology Corp	USA-VA-Reston	Info Tech Services	$646,000,000			
Express Scripts Holding (sub. of Cigna)	USA-MO-St. Louis	Pharmacy Benefit Management	$642,000,000		$100,065,000,000	
Serco Group plc	UK-Hampshire	Business Services	$626,000,000	$1,472,000,000	$2,810,000,000	22.9x
Fedex Corporation	USA-TN-Memphis	Shipping & Logistics	$613,000,000	$44,636,000,000	$68,720,000,000	09.3x
Advanced Technology International (sub. of ANSER)	USA-SC-Summerville	Research & Development	$604,000,000			
Leland Stanford Junior University	USA-CA-Palo Alto	Research & Development	$603,000,000			
Austal Limited	Australia-Henderson	Shipbuilder	$603,000,000			
Patriot Team	USA-OK-Tulsa	Charter Airlift Services	$597,000,000			
Anham Fzco	USA-VA-McLean	Supply Chain Management	$579,000,000			
Hensel Phelps Construction	USA-CO-Greeley	Construction & Engineering	$560,000,000			
Brookhaven Science Associates (Stony Brook Univ & Battelle)	USA-NY-Upton	Research & Development	$538,000,000			
Coins 'N Things Inc	USA-MA-Bridgewater	Precious Metals Dealer	$529,000,000			
The Geo Group	USA-FL-Boca Raton	Prison Operator	$528,000,000	$2,677,000,000	$2,300,000,000	18.0x
Corrections Corporation Of America	USA-TN-Nashville	Prison Operator	$527,000,000			
S&K Aerospace LLC	USA-MT-St. Ignatius	Aerospace & Defense	$522,000,000			

Notes:
Table does not include the New York Federal Reserve Bank as depository and agent managing the Exchange Stabilization Fund.
LTM stands for last twelve months.
Blank entries mean the company does not publicly report its financials, so the information is not available.

Sources:
U.S. General Services Administration's Federal Procurement Data System
Financial data from Morningstar Inc., as of January 11, 2019
Revenue information for privately held companies sourced from Wikipedia.org

Official U.S. Debt Investors

Depending upon what news sources you read, you may have the impression that the vast majority of the official U.S. government debt is held by China and certain other large foreign governments. While it is true that China is the largest foreign holder of U.S. government-issued debt securities, a closer look at the facts presents a different picture.



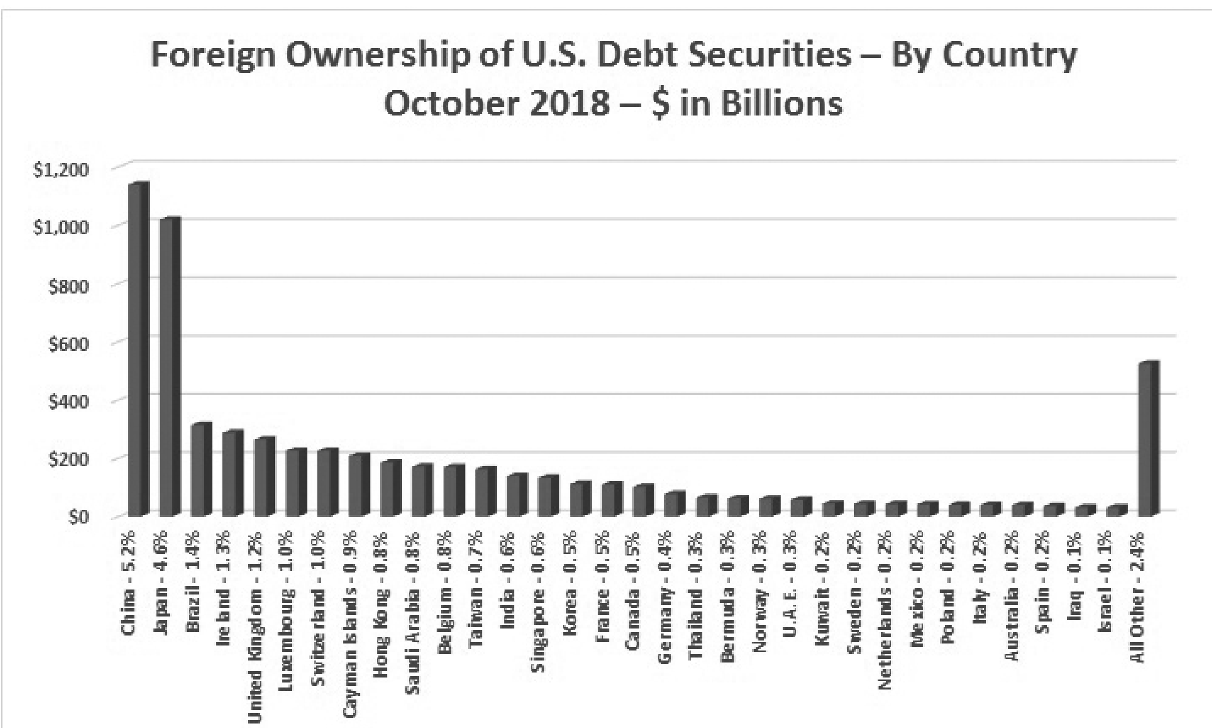
As of December 31, 2018, there were $21.97 trillion of U.S. government-issued debt securities outstanding. U.S. investors were the largest owners of these securities, holding 34.9%, or $7.7 trillion, of the amount outstanding. These investors represent everything from state pension funds, corporate pension funds, college endowment funds, mutual funds, hedge funds, and corporations on down to small mom-and-pop individual investors.

