Freddie Mac
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Appendix

Internal Control Over Financial Reporting

Freddie Mac has evaluated whether any changes in its internal control over financial reporting during the quarter ended June 30, 2008 have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting. Based on that evaluation, the company has concluded that no such changes have occurred during the quarter.

Progress Toward Remediation of Significant Deficiencies

Significant deficiencies that existed in the company's internal control over financial reporting as of March 31, 2008, and progress toward their remediation as of June 30, 2008, are summarized below. Progress toward remediation is reported in the following stages:

• In process — Freddie Mac is in the process of designing and implementing controls to correct identified internal control deficiencies and conducting ongoing evaluations to ensure all deficiencies have been identified.

• Remediation activities implemented — Freddie Mac has designed and implemented the controls that it believes are necessary to remediate the identified internal control deficiencies.

• Remediated —After a sufficient period of operation of the controls implemented to remediate the control deficiencies, management has evaluated the controls and found them to be operating effectively.

	Remediation Progress as of March 31, 2008	**Remediation Progress as of June 30, 2008**
Guarantee Asset/Guarantee Obligation Governance The company's process for valuation of and accounting for its guarantee asset and guarantee obligation was complex, manually intensive and dependent on end-user computing solutions, which resulted in an unacceptable likelihood of risk of significant error.	Remediation activities implemented	Remediated
Tax Basis Balance Sheet The company does not maintain a tax basis balance sheet to support deferred tax accounting under GAAP, which could result in balance sheet misclassifications and potential income statement adjustments.	In process	In process
Oversight of Models and Model Applications The company's model governance and monitoring procedures did not effectively ensure that changes to and the company's use of models in its financial reporting process are appropriate.	Remediation activities implemented	Remediation activities implemented
IT Security — Shared IDs The company has not consistently executed security controls over system and user accounts that can be used by multiple individuals.	In process	In process
User Access Recertification The company has not effectively executed periodic review and recertification of user access to financial applications and related technical platforms.	In process	In process
Consideration of Controls in Application Design The company's business or technical design requirements for financial application development projects did not adequately consider requirements for automating process controls.	In process	Remediated
Pre-Deployment Application Testing and Maintenance Approval The company did not consistently execute the appropriate testing of new financial applications prior to their deployment nor did it consistently obtain the appropriate approvals of application maintenance changes.	In process	Remediated

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Non-GAAP Financial Measure – Segment Earnings

In managing its business, Freddie Mac presents the operating performance of its segments using Segment Earnings. Freddie Mac's reportable segments are set forth below. Certain activities that are not part of a segment are included in the All Other category.

- Investments, which encompasses its investment activity in mortgage-related securities and single-family mortgage loans, and its activities related to the company's cash and non-mortgage-related securities investment portfolio.
- Single-family Guarantee, which encompasses its credit guarantee activity for single-family mortgages.
- Multifamily, which encompasses both its investment activity and its credit guarantee activity related to multifamily mortgages and its investments in low-income housing tax credit (LIHTC) partnerships.

Segment Earnings differs significantly from, and should not be used as a substitute for, net income (loss) as determined in accordance with GAAP. There are important limitations to using Segment Earnings as a measure of the company's financial performance. Among other things, the company's regulatory capital requirements are based on its GAAP results. Segment Earnings adjusts for the effects of certain gains and losses and mark-to-fair-value items, which depending on market circumstances, can significantly affect, positively or negatively, the company's GAAP results and which, in recent periods, have caused the company to record GAAP net losses. GAAP net losses will adversely impact the company's regulatory capital, regardless of results reflected in Segment Earnings. Also, Freddie Mac's definition of Segment Earnings may differ from similar measures used by other companies.

The company believes that the presentation of Segment Earnings highlights the results from ongoing operations and the underlying results of the segments in a manner that is useful to the way the company manages and evaluates the performance of its business. The objective of Segment Earnings is to present Freddie Mac's results on an accrual basis, as cash flows from the company's segments are earned over time, in a manner more consistent with the company's business models. Freddie Mac is primarily a buy and hold investor in mortgage assets, and given the company's business objectives, management believes it is meaningful to measure performance of its investment business using long-term returns, not on a short-term fair value basis. The company's business model for its investment activities is one where it buys and holds investments in mortgage-related assets for the long term, funds the investments with debt and uses derivatives to minimize interest-rate risk, and generates net interest income in line with the company's return on equity objectives. The company's business model for its credit guarantee activities is one where the company is a long-term guarantor in the conforming mortgage markets, manages credit risk, and generates guarantee and credit fees, net of incurred credit losses. As a result of these business models, the company believes that an accrual-based metric is a meaningful way to present its financial results as actual cash flows are realized, net of credit losses and impairments. The company believes Segment Earnings provides a view of the company's financial results that is more consistent with management's business objectives, which helps management better evaluate the performance of the company's business, both from period-to-period and over the longer term.

