CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE

A Component Unit of the State of California

Independent Auditor's Reports, Financial Statements
and Required Supplementary Information

For the Year Ended June 30, 2006

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

JUNE 30, 2006

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To the Members of the
Independent Citizen's Oversight Committee of the
California Institute for Regenerative Medicine
Sacramento, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities and major fund of the California Institute for Regenerative Medicine (CIRM), a component unit of the State of California, as of and for the year ended June 30, 2006, which collectively comprise CIRM's basic financial statements as listed in the table of contents. These financial statements are the responsibility of CIRM's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CIRM's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of CIRM as of June 30, 2006, and the respective changes in financial position and the budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 5, 2007, on our consideration of CIRM's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the Unites States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise CIRM's basic financial statements. The supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 5, 2007, except for
Note 9 to the financial statements,
as to which the date is
February 27, 2007

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

Management's Discussion and Analysis

The Management of the California Institute for Regenerative Medicine (CIRM) is pleased to provide this overview and analysis of the financial activities of CIRM for the year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the Financial Statements that follow this discussion.

Financial Highlights

- The net assets of CIRM at June 30, 2006 were $(15,204,115) compared to the end of the prior fiscal year of $2,457,613. Of that amount, $60,582 was invested in capital assets and $(15,264,697) was unrestricted.

- CIRM's cash and investments balance at June 30, 2006 is $2,651,574, a decrease of $2,460,580 from the balance at June 30, 2005.

- For fiscal year ended June 30, 2006 CIRM had program revenues of $350,000, which represents a decrease of $4,650,000 from the prior year. Additionally, general revenues were $73,716 for fiscal year 2006 representing a slight decrease of $10,944 from the prior year. Expenses for fiscal 2006 were $18,085,444, a $15,458,397 increase from the prior year.

- All financial assets of CIRM continue to be devoted to providing funds for medical research.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to CIRM's basic financial statements, which are comprised of the following components, in addition to management's discussion and analysis: 1) Government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The government-wide and fund financial statements are presented in a combined format as listed in the table of contents. Items in the adjustment column of each respective financial statement are discussed in Note 3.

Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of CIRM's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of CIRM's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of CIRM is improving or deteriorating.

Government-Wide Financial Statements (Continued)

The *statement of activities* presents information showing how CIRM's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. CIRM uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. CIRM reports one governmental-type fund, the Stem Cell Fund.

Governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating CIRM's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for the governmental funds with similar information presented for governmental activities. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a column detailing the differences (adjustments) between the governmental funds and governmental activities. These adjustments are discussed in further detail in Note 3 to the basic financial statements.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in CIRM-wide and fund financial statements. The notes to the financial statements can be found on the pages as listed in the table of contents of this report.

Government-Wide Financial Analysis

The government-wide financial statements provide long-term and short-term information about CIRM's overall financial condition. This analysis addresses the financial statements of CIRM as a whole.

As noted earlier, net assets may serve over time as a useful indicator of CIRM's financial position. At June 30, 2006 CIRM's net assets were ($15,204,115) a decrease of $17,661,728 over the prior year net assets of $2,457,613.

Government-Wide Financial Analysis (Continued)

At June 30, 2006 ($15,264,697) of CIRM's net assets are unrestricted. The remaining net assets of $60,582 reflect its investment in capital assets.

For the year ended June 30, 2006, net assets decreased by $17,661,728 primarily due to the issuance of bond anticipation notes, the proceeds of which were used to support the operations of the CIRM and award $12.1 million in training grants. Program revenues decreased by $4,650,000 over the previous year. The decrease is attributable to a decrease in private donations. Expenses increased $15,458,397 due to the issuance of training grants and the first full year of operational costs.