Behind the U.S. domestic holders, foreign investors held the next largest chunk of our nation's debt, at 28.2%, or $6.2 trillion. By far, the two largest foreign holders of our debt were China ($1.1 trillion, or 5.2% of our total issuances) and Japan ($1.0 trillion, or 4.6% of our total). It then drops off very quickly, and the third largest foreign holder, Brazil, is at $314 billion, or 1.4% of our total issuances.

Very interesting is the third largest overall holder of U.S. government-issued debt—it is the U.S. government itself. The U.S. government owns 26.7% of itself, at $5.9 trillion of U.S. debt. How is this possible? Any government agency that brings in money, with an expectation of paying it out someday, can decide to invest in U.S. government debt securities, as it could in any other investment security. These agencies include: the Social Security Trust Fund and Federal Disability Insurance Trust Fund (which own about $2.87 trillion), the Office of Personnel Management Retirement Fund ($989 billion), the Military Retirement Fund ($829 billion), and Medicare ($277 billion), among many others. For all the talk about how much U.S. debt China owns . . . U.S. taxpayers must pay more than 2.5 times that amount back to our national social security system.

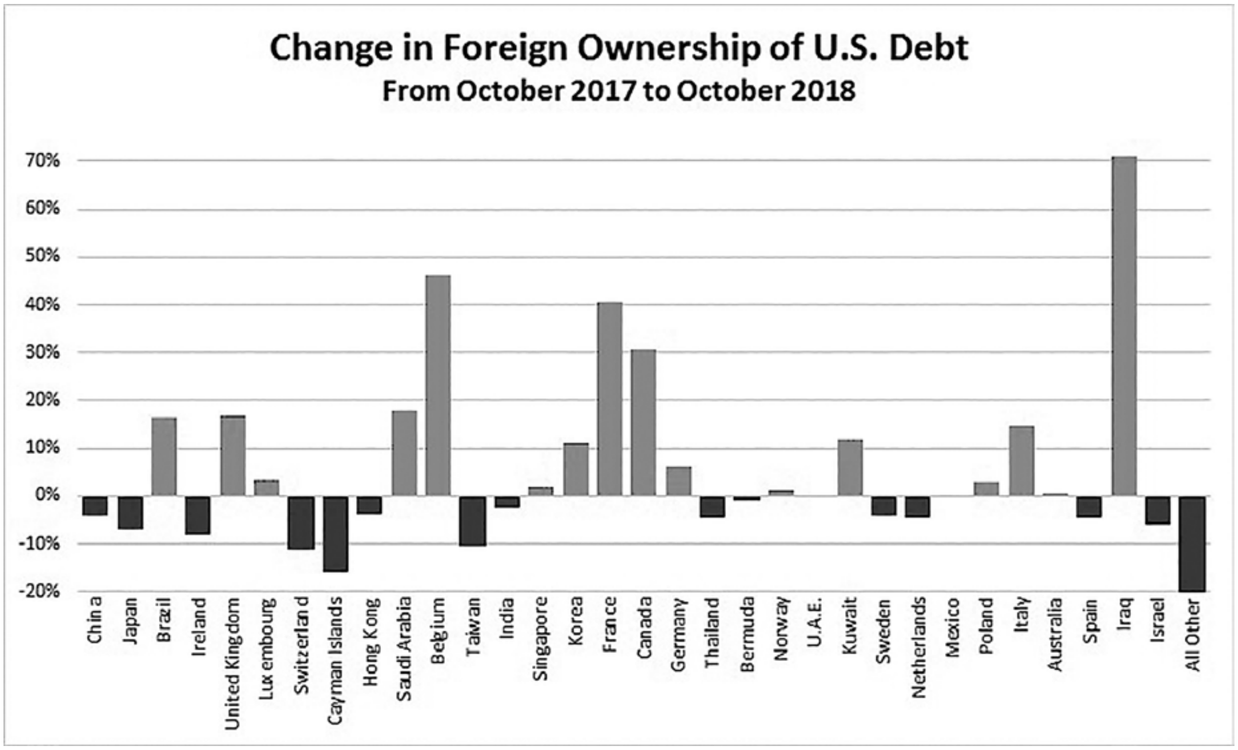
And finally, with all the discussion about "quantitative easing," QE2, QE3, and the "monetization" of our nation's debt, the Federal Reserve Bank represents the fourth largest category of holders of U.S. government debt issuances. Clocking in at $2.24 trillion worth of U.S. debt holdings, the friendly faces commanding and commandeering the U.S. banking system collectively own 10.2% of our nation's overall debt. In return, these non-federal commercial institutions (and their private shareholders) reap billions of dollars in interest payments per year for dollar issuances to the U.S. government, which they were able to create based solely upon the full faith and credit of the U.S. government. Now that's a lucrative gig if you can get it!

