CHRISTOPHER  BYRON

FREDDIE MAC'S MISSTEP

Mortgage agency's mess is too big for Syron's shovel

HERE'S what I want to know: Why isn't everybody completely freaked out over what has apparently been going at the Federal Home Loan Mortgage Association? And while we're on the subject, why does anyone think this company is suddenly going to turn back into a good place to put your money now that the former head of the American Stock Exchange has been tapped to run it?

In case you haven't been following developments at Freddie Mac (which is the other name this outfit goes by), the organization has been reeling for more than a year from a multibillion-dollar accounting scandal that has been spreading through the company like oil on a mud puddle.

Last month the company announced something that from an accounting and management oversight point of view looked to be just about as bad as things could get: Investigators had discovered that the core financial accounts for the 2000, had been totally corrupted and that an incredible $5.2 billion in balance-sheet assets and liabilities had been misallocated.

The apparent purpose: To smooth out income volatility and help the company report steadily increasing earnings year after year.

Want to guess who approved the misallocations? Would you be surprised to learn it's the disgraced and now-defunct Arthur Andersen accounting firm — the same bunch that brought you Enron, WorldCom, Boston Chicken, Global Crossing and plenty more?

Yet another stunner came just last week, when Freddie Mac's financial regulators — at a place called the Office of Federal Housing Enterprise Oversight — issued an astounding 185-page report that says bogus accounting at Freddie Mac did not simply pop out of nowhere beginning in 2000, but in fact spanned much of the 1990s as well.

After reading this report, you'll want to go right to the shower and scrub down for a nice long time with some Brillo pads.

Freddie Mac is a U.S. government-sponsored agency, folks. It was created by an Act of Congress in 1970 to boost investment in the housing market. And in 1993 this oversight outfit — the OFHEO — was set up to keep an eye on it. So read on to see how your tax dollars have been spent.

FOR maybe the whole of the last 13 years, this entire organization seems to have been driven by just one relentless, single-minded (and totally illegal) obsession: creating a fake track record of rapid and relentlessly rising earnings growth, year after year.

If you look at a price chart of Freddie Mac's stock, which trades on the New York Stock Exchange, you'll see the result. From the start of the 1990s all the way through to nearly the very end of the decade, the stock did just one thing: It went up, more than 1,223 percent. That's more than four times the growth rate of the Dow industrials during the period, three times IBM's rate and twice the gain racked up by General Electric.

And the OFHEO report is now telling us the whole thing was achieved by bogus accounting. Here's a quote from the report, discussing the "tone" set by the top brass at Freddie Mac — and there are many other equally rough quotes in the report regarding one aspect or another of this horrid situation:

"The corporate culture fostered by the 'tone at the top' resulted in intense and sometimes improper efforts by the Enterprise to manage its reported earnings, compromised the integrity of many employees, and limited the effectiveness of its control structure."

The report finds that Freddie Mac set up and used huge, multibillion-dollar accounts that had no identifiable purpose other than to mislead investors and Wall Street by smoothing out the company's real earnings pattern, which was up one quarter and down the next.

To accomplish this, Freddie Mac's management did things like:

■ Transferred $30 billion of securitized mortgages to the Salomon Smith Barney investment firm, which then transferred them right back three hours later — enabling Freddie Mac to place them in a different portfolio from the one in which the mortgages had earlier been held, and thereby creating more favorable accounting treatment for the assets.

■ Maintained loan loss reserves at excessively high levels, despite SEC criticism of the practice, to hold down current reported income and thereby have it available as a kind of slush fund for future use, if needed.

■ On at least one occasion, set up a transaction for no other purpose than to disguise the true size of Freddie Mac's derivatives portfolio and calm down a nervous investor.

Why were the brass so willing to engage in such massive deceptions? The OFHEO report points the finger of blame directly at a compensation scheme presided over by the company's top two men — Chief Executive Officer Leland Brendsel and his sidekick David Glenn — in which big bonuses were paid out to executives who could meet or exceed specified earnings-per-share targets.

How come the public never found out about any of this at the time? According to the report, the top brass simply ignored the law when it came to disclosing material information to the investing public: "A disdain for appropriate disclosure standards, despite oft-stated management assertions to the contrary, misled investors and undermined market awareness of the true financial condition of the Enterprise."

It just goes on and on like that, for 185 oily and revolting pages — a lurid picture of an out-of-control, rudderless company careening through the stock market with no one responsible for anything except to show the relentless upward surge of earnings whether they were rising or not.

NOW the Freddie Mac board has appointed a Boston businessman named Richard F. Syron to take over as chairman and CEO and straighten the place out. In Boston, Syron had worked for a company called Thermo Electron Corp., and before that, from 1994 to 1999, he served as chairman of the American Stock Exchange.

A Freddie Mac press release on the Syron appointment cited his success at the Amex in "restor[ing] investor confidence by setting the highest ethical standards and removing companies that failed to meet those standards."

Really? In November 1998, Business Week magazine began a six-month probe of American Stock Exchange practices, unearthing corruption, self-dealing, price-fixing and cover-ups that had been going on at the exchange for years. According to an April 1999 cover story on the matter, one of the exchange's biggest offenders of all was also one of its most powerful floor specialists: Joseph Giamanco, whom Syron strongly supported in the story.

