



“Are We Paying for Integrity, Incompetence, or Indifference?”

March 17, 2008

There is a growing misperception in the marketplace that new regulations such as Sarbanes-Oxley and more stringent accounting standards have lowered risks for investors. The hard reality, is that risk-related blow-ups continue to cost investors dearly. At Audit Integrity, our business is to monitor public companies for indications that management behaviors and motivations are creating meaningful risk. Though our ratings are reliable indicators of future problems for investors, we find it no less painful to watch the destruction of equity due to ongoing failures by corporate management to identify and manage risk.

The latest unraveling is the now Fed-assisted bailout sale of beleaguered Bear Stearns, one of the leading players in subprime originations and repackaging. This shocking news of intervention comes just mere days after the firm dismissively announced it had no liquidity problems (Stearns’ Alan Greenberg even referring to such talk as “ridiculous”¹). Its stock today lays battered at ~\$3 (crash-diving from ~\$90 in under 3 weeks), leaving investors horrified at the brunt of their losses.

The questions that rise repeatedly as the credit crisis continues to unwind relate to both accounting transparency and corporate governance. Was financial risk competently monitored and was it communicated to investors? Given the level of panic and shock from all sides, it appears not. On February 28 this year the Wall Street Journal had an interesting article, “Citigroup Installs New Risk Managers”². The article points to the fact that Citigroup has just suffered more than \$20 billion in losses from exposure to risky investments, then goes on to say:

“Like other Wall Street banks, Citigroup calculates the amount of risk its investment bank is taking every day with a metric known as value-at-risk, or VAR. It is designed to provide a ballpark estimate of how much money a bank’s traders potentially could lose on a given day.

“At the end of last year, Citigroup’s VAR stood at \$191 million, compared with \$106 million a year earlier. That is not out of line with other Wall Street firms.

“But Citigroup’s annual report noted an important caveat. The VAR figures don’t include Citigroup’s exposure to collateralized debt obligations – which were responsible for nearly \$20 billion in investment-banking losses last year. The annual report said that the CDOs weren’t included in the risk tally because they are tough to value.” (our emphasis)

Less than a week later, on March 5, Marketwatch.com quoted Vikram Pandit, the new CEO of Citigroup, as saying the firm was “financially sound”³. Pandit was quoted as saying,

“While we face a challenging economic environment in many segments of our operations, fundamentally we remain strong. On a pro forma basis at the end of last year, we exceeded our regulatory requirements and internal targets for capital levels.”

The report continues:

“Citi raised \$30 billion in the last two months of 2007 from Mideast sovereign-wealth funds and a public offering.

“The bank is expected to experience a first-quarter loss of at least \$14 billion on around \$37 billion of existing exposure to debit tied to subprime mortgages, analysts said.”

It is important to recognize that all banking institutions are subject to risk management regulations which provide detailed standards for risk analysis and risk capital. Citigroup elected to determine their overall risk level by utilizing the method defined as Value At Risk (VAR), referenced in the Wall Street Journal excerpt.

This risk valuation methodology for traded securities requires not only sophisticated modeling tools, but also substantial judgment on the part of the user. I can’t evaluate the models Citigroup uses for

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¹ Bear Stearns’ Greenberg: Liquidity Talk Is ‘Ridiculous’, www.cnbc.com, March 10, 2008

² Enrich, David, “Citigroup Installs New Risk Managers”, February 28, 2008, Wall Street Journal, Page C3

³ Citigroup CEO says firm ‘financially sound’, www.marketwatch.com, March 5, 2008

its VAR testing, but I can seriously question their judgment. How can a lender with substantial exposure in CDO's (approximately \$40 billion-plus) come to a conclusion that it is "financially sound" when it is incapable of measuring the risk associated with its holdings?

Unfortunately, given Citigroup's inability to value their CDO loan exposure, I have no confidence in their ability to assess the risk stated on their balance sheet. As of December 31, Citigroup acknowledged an allowance for credit losses of \$17.36 billion. What actual risk does that represent?

Mr. Pandit has only been at the helm since December of 2007. He did not create this mess, and may feel that an optimistic – but, as yet, completely unsupported -- outlook is critical to turning his company around. Still, as an investor watching the Bear Stearns drama unfold, I would appreciate a little less spin and a little more candor.

Who, then, is responsible for approximately \$152 billion in losses to Citigroup's investors over the period starting January 1, 2007

to date? First and foremost, it is the Citigroup managers who gave a green light to questionable loans. Beyond that, in ever-widening circles, we can fault the CFO who allowed for the full scope of the actual risk to be obfuscated by simply excluding the most unreliable assets from analysis; the Audit Committee members who approved misleading financial statements; and the outside auditors who signed off on the 10-K.

In Audit Integrity ratings, Citigroup has been ranked Very Aggressive or Aggressive (our highest risk categories) for aggressive accounting and governance risk since 2005. Persistently bad ratings have proven to be highly predictive of major negative events. That means that while the size of the losses may be shocking, the fact that Citigroup investors are facing these results is not a surprise to us or our subscribers. These Accounting & Governance Risk (AGR®) ratings are used by investment managers, fund managers, Federal regulators, and the corporations themselves as a means of quantifying the likelihood of serious financial problems.