Boring in a little on the foreign holders of our nation's debt, we see China (#1) and Japan (#2) far and above at the top. Note that some observers believe that Luxembourg (#6) and the Cayman Islands (#8) rank so far up the list, not because their nations are shrewd investors with large capital pools to invest, but because certain investors preferring to hide their investing identities choose these countries through which to invest covertly and privately. Perhaps the same can be said for Switzerland (#7). And could Ireland be so high up on the list because it is a chosen tax haven for highly profitable tech firms such as Apple, who direct their profits through this small country because of its tax savings???



Another interesting trend to consider is the change in ownership of U.S. government securities by foreign holders. The threat of China "dumping" its U.S. debt holdings is mentioned at times in the press. While we have seen a 4.2% ($50 billion) reduction in Chinese holdings of U.S. government securities from October

2017 to October 2018, it is by no means a dumping. Japan actually sold more, on a percentage (6.9%) and actual ($76 billion) basis, during this time. Perhaps more interesting are those countries that significantly increased their holdings: Brazil (+16%), United Kingdom (+17%), Saudi Arabia (+18%), Belgium (+46%), France (+40%), Canada (+31%), Kuwait (+12%), Italy (+15%), and Iraq (+71%).



Sources for these various charts include:

- "Monthly statement of the public debt of the United States, December 31, 2018." The U.S. Treasury Department, https://www.treasurydirect.gov/govt/reports/pd/mspd/2018/opdm122018.pdf.
- "Major foreign holders of Treasury securities." The U.S. Treasury Department, https://ticdata.treasury.gov/Publish/mfh.txt.
- "Who owns the US national debt? The biggest owner is you!" *The Balance,* https://www.thebalance.com/who-owns-the-u-s-national-debt-3306124.
- "National debt of the United States," Wikipedia, https://en.wikipedia.org/wiki/National_debt_of_the_United_States.

  And if you want to see just how much the U.S. debt is going up every single day. . .
- "The debt to the penny and who holds it," https://www.treasurydirect.gov/govt/reports/pd/pd_debttothepenny.htm.

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Solari Report *2017 Annual Wrap Up*—The State of Our Pension Funds

Primary Dealers of U.S. Government Securities

The following table shows the primary dealers of U.S. government securities. According to the Federal Reserve Bank of New York, "Primary dealers are trading counterparties of the New York Fed in its implementation of monetary policy. They are also expected to make markets for the New York Fed on behalf of its official accountholders as needed, and to bid on a pro-rata basis in all Treasury auctions at reasonably competitive prices."