As described below, Segment Earnings is calculated for the segments by adjusting net income (loss) for certain investment-related activities and credit guarantee-related activities. Segment Earnings includes certain reclassifications among income and expense categories that have no impact on net income but provide the company with a meaningful metric to assess the performance of each segment and the company as a whole.

Investment activity-related adjustments

GAAP-basis earnings related to investment activities of the Investments segment, and to a lesser extent, the Multifamily segment, are subject to significant period-to-period variability, which management believes is not necessarily indicative of the risk management techniques it employs and the performance of these segments. The adjustments made, and described below, to the GAAP-basis results are consistent with the financial objectives of the company's investment activities and related hedging transactions and provide management with a view of expected investment returns and effectiveness of the company's risk management strategies that it believes are useful in managing and evaluating its investment-related activities.

Investment activity-related adjustments include the following:

- Derivative and foreign-currency denominated debt-related adjustments: Segment Earnings excludes fair value adjustments on derivative positions as these positions economically hedge the company's investments activities. The payments received or paid to terminate derivative positions and the payment of up-front premiums are amortized prospectively into Segment Earnings on a straight-line basis. The up-front payments, primarily for option premiums, are amortized to reflect the periodic cost associated with the protection provided by the option contract. Foreign-currency translation gains and losses as well as the unrealized fair value adjustments associated with foreign-currency denominated debt along with the foreign-currency derivatives gains and losses are excluded from Segment Earnings, as the foreign currency exposure is economically hedged.
- Investment sales, debt retirements and fair value-related adjustments: Gains and losses on securities sold out of the retained portfolio and cash and investments portfolio and debt retirements are amortized prospectively into Segment Earnings on a straight-line basis. Trading losses or impairments that reflect expected or realized credit losses are realized immediately pursuant to GAAP and in Segment Earnings since they are not economically hedged. Fair value adjustments to trading securities related to investments that are economically hedged are not included in Segment Earnings. Similarly, non-credit related impairment losses on securities are not included in Segment Earnings. These amounts are deferred and amortized prospectively into Segment Earnings on a straight-line basis. GAAP-basis accretion income that may result from these impairment adjustments is also not included in Segment Earnings.
- Fully taxable-equivalent adjustment: Interest income generated from tax-exempt investments is adjusted in Segment Earnings to reflect its equivalent yield on a fully taxable basis.

As discussed above, the company funds its investment assets with debt and derivatives to minimize interest-rate risk as evidenced by its portfolio market value sensitivity (PMVS) and duration gap metrics. As a result, in situations where gains and losses are recorded on derivatives, securities or debt buybacks, these gains and losses are offset by economic hedges that the company does not mark to market for GAAP purposes. For example, when the company realizes a gain on the sale of a security, the debt that is funding the security has an embedded loss that is not recognized under GAAP, but instead over time as the company realizes the interest expense on the debt. As a result, in Segment Earnings, the company defers and amortizes the security gain to interest income to match the interest expense on the debt that funded the asset. Because of Freddie Mac's risk management strategies, the company believes that amortizing gains or losses on economically hedged positions in the same periods as the offsetting gains or losses is a meaningful way to assess performance of its investment activities.

Credit guarantee activity-related adjustments

Freddie Mac's credit guarantee activities consist largely of the company's guarantee of the payment of principal and interest on mortgages and mortgage-related securities in exchange for management and guarantee and other fees. Over the longer term, earnings from this business consist almost entirely of the management and guarantee fee revenues, including management and guarantee fees collected throughout the life of the mortgage loan and upfront compensation Freddie Mac receives, trust management fees less related credit costs (*i.e.*, provision for credit losses) and operating expenses. The company's measure of Segment Earnings for the credit guarantee business consists primarily of these elements of revenue and expense. Management believes this measure is a relevant indicator of operating performance for specific periods, as well as trends in results over multiple periods, because it more closely aligns with how the company manages and evaluates the performance of the credit guarantee business.

Credit guarantee activity-related adjustments include the following:

- Segment Earnings excludes: (i) certain amortization and valuation adjustments pertaining to the guarantee asset and guarantee obligation, (ii) initial recognition of gains and losses recorded prior to January 1, 2008 and in connection with the execution of either securitization transactions that qualify as sales or guarantor swap transactions, such as losses on certain credit guarantees, and (iii) fair value adjustments recorded upon the purchase of delinquent loans from pools that underlie securities that Freddie Mac guarantees. Segment Earnings include the amortization of the upfront credit fees.
- Under Segment Earnings, the GAAP-basis loan loss provision is adjusted to reflect the company's estimate of the losses it will ultimately realize on delinquent loans it purchases from pools that underlie securities that Freddie Mac guarantees.