Citigroup (NYSE: C)
Current AGR Rating: Very Aggressive (37)

AGR Risk Categories	Current Quarter AGR Impact	Quarterly Risk History (Quarter/AGR/Red Flags)											
		9/07	6/07	3/07	12/06	9/06	6/06	3/06	12/05	9/05	6/05	3/05	12/04
		37	42	17	20	55	65	44	49	48	36	36	23
Revenue Recognition	-15.2												
Expense Recognition	0												
Asset-Liability Valuation	-17.2												
High-Risk Events	-19.8												
Governance	-10.7												

The story of failure to measure or communicate risk does not stop with Citigroup and its auditors, because the largest number of individual investors exposed to these losses probably never thought to depend on Citigroup for risk information but reasonably expected to be advised by their portfolio managers. Hundreds of mutual fund managers and other professional money managers purchased shares in Citigroup on behalf of their investment clients and in most cases, continue to hold them despite overwhelming losses to millions of Americans whose future well-being is dependent on their judgment.

current risk management tools failed to identify the scope of risk associated with Citigroup (which has dropped from over \$50/share to ~\$20/share since the beginning of 2007), they need to look for new approaches to quantifying risk.

As investors, we pay investment advisors and fund managers to use sound judgment in directing our investments to corporations that maintain a high standard of integrity in their management practice and financial reporting. What are we receiving in return?

Fiduciaries, including mutual funds, have a responsibility to the investors they advise, or whose assets they manage. If their

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The Tables below show the largest Fund owners of Citigroup stock (Index Funds are excluded as the selection criteria are not subjective).

**Largest Fund Owners of Citigroup, Inc.
By Number of Shares**

Fund Name	Fund Manager	Fund Expense Ratio	Fund 2008 YTD Return	Date of Portfolio	% of Fund Net Assets	Approx. # of Shares	Approx. Loss since 12/31/2007
American Funds Growth Fund of America	James E. Drasdo	0.62%	-6.60%	12/31/2007	0.72	42953397	-\$12,099,972
American Funds Washington Mutual Inv Fund	James K. Dunton	0.57%	-8%	12/31/2007	1.52	38957732	-\$10,974,393
American Funds Investment Co of America	R. Michael Shanahan	0.54%	-7.80%	12/31/2007	1.53	42453939	-\$11,959,274
CREF Stock Account (Instl Large Cap Value)	-	-	-	12/31/2007	1.57	31210000	-\$8,791,857
American Funds Income Fund of America	Abner D. Goldstine	0.54%	-6.80%	12/31/2007	1.07	28968570	-\$8,160,446
Vanguard Windsor II Fund	James P. Barrow	0.32%	-8.30%	12/31/2007	2.12	32964235	-\$9,286,025
Dodge & Cox Stock Fund	John A. Gunn	0.52%	-9%	12/31/2007	1.08	20977240	-\$5,909,289
American Funds Capital World Gr & Inc Fund	Stephen E. Beppler	0.69%	-7.30%	12/31/2007	0.54	18979408	-\$5,346,499
Davis New York Venture Fund	Christopher Cullom	0.84%	-7.50%	10/31/2007	1.54	17481034	-\$4,924,407
American Funds New Perspective Fund	Gregg E. Ireland	0.70%	-6.60%	12/31/2007	0.89	16981575	-\$4,783,710

**Largest Fund Owners of Citigroup, Inc.
By Percentage of Portfolio**

Fund Name	Fund Manager	Fund Expense Ratio	Fund 2008 YTD Return	Date of Portfolio	% of Fund Net Assets
ProFunds Banks UltraSector Inv	Hratch Najarian	1.57%	-12.50%	10/31/2007	13.28
AIM Financial Services Inv	Michael J. Simon	1.28%	-11.80%	12/31/2007	7.62
Wells Fargo Advantage Spec Fin Serv A	Allen J. Ayvazian	1.35%	-12.10%	10/31/2007	7.28
Burnham Financial Industries A	Anton Schutz	1.81%	-1.40%	12/31/2007	5.43
Profunds UltraSector Financials Inv	Hratch Najarian	1.68%	-17.20%	10/31/2007	5.26
Hennessy Total Return	Neil J. Hennessy	1.16%	-6.80%	12/31/2007	4.83
Wells Fargo Advantage U.S. Value Z	Robert Costominis	1.32%	-7.80%	10/31/2007	4.81
Fidelity Advisor Financial Services A	Richard Manuel	1.22%	-12.20%	12/31/2007	4.8
JHancock Classic Value A	Richard S. Pzena	1.30%	-9.90%	12/31/2007	4.75
UBS U.S. Large Cap Value Equity Y	Thomas M. Cole	0.85%	-10.50%	9/30/2007	4.65

James A. Kaplan
CHAIRMAN