Condensed Statement of Net Assets
(Amounts Expressed in Thousands)

	June 30,	
	2006	2005
Current and other assets	$ 2,651,654	$ 5,112,154
Capital assets	60,582	--
Total assets	2,712,236	5,112,154
Long-term liabilities	14,221,329	--
Other liabilities	3,695,022	2,654,541
Total liabilities	17,916,351	2,654,541
Net assets:		
Invested in capital assets	60,582	--
Unrestricted	(15,264,697)	2,457,613
Total net assets (deficit)	$(15,204,115)	$ 2,457,613

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

Management's Discussion and Analysis

Condensed Statement of Activities
(Amounts Expressed in Thousands)

	Fiscal Year Ended June 30, 2006	2004
Revenues:		
Program revenues:		
Operating grants and Contributions	$ 350,000	$ 5,000,000
General revenues:		
Investment earnings	73,716	--
Other	--	84,660
Total revenues	423,716	5,084,660
Expenses:		
State operations	4,215,984	736,705
Research grants	13,633,862	1,890,342
Interest	225,416	--
Depreciation	10,182	--
Total expenses	18,085,444	2,627,047
Increase (decrease) in net assets	(17,661,728)	
Net assets, beginning of year	2,457,613	--
Net assets, end of year	$ (15,204,115)	$ 2,457,613

Financial Analysis of CIRM's Funds

The focus of the Stem Cell Fund is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing CIRM's financing requirements. In particular, fund balance may serve as a useful measure of CIRM's net resources available for spending for program purposes at the end of the fiscal year.

As of the end of the June 30, 2006 fiscal year, the Stem Cell Fund reported ending fund balance of $(817,952) compared to the June 30, 2005 ending fund balance of $2,457,613. CIRM's major source of revenues is private donor grants. CIRM's major expenditures are training grants.

Stem Cell Fund Budgetary Highlights

The Stem Cell Fund budget projected total expenditures of $18,072,050. Actual expenditures were lower than budgeted projections by $372,769 due to savings in meeting and travel costs.

Capital Assets and Debt Administration

Capital Assets
CIRM's investment in capital assets was $60,582 at June 30, 2006 (net of accumulated depreciation). Major capital asset activities during the current fiscal year included computer and office equipment purchases.

Additional information on CIRM's capital assets can be found in Note 2 of this report.

Long-term Liabilities
During the year ended June 30, 2006, CIRM issued $14,000,000 of bond anticipation notes and recognized a long-term obligation of $221,329 for unused compensated leave. CIRM did not report similar liabilities in the prior year. Additional information on CIRM's long-term liabilities can be found in Note 4 of this report.

Future Events That Will Financially Affect CIRM

In November 2006 the Governor authorized a loan of $150,000,000.00 to CIRM to support the Institute's research funding. The loan is payable from the net proceeds of the state general obligation bonds authorized in the California Stem Cell Research and Cures Bond Act of 2004 to repay the principal and interest on the loan to the General Fund.

The oral arguments in the litigation challenging the Constitutionality of the California Stem Cell Research and Cures Act have been set by the Court of Appeal (First District) for February 2007. The CIRM anticipates the litigation will be resolved in 2007.

The CIRM awarded the first round of the Training Grant Program in Stem Cell Research totaling $12.1 million in FY 2005-06. The three year Training Grant Program estimates additional $12.1 million annually in awards to be made in 2007 and 2008.

The CIRM Innovation Grants Program (SEED and Comprehensive) has an estimated budget of $104 million as approved by the ICOC in August 2006 which will be paid over a two to four year period. These grant awards await final approval by the ICOC at their February and March 2007 meetings. The CIRM Shared Research Laboratory Grant Program will fund dedicated laboratory space for the culture of Human Embryonic Stem Cells, particularly those that fall outside federal guidelines. CIRM intends to fund up to $48.5 million over three years for the shared facilities grants, with awards expected in June 2007.