Company	Headquarters	Market Cap ($Ms)	LTM Revenue ($Ms)	Trailing P/E
Bank of Nova Scotia, New York Agency	Canada-Halifax	$65,977	$21,247	10.4x
BMO Capital Markets Corp	Canada-Montreal	$44,700	$17,219	11.3x
BNP Paribas Securities Corp	EU-France-Paris	$58,895	$89,627	7.1x
Barclays Capital	UK-London	$34,737	$27,086	20.2x
Cantor Fitzgerald & Co	USA-NY-New York	N/A	N/A	N/A
Citigroup Global Markets	USA-NY-New York	$138,445	$72,240	14.7x
Credit Suisse AG, New York Branch	EU-Switzerland-Zurich	$30,169	$20,082	N/A
Daiwa Capital Markets America	Asia-Japan-Tokyo	$8,398	$5,216	9.1x

Deutsche Bank Securities	EU-Germany-Frankfort	$17,676	$28,950	N/A
Goldman Sachs & Co LLC	USA-NY-New York	$65,813	$33,150	12.5x
HSBC Securities (USA) Inc.	UK-London	$165,975	$82,812	15.5x
Jefferies LLC	USA-NY-New York	$5,871	$11,370	35.4x
J.P. Morgan Securities LLC	USA-NY-New York	$332,242	$106,300	12.4x
Merrill Lynch, Pierce, Fenner & Smith (BofA)	USA-NC-Charlotte	$255,464	$88,950	12.3x
Mizuho Securities USA LLC	Asia-Japan-Tokyo	$40,446	$21,447	9.0x
Morgan Stanley & Co LLC	USA-NY-New York	$71,799	$38,730	10.0x
NatWest Markets Securities	UK-London	N/A	N/A	N/A
Nomura Securities International	Asia-Japan-Tokyo	$13,431	$12,391	14.7x
RBC Capital Markets LLC	Canada-Toronto	$104,731	$32,043	11.5x
Societe Generale, New York Branch	EU-France-Paris	$26,230	$54,735	8.1x
TD Securities (USA) LLC	Canada-Toronto	$94,924	$29,009	11.4x
UBS Securities LLC	EU-Switzerland-Zurich	$49,120	$30,119	27.9x
Wells Fargo Securities LLC	USA-CA-San Francisco	$225,336	$85,920	11.3x

Notes:
Financial data shown represent the valuation and revenue of the primary dealers' parent company, which may be engaged in other lines of business besides the brokerage of government securities.
LTM stands for last twelve months.
All numbers are in (or have been converted to) U.S. dollars.
Cantor Fitzgerald & Co. is privately held.

Sources:
Federal Reserve Bank of New York
Financial data from Morningstar Inc., as of January 11, 2019

Top Broker-Dealers

The following table shows the top 15 broker-dealers based on their assets under management in 2018. These are the firms that play an important role in helping U.S. government-issued securities to be distributed from the primary brokers that contract directly with the Federal Reserve Bank all the way down the investment chain to small retail investors as well as larger, commercial purchasers. Whereas the very large brokers that trade directly with the Federal Reserve Bank are called "primary dealers," these smaller firms are typically referred to as "secondary dealers."

Company	Headquarters	Assets Under Mgmt ($B)	Market Capitalization ($M)	LTM Revenue ($M)	Trailing P/E
Fidelity Investments	USA-MA-Boston	$6,850	NA	NA	NA
Charles Schwab	USA-CA-San Francisco	$1,850	$63,066	$9,500	20.2x
Wells Fargo Advisors	USA-CA-San Francisco	$1,600	$230,373	$85,920	11.3x
TD Ameritrade	USA-NE-Omaha	$1,300	$30,515	$5,340	20.0x

Edward Jones	USA-MO-Des Peres	$1,100	NA	NA	NA
Raymond James Financial	USA-FL-Petersburg	$754	$11,139	$7,270	13.5x
AXA Advisors	EU-France-Paris	$665	$47,909	$135,656	7.9x
LPL Financial	USA-MA-Boston	$669	$6,029	$1,720	16.1x
Ameriprise Financial	USA-MN-Minneapolis	$485	$16,480	$12,810	9.9x
Voya	USA-NY-New York	$209	$6,893	$8,520	NA
Commonwealth Financial Network	USA-MA-Waltham	$156	NA	NA	NA
Northwestern Mutual Inv. Services	USA-WI-Milwaukee	$132	NA	NA	NA
Cambridge Investment Research	USA-IA-Fairfield	$99	NA	NA	NA
Securities America	USA-NE-La Vista	$86	NA	NA	NA
Waddell & Reed	USA-KS-Overland Park	$80	$1,378	$12,810	7.7x

Notes:
Financial data shown represent the valuation and revenue of the broker-dealers' parent company, which may be engaged in other lines of business besides the brokerage of government securities.
LTM stands for last twelve months.

Sources:
Investopedia https://www.investopedia.com/investing/broker-dealer-firms/
Financial data from Morningstar Inc., as of January 17, 2019

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