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UPDATE 2-OFHEO sues ex-Fannie Mae execs over accounting

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(Adds background in paragraphs 2, 4-6, adds attorney statements in paragraphs 7-10)

WASHINGTON, Dec 18 (Reuters) - The top regulator for Fannie Mae <FNM.N> on Monday sued three former executives who led the mortgage finance company during years in which flawed accounting led it to understate losses by billions of dollars.

The three executives were at the helm when improper bookkeeping was used to "grow Fannie Mae in an unsafe and unsound manner" and sparked an accounting scandal that erased billions of dollars in shareholder value, according to the suit filed by the Office of Federal Housing Enterprise Oversight (OFHEO).

Former Chief Executive Officer Franklin Raines, former Chief Financial Officer Timothy Howard, and Leanne Spencer, the former senior vice president and controller, were named in the civil suit.

Attorneys for the three said their clients looked forward to challenging the allegations.

The lawsuit was filed with a federal administrative law judge, who can hear such cases brought by a federal regulator.

The regulator is seeking penalties and bonuses that could exceed \$215 million for six years of wrongdoing, the regulator said.

OFHEO Director James Lockhart said in a statement that the 101 allegations in the suit were signs of "misconduct," including executives' effort to "improperly manipulate earnings to maximize their bonuses."

Besides costing shareholders money, the executives' actions "damaged the public trust," Lockhart said.

In separate statements, attorneys for Raines and Howard said they looked forward to challenging the OFHEO claims.

"Today's complaint is a work of unsubstantiated fiction," said Steven Salky, Howard's attorney. "We are eager for a fair and impartial adjudication of these claims."

For years before the scandal broke, both accounting firm KPMG and OFHEO cleared Fannie Mae's bookkeeping, Salky said.

Raines' attorney, Kevin Downey, asked the regulator to expeditiously produce documents compiled during OFHEO's investigations.

Raines and Howard resigned in December 2004, shortly after the company was forced to restate years of flawed earnings. Spencer left the company later.

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