Contacting CIRM's Financial Management

This financial report is designed to provide a general overview of CIRM's finances, and to demonstrate CIRM's accountability for the money it receives. If you have questions about this report, or need additional financial information, please contact the California Institute for Regenerative Medicine, 210 King Street, Third Floor, San Francisco, California 94107.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Statement of Net Assets and Governmental Fund Balance Sheet
June 30, 2006

	Stem Cell Fund	Adjustments (Note 3)	Statement of Net Assets
Assets			
Cash and investments	$ 2,651,574	$ -	$ 2,651,574
Accounts receivable	80	-	80
Capital assets being depreciated, net	-	60,582	60,582
Total assets	$ 2,651,654	$ 60,582	$ 2,712,236
Liabilities			
Liabilities:			
Accounts payable	$ 919,606	$ -	$ 919,606
Due to the State General Fund	2,550,000	-	2,550,000
Interest payable	-	225,416	225,416
Noncurrent liabilities			
Due in more than one year	-	14,221,329	14,221,329
Total liabilities	3,469,606	14,446,745	17,916,351
Fund balance/net assets:			
Fund balance			
Ureserved	(817,952)	817,952	-
Total liabilities and fund balance	$ 2,651,654		
Net assets			
Invested in capital assets		60,582	60,582
Unrestricted		(14,446,745)	(15,264,697)
Total		$ (14,386,163)	$ (15,204,115)

See accompanying notes to the financial statements.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance
For the Year Ended June 30, 2006

	Stem Cell Fund	Adjustments (Note 3)	Statement of Activities
Revenues:			
Program revenues:			
Operating grants and contributions			
Private donor grants	$ 350,000	$ -	$ 350,000
General revenues:			
Investment earnings	73,716	-	73,716
Total revenues	423,716	-	423,716
Expenditures/expenses:			
Current:			
State operations	4,065,419	150,565	4,215,984
Research grants	13,633,862	-	13,633,862
Interest	-	225,416	225,416
Depreciation	-	10,182	10,182
Total expenditures/expenses	17,699,281	386,163	18,085,444
Excess of expenditures over revenues	(17,275,565)		-
Other financing sources:			
Bond anticipation note issuance	14,000,000	(14,000,000)	-
Net change in fund balance	(3,275,565)	3,275,565	
Change in net assets	-	(14,386,163)	(17,661,728)
Fund balance/net assets, beginning of year	2,457,613	-	2,457,613
Fund balance(deficit)/net assets (deficit), end of year	$ (817,952)	$ (14,386,163)	$ (15,204,115)

See accompanying notes to the financial statements.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Stem Cell Fund
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Year Ended June 30, 2006

	Original/ Final Budget	Stem Cell Fund	Variance with Final Budget Positive (Negative)
Expenditures/expenses:			
Current:			
State operations	$ 5,959,799	$ 4,065,419	$ 1,894,380
Research grants	12,112,251	13,633,862	(1,521,611)
Total expenditures/expenses	$ 18,072,050	$ 17,699,281	$ 372,769

See accompanying notes to the financial statements.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006

NOTE 1 – THE FINANCIAL REPORTING ENTITY

The California Institute for Regenerative Medicine (CIRM) is an agency of the State of California that was established with the passage of Proposition 71, creating the California Stem Cell Research and Cures Act (the Act). The statewide ballot measure, which provided $3 billion in funding for stem cell research at California universities and research institutions, was approved by California voters on November 2, 2004, and called for the establishment of a new state agency to make grants and provide loans for stem cell research, research facilities and other vital research opportunities.

CIRM was established for the purpose of issuing bonds to support stem cell research for the development of life-saving regenerative medical treatments and cures. CIRM is authorized under the Act to grant an average of $295 million per year in funds over a 10-year period to fund stem cell research and dedicated facilities for scientists at California's universities and other advanced medical research facilities throughout the state.

Due to the financial and operational relationship between CIRM and the State of California (State), CIRM meets the definition of a component unit of the State.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *BASIS OF ACCOUNTING/FUND FINANCIAL STATEMENTS*

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements.

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all of the activities of CIRM. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Separate financial statements are provided for CIRM's operating fund, the Stem Cell Fund, a governmental fund. The Stem Cell fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, revenues are considered to be available if they are collected within 12 months of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. *ACCOUNTING PRINCIPLES*

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the accounts are maintained by CIRM in accordance with the principles of fund accounting under standards issued by the Governmental Accounting Standards Board (GASB). Fund accounting is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds established in accordance with their nature and purpose. The operations of the fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures.