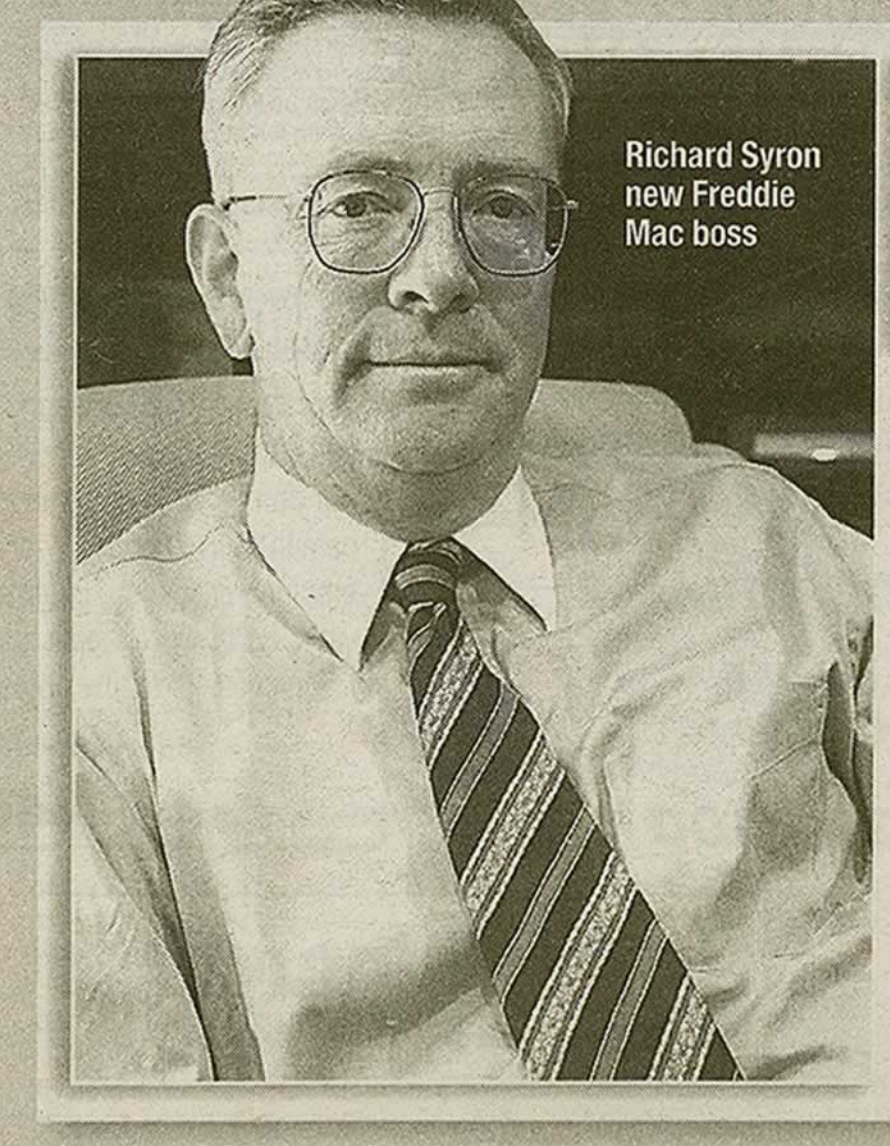
Syron left the Amex in May 1999 to join Thermo Electron, whose co-founder and president, John Hatsopoulos, was then serving as a member of the Amex board of directors. Two years later Giamanco was barred for life from the exchange after an Amex disciplinary panel investigated the BusinessWeek allegations. Giamanco had been an investor in numerous penny stocks held by the collapsed Lancer hedge fund group, shut down by the SEC this summer.

Thermo Electron, where Syron had served as an outside director since 1997, was itself an investor in one of those stocks: Hemispherx Biopharma. A well-known Wall Street short-seller, Manuel Asensio, pursued a lengthy but futile effort to get the exchange to delist the stock.

Now I am sure Syron is a fine man, and that given the right circumstances he would do a fine job at Freddie Mac. But these are not the right circumstances. If the OFHEO report is even halfway correct, the place has more in common with the Fulton Fish Market than the home mortgage market, and Syron simply may not be up to the fumigation job that needs to be done.

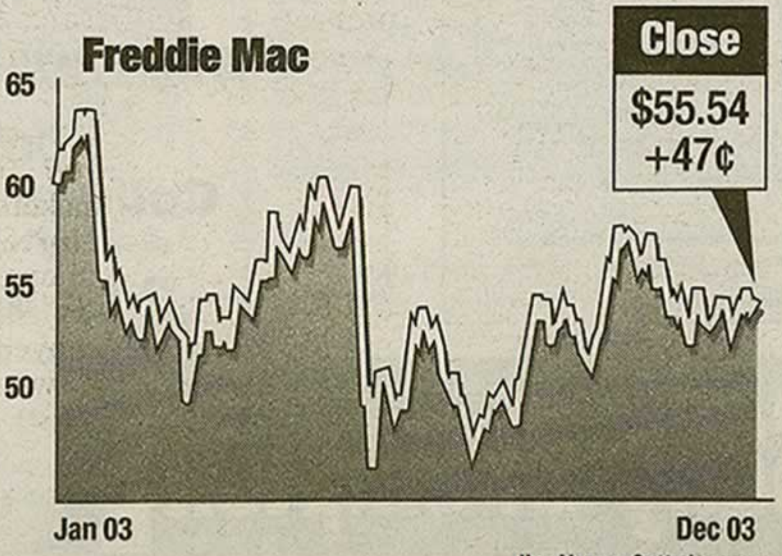
■ *Please send e-mail to: cbyron@nypost.com*

Mr. Fix-it?



Richard Syron new Freddie Mac boss

Richard Syron, who had a tough time trying to clean up the American Stock Exchange, faces an even bigger challenge in getting Freddie Mac back on track.



Jim Alcorn, Getty Images

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