



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
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*Office of the Director*

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February 24, 2004

Mr. Franklin D. Raines  
Chairman of the Board and Chief Executive Officer  
Fannie Mae  
3900 Wisconsin Avenue, NW  
Washington DC 20016-2892

Dear Mr. Raines:

The special examination of accounting policies and practices at Fannie Mae is ongoing. Nonetheless, at the point that Fannie Mae reported an error of \$1 billion in their 3Q'03 8-K release, I requested a separate review of the events surrounding that error. OFHEO's review has raised concerns about the extensive reliance of Fannie Mae on manual systems (otherwise known as end user computing systems).

End user computing systems carry significant risk of error. As such the use of these systems, especially in financial reporting processes, should occur only with strong controls and as an interim step to full automation. The recent error with Fannie Mae's 3Q03 8-K filing occurred in an end user computing application and highlights a basic flaw of these systems: a lack or failure of change control processes.

It was during the process of marking the SFAS 149 settled commitments designated as Available for Sale (AFS) securities to fair value that the error occurred. The error was a result of a computational miscalculation contained in a spreadsheet formula that calculates the gain/loss of the AFS portfolio. More specifically, the error resulted when an employee made an unapproved change to a formula contained within a Microsoft Excel spreadsheet. The formula error went undetected during the normal managerial review process. The error was ultimately discovered during the course of the standard review in preparation for the SEC Form 10-Q for the third quarter.

Other flaws found in this specific end user system were lack of technical and user documentation, insufficient testing, and inadequate backup and recovery techniques. The lack of a fully automated SFAS 149 accounting process as well as the total number of other end user computing systems at Fannie Mae raise concern. In the financial reporting area alone, Fannie Mae relies on more than 70 end user systems, including systems involving the implementation of FAS 133.

Accordingly, please submit a remediation plan that addresses the following:

**1. FAS 149 Systems Automation**

A schedule for the development and implementation of a fully automated FAS 149 accounting commitment process.

**2. Financial Reporting End User Systems**

A plan of action to address all financial reporting end user systems. Specifically:

a. An internal assessment of all financial reporting end user computing applications including the risks and controls surrounding these applications.

b. A plan and timetable for full automation of the financial reporting end user computing applications and controls; or, if Fannie Mae believes that any of these systems should not be automated, then an explanation of the special circumstances preventing their full automation.

Please submit this remediation plan for OFHEO's review and approval within 30-days to Chris Dickerson, Chief Compliance Examiner at OFHEO. Any questions should be directed to his office.

Sincerely,



Armando Falcon Jr.  
Director