C. *CASH AND INVESTMENTS*

Cash and investments are reported at amortized cost, which approximates fair value. CIRM maintains its resources in the Surplus Money Investment Fund (SMIF) and operating accounts, which are part of the State Treasurer's pooled investment program. The resources of the SMIF are invested through the Treasurer's Pooled Money Investment Account (PMIA). Investments of the PMIA are restricted by State statutes and regulatory oversight is provided by the Pooled Money Investment Board. Investment income is distributed to the stem cell fund quarterly based on the Fund's relative participation during the quarter. As of June 30, 2006, the weighted average maturity of the PMIA was approximately 152 days. Neither the SMIF or PMIA are rated. Additional information regarding investment risks, including interest rate risk, credit risk and foreign-currency risk of the PMIA can be found in the State's financial statements.

At June 30, 2006, $1,161,000 was invested in SMIF and $1,490,574 was held in the State Treasury.

D. *CAPITAL ASSETS AND DEPRECIATION*

In accordance with the State's capitalization policy, capital assets are defined as assets with a useful life of at least one year and a unit acquisition cost of at least $5,000. Capital assets are reported at historical cost. Equipment is depreciated using the straight-line method over an estimated useful life of 5 years. For the year ended June 30, 2006, capital asset additions totaled $70,764 and depreciation expense totaled $10,182, for an ending capital asset balance, net of accumulated depreciation of $60,582. There was no capital asset activity in fiscal year 2005.

E. *DUE TO OTHER FUNDS*

Pursuant to The Act, the State Director of Finance is authorized to loan to CIRM, from the State general fund, amounts not to exceed the amount of the unsold bonds that have been authorized by the ICOC to be issued for the purpose of carrying out the provisions of the Act. At June 30, 2006, $2,550,000 represents amounts payable to the State general fund pursuant to the loan provisions outlined in the Act. As of June 30, 2006, interest of $78,034 has accrued on the loan pursuant to the California Government Code.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. *COMPENSATED ABSENCES*

The statement of net assets includes compensated absences of $221,329, which represent vested unpaid vacation and annual leave. Unused sick leave balances are not accrued as they do not vest to employees. Compensated absences are not considered fund liabilities as they will not be paid with current financial resources.

G. *CLASSIFICATION OF NET ASSETS AND FUND BALANCE*

The difference between assets and liabilities is reported as "fund balance" in the Stem Cell Fund balance sheet and as "net assets" in the government-wide statement of net assets. The following describes the categories of net assets and fund balances:

Net assets invested in capital assets – represents capital assets, net of accumulated depreciation.

The remaining balances are reported as unrestricted net assets (deficit) and unreserved fund balance (deficit).

H. *RISK MANAGEMENT*

CIRM participates in the State's self-insurance programs. The State is primarily self-insured against loss or liability. The State generally does not maintain reserves; losses are covered by appropriations in the year in which the payment occurs or it becomes fixed and determinable. Information regarding the State's risk management programs is included in the State's Comprehensive Annual Financial Report.

I. *BUDGETARY CONTROL*

The State prepares an annual budget, which is prepared on the modified accrual basis of accounting. Revenues are not included in the annual budget bill adopted by the State Legislature. Under State law, the State cannot adopt a spending plan that exceeds estimated revenues. Under the State Constitution, money may be withdrawn from the Treasury only through a legal appropriation. Appropriations for CIRM continue indefinitely. The legal level of budgetary control is the fund level.

J. *USE OF ESTIMATES*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3 – RECONCILIATION OF GOVERNMENTAL FUND FINANCIAL STATEMENTS AND GOVERNMENT-WIDE FINANCIAL STATEMENTS

The fund balance (deficit) of the Stem Cell fund differs from net assets (deficit) of governmental activities primarily because of the long-term economic resources focus of the statement of net assets versus the current financial resources focus of the governmental fund balance sheet. At June 30, 2006, the differences included the following:

Fund balance (deficit)	$ (817,952)
Capital assets used in the governmental activities are not financial resources, and therefore are not reported in the governmental funds.	
Capital assets	70,764
Less: accumulated depreciation	(10,182)
	60,582
Long-term liabilities are not due and payable in the current period, and therefore are not reported in the funds.	
Bond anticipation notes	(14,000,000)
Accrued compensated absences	(221,329)
Interest payable	(225,416)
Net assets (deficit)	$ (15,204,115)