For a detailed explanation of the company's Segment Earnings metric and segment reporting, *see* "NOTE 15: SEGMENT REPORTING" to the company's unaudited consolidated financial statements in its Registration Statement on Form 10 dated July 18, 2008.

Reconciliations

The following table reconciles Segment Earnings to GAAP net income (loss).

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Table 1 – Reconciliation of Segment Earnings (Loss) to GAAP Net Income (Loss)

	Three Months Ended		
	June 30, 2008	**March 31, 2008**	**June 30, 2007**
		($ in millions)	
Segment Earnings (loss) after taxes:			
Investments	$793	$113	$571
Single-family Guarantee	(1,388)	(458)	129
Multifamily	118	98	84
All Other	144	(4)	(43)
Total Segment Earnings, net of taxes	**(333)**	**(251)**	**741**
Reconciliation to GAAP net income (loss)			
Derivative- and foreign-currency denominated debt-related adjustments	527	(1,194)	(471)
Credit guarantee-related adjustments	1,818	(174)	831
Investment sales, debt retirements and fair value-related adjustments	(3,096)	1,525	(379)
Fully taxable-equivalent adjustments	(105)	(110)	(97)
Total pre-tax adjustments	(856)	47	(116)
Tax-related adjustments	368	53	104
Total reconciling items, net of taxes	(488)	100	(12)
GAAP net income (loss)	**$(821)**	**$(151)**	**$729**

The following tables reconcile certain financial information for the company's reportable segments and All Other.

Table 2 - Segment Earnings and Reconciliation to GAAP Results

	Three Months Ended June 30, 2008										
	Net Interest Income (Expense)	**Management and Guarantee Income**	**Other Non-Interest Income (Loss)**	**Administrative Expenses**	**Provision for Credit Losses**	**REO Operations Expense**	**LIHTC Partnerships**	**Other Non-Interest Expense**	**LIHTC Partnerships Tax Benefit**	**Income Tax (Expense) Benefit**	**Net Income (Loss)**
						(in millions)					
Investments	$ 1,481	$ -	$ (125)	$ (130)	$ -	$ -	$ -	$ (7)	$ -	$ (426)	$ 793
Single-family Guarantee	58	840	103	(212)	(2,630)	(265)	-	(29)	-	747	(1,388)
Multifamily	98	17	7	(49)	(7)	-	(108)	(5)	149	16	118
All Other	-	-	(3)	(13)	-	-	-	(17)	-	177	144
Total Segment Earnings (loss), net of taxes	1,637	857	(18)	(404)	(2,637)	(265)	(108)	(58)	149	514	(333)
Reconciliation to GAAP net income (loss):											
Derivative- and foreign-currency translation-related adjustments	(482)	-	1,009	-	-	-	-	-	-	-	527
Credit guarantee-related adjustments	14	(156)	2,054	-	79	-	-	(173)	-	-	1,818
Investment sales, debt retirements and fair value-related adjustments	73	-	(3,169)	-	-	-	-	-	-	-	(3,096)
Fully taxable-equivalent adjustments	(105)	-	-	-	-	-	-	-	-	-	(105)
Reclassifications(1)	392	56	(469)	-	21	-	-	-	-	-	-
Tax-related adjustments	-	-	-	-	-	-	-	-	-	368	368
Total reconciling items, net of taxes	(108)	(100)	(575)	-	100	-	-	(173)	-	368	(488)
Total per consolidated statement of income	$ 1,529	$ 757	$ (593)	$ (404)	$ (2,537)	$ (265)	$ (108)	$ (231)	$ 149	$ 882	$ (821)

(1) Includes the reclassification of: a) the accrual of periodic cash settlements of all derivatives not in qualifying hedge accounting relationships from other non-interest income (loss) to net interest income (expense) within our Investments segment; b) implied management and guarantee fees from net interest income (expense) to other non-interest income (loss) within our Single family Guarantee and Multifamily segments; c) net buy-up and buy-down fees from management and guarantee income to net interest income (expense) within the Investments segment; d) interest income foregone on impaired loans from net interest income (expense) to provision for credit losses within our Single-family Guarantee segment; and e) certain hedged interest benefit (cost) amounts related to trust management income from other non-interest income (loss) to net interest income (expense) within our Investments segment.