CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE

(A Component Unit of the State of California)

Report to Management

For the Fiscal Year Ended June 30, 2006

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)

REPORT TO MANAGEMENT
For the Fiscal Year Ended June 30, 2006

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To the Independent Citizens Oversight Committee
of the California Institute for Regenerative Medicine
San Francisco, California

In planning and performing our audit of the financial statements of the California Institute for Regenerative Medicine (CIRM) for the year ended June 30, 2006, we considered CIRM's internal controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control. However, during our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and recommendations and the current status of prior year comments and recommendations communicated to you by other auditors. This letter does not affect our report dated January 5, 2007, on the financial statements of CIRM.

Additionally, we have included in this letter a report on communications with the Independent Citizens Oversight Committee as required by auditing standards generally accepted in the United States of America.

The accompanying report is intended solely for the information and use of the Independent Citizens Oversight Committee and management of CIRM and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 5, 2007

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Report to Management
Required Communications
For the Fiscal Year Ended June 30, 2006

Professional auditing standards require that we provide you with the following information related to our audit.

I. Our Responsibility Under U.S. Generally Accepted Auditing Standards and *Government Auditing Standards*

As stated in our engagement letter dated December 1, 2006, our responsibility as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting standards. Because an audit is designed to provide reasonable, but not absolute assurance, and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered CIRM's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the CIRM's financial statements are free of material misstatement, we performed tests of CIRM's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit.

II. Significant Accounting Policies and Unusual Transactions

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by CIRM are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by CIRM during the period that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

III. Accounting Estimates

Accounting estimates are an integral part of the financial statements. Those judgments are based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. There were no significant estimates in the financial statements.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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Report to Management
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2006

IV. Audit Adjustments

For the purposes of this report, professional standards define an audit adjustment as a proposed correction of the basic financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on CIRM's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we posed, whether recorded or unrecorded by CIRM, either individually or in aggregate, indicate matters that could have a significant effect on CIRM's financial reporting process. In addition, the attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

V. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

VI. Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

VII. Issues Discussed Prior to Our Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as CIRM's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

VIII. Difficulties in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Report to Management
Comments and Recommendations
For the Fiscal Year Ended June 30, 2006

FINANCIAL REPORTING PROCESS

As part of our audit, we proposed numerous adjustments and accounting entries to properly reflect CIRM's assets, liabilities, revenues and expenses. The financial reporting process can be improved in the following areas to more efficiently and accurately prepare CIRM's financial statements in accordance with generally accepted accounting principles:

Cash and investments

As part of the closing process, the State Controller's Office eliminates the balance of the cash in State Treasury account in accordance with SAM chapter 10500. As a result, the trial balance generated by the general ledger system does not reflect all of CIRM's cash and investments at year end. In fiscal year 2006, an audit adjustment was posted to increase cash and investments by $1,490,574. Cash and investment balances should be adjusted to include the cash in State Treasury account for external financial reporting and to provide CIRM's management with accurate financial information.

Capital assets

In the current and prior years, CIRM purchased or acquired various office and computer equipment, which are reported as capital assets in the financial statements. For external reporting purposes, the accounting records should include a detailed accounting of capital assets acquired during the current year, historical cost of assets acquired in prior years, sale or disposal of obsolete assets and depreciation expense and accumulated depreciation. Such records are important for accurate financial reporting and proper safeguarding of assets.

Interest on long-term and interim debt

Interest on long-term and interim debt should be reported in the government-wide financial statements. The State Controller's Office (SCO) Division of Accounting and Reporting (DAR) prepares detailed interest calculations as part of the State's financial reporting process. In preparing CIRM's financial statements, the SCO should include accrued interest and interest expense.

Management's response:

CIRM is in agreement with the financial statement in accordance with GAAP as presented in the statement of net assets and governmental fund balance sheet. However, the SCO abides by SAM Chapter 10500 which states that the cash in State Treasury account balance is transferred to the Fund Balance-Clearing Account when reporting the cash and investment year end statements. For this reason, the cash in State Treasury account balance of was transferred to the Fund Balance-Clearing Account. It is not an adjusting entry; it is the required entry at June 30th.

The capital assets information for this audit period was provided to the financial auditors. This information will be included on CIRM's future financial statements.

The accrued interest information for June 30, 2005 and June 30, 2006 was provided to the financial auditors. This information will be included on CIRM's future financial statements.

ENSURING COMPLIANCE WITH DEBT AND DONOR RESTRICTIONS

CIRM's activities are dependant upon debt financing and donor contributions. Debt agreements often contain minimum debt service requirements, repayment terms and cash reserve provisions. Donor contributions often stipulate spending restrictions and financial and operational reporting requirements. There does not appear to be a formal policy for monitoring and reviewing compliance with such agreements. We recommend that management establish a policy to identify and periodically monitor significant provisions to ensure compliance with these requirements.

Management Response:

The CIRM does monitor the requirements for debt services and donor agreements information internally and provides the information to the SCO. The CIRM agrees that a formal policy should and will be put in place to monitor and review compliance with debt financing and donor contributions agreements.

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Report to Management
Status of Prior Year Comments and Recommendations
For the Fiscal Year Ended June 30, 2006

FINANCIAL STATEMENT CLOSING PROCESS

For the year ended June 30, 2005 the accounting records of CIRM were properly closed in accordance with State accounting procedures. In the future, we recommend that in addition to closing the books in accordance with standard State accounting procedures, separate financial statements for CIRM should also be prepared in accordance with GASB 34. This includes converting fund-basis financial statements to government-wide financial statements, preparation of footnotes, and the preparation of a management's discussion and analysis section. This will benefit CIRM by increasing control over the content and completion of the financial statements and reducing the completion time of the audited financial statements. To accomplish this, we recommend that CIRM consider enlisting the assistance of the State Controller's Office Division of Accounting and Reporting.

Current Year Status:

The SCO provided year-end information which allowed the financial auditor to prepare separate financial statements in accordance with GASB 34. Also see current year comments and recommendations.

CONFLICT OF INTEREST FORMS

In accordance with Chapter 3. Article 1, Section 125290.30(g) of Proposition 71 and Government Code Section 87300, the Independent Citizens' Oversight Committee (ICOC) adopted a proposed Conflict of Interest Code for its members and for employees of CIRM. In addition, the ICOC also adopted conflict of interest policy statements for its members and employees of CIRM.

It is our understanding that most of the ICOC members attended the meeting at which the ICOC policy statement was considered and they voted unanimously to approve it. In addition, copies of the conflict of interest statement for ICOC members have been given to all members not in attendance at that meeting and to new ICOC members, including authorized alternates, at the time of appointment. However, during the audit period we noted that there was no place for the ICOC members to sign the statement indicating their agreement to abide by requirements of the conflict of interest statement. We recommend that CIRM management ensure that all ICOC members and designated alternates sign the approved conflict of interest statement.

Current Year Status:

A signature line was added to the ICOC Conflict of Interest document in early 2006, and signed forms were obtained from all 29 ICOC members and their alternates (there are 10 total alternates appointed to date) by May 30, 2006.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE
SCHEDULE OF UNCORRECTED MISSTATEMENTS
JUNE 30, 2006

#	ACCOUNT #	FUND NAME	DESCRIPTION	ASSETS	LIABILITIES	FUND BALANCE	REVENUE	EXPENSES
1	9010	Stem Cell Research Fund	State Operations					10,652
	3010	Stem Cell Research Fund	Accounts Payable		10,652			
2	XXX	Stem Cell Research Fund	Interest Receivable	15,333				
	8000	Stem Cell Research Fund	Revenue				15,333	
				15,333	10,652	-	15,333	10,652