NOTE 3 – RECONCILIATION OF GOVERNMENTAL FUND FINANCIAL STATEMENTS AND GOVERNMENT-WIDE FINANCIAL STATEMENTS (Continued)

The net change in fund balance for governmental fund differs from the change in net assets for governmental activities primarily because of the long-term economic resources focus of the statement of activities versus the current financial resources focus of the governmental fund. The differences are described below:

Net change in fund balance	$ (3,275,565)
Governmental fund reports capital outlay as expenditures. In the statement of activities however, the cost of capital assets is allocated over their estimated useful lives as depreciation expense.	
Capital outlay	70,764
Depreciation expense	(10,182)
	60,582
Some expenses reported in the statement of activities do not require the use of current financial resources, and therefore are not reported as expenditures in the governmental fund:	
Change in compensated absences	(221,329)
Change in interest payable	(225,416)
Long-term debt proceeds provide current financial resources to the governmental fund, but issuing debt increases long-term liabilities in the statement of net assets	
Bond anticipation notes issuance.	(14,000,000)
Change in net assets	$ (17,661,728)

NOTE 4 – LONG TERM LIABILITIES

Bond anticipation notes in the amount of $14,000,000 were issued at various times during the year. The notes bear interest at rates ranging from 65% - 100% of LIBOR, resetting on the first business day of each month. Each note specifies a maximum interest rate, which ranges from 4.5% - 5.0%. Repayment of the bond anticipation notes will occur upon the issuance of bonds authorized by the Act. The bond anticipation notes will not be repaid if such bonds cannot be issued within a period of 10 years from the issuance of the bond anticipation notes. At June 30, 2006, interest payable totaled $147,382.

Changes in long-term liabilities are summarized below:

	Balance July 1, 2005	Additions	Balance June 30, 2006
Bond anticipation notes	$ --	$ 14,000,000	$ 14,000,000
Compensated absences	--	221,329	221,329
Total long-term liabilities	$ --	$ 14,221,329	$ 14,221,329

There were no amounts due within one year.

NOTE 5 – OFFICE LEASE

Effective November 2006, CIRM took occupancy of office space in San Francisco, California for use as its headquarters. The San Francisco office space was acquired in response to a competitive bidding process. As part of the City of San Francisco's proposal, the City provides to CIRM approximately 20,000 square feet of premium office space free of charge for the next 10 years. In addition to the office space, a substantial amount of other incentives were included in the proposal. The fair value of the office space and other incentives totaled $1,000,000 for the year ended June 30, 2006.

NOTE 6 – GRANTS AND DONATIONS

The Act authorized CIRM to receive gifs that may be used for its operations. In June 2006, CIRM received a grant of $350,000 from the Richard and Rhoda Goldman Foundation to support scientific activities of the institute in 2006. CIRM management believes it has complied with this requirement. The provisions of the grant further require a report on the program be submitted to the Foundation prior to April 30, 2007.

NOTE 7 – RELATED PARTY TRANSACTIONS

As a component unit of the State of California, other State agencies provided CIRM with various services during the year ended June 30, 2006. The State Controller's Office provided administrative and accounting support, the Department of Justice provided legal support, the University of California, San Francisco provided human resources staff and the Stephen P. Teale Data Center provided information technology support. Amounts paid for these services for the year ended June 30, 2006 are summarized below:

State Controller's Office	$ 132,845
Department of Justice	291,064
University of California, San Francisco	71,694
Stephen P. Teale Data Center	15,355
Total	$ 510,958

NOTE 8 – RETIREMENT SAVINGS PLAN

The State of California has established the Alternate Retirement Program (ARP), a retirement program for specified State of California employees hired on or after August 11, 2004. Under the ARP, employees do not earn retirement service credit with the California Public Employees' Retirement System of the State of California (CalPERS) during their first two years of employment with the State. Rather, they are automatically enrolled in a retirement savings program, in which an ARP account is automatically set up for each employee as a 401(a) plan-a type of retirement savings account governed by federal IRS rules. During this two-year period, approximately five percent of each employee's paycheck is deducted each month (pre-tax) and deposited in the ARP account. At the end of the two-year period, the employee begins to earn retirement credit as a CalPERS Tier I member.

NOTE 8 – RETIREMENT SAVINGS PLAN (Continued)

Money in the ARP account, plus any interest, remains in that account. The employee will have a 90-day window to exercise a one-time option to (1) buy previous retirement service credit for time in ARP (the State will fund the portion of the liability not paid for the by the employee's ARP account); (2) receive a lump-sum distribution; or (3) transfer all funds into a 401(k) account within the Savings Plus Program. Participant's failure to designate an option will result in automatic enrollment in option 3.

Since all CIRM employees as of June 30, 2006 were hired after the implementation of ARP, most CIRM employees participate in this program and are not eligible to participate in CalPERS.

CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

NOTE 9 – CONTINGENCY

CIRM and its officers are currently defendants in three separate legal actions. One of these cases was dismissed in October 2005 and is now pending appeal. The two remaining actions were consolidated into one action in October 2005. Collectively, the two actions challenged the constitutionality of Proposition 71. On May 12, 2006, the Superior Court issued a single validation judgment upholding the constitutionality of Proposition 71 and the validity of the bonds against all challenges. The two sets of plaintiffs filed two separate appeals of the judgment. The First District Court of Appeals consolidated the two appeals for briefing and oral argument and granted calendar preference. The consolidated case was argued before the First District Court of Appeal on February 14, 2007, and on February 27, 2007, the Court affirmed the Superior Court judgment in CIRM's favor in full, in a unanimous decision. Should the plaintiffs seek review by the California Supreme Court, they must do so within 40 days. Review by the Supreme Court is discretionariy. Due to the uncertain nature of these legal actions, management was unable to estimate any potential range of loss or impact on CIRM's proposed operations.

NOTE 10 – SUBSEQUENT EVENT

In July 2006, Governor Arnold Schwarzenegger authorized a State general fund loan of $150,000,000 to CIRM in accordance with Section 125291.60 of the Act. Pursuant to the Act, the State Director of Finance is authorized to loan to CIRM, from the State general fund, amounts not to exceed the amount of the unsold bonds that have been authorized by the ICOC to be issued for the purpose of carrying out the provisions of the Act. CIRM is required to repay the principal amount borrowed plus interest equal to the amount that would have been earned in the PMIA.

In addition, subsequent to June 30, 2006, CIRM sold an additional $31,000,000 of bond anticipation notes to private individuals and philanthropic foundations. The proceeds of the general fund loan and the bond anticipation notes will be used to finance stem cell research in accordance with the Act. These loans will be repaid with the proceeds of bonds authorized by the Act.

CALIFORNIA INSTITUTE OF REGENERATIVE MEDICINE
(A Component Unit of the State of California)
Dolby Grant
Schedule of Revenues, Expenditures and Available Resources
For the Year Ended June 30, 2006

	Dolby Grant
Revenues:	
Investment earnings	$ 73,716
Total revenues	73,716
Expenditures:	
Current:	
Salaries and wages	2,341,661
Operating expenses	
Interagency and external agreements	707,932
ICOC meetings	123,355
Scientific meetings	73,472
Workgroup meetings	166,809
Other travel	41,197
Furniture and equipment	264,161
Information technology	122,654
Dues, memberships and publications	14,425
Office supplies	16,018
Printing	11,419
Telephone	36,988
Postage	6,595
Facilities operations	26,414
Other	19,070
Total expenditures	3,972,170
Excess of expenditures over revenues	(3,898,454)
Available resources, beginning of year	4,107,903
Available resources, end of year	$ 209,449

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To the Members of the
Independent Citizen's Oversight Committee of the
California Institute for Regenerative Medicine
Sacramento, California

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENTAL AUDITING STANDARDS*

We have audited the financial statements governmental activities and major fund of the California Institute for Regenerative Medicine (CIRM) as of and for the year ended June 30, 2006, which collectively comprise CIRM's basic financial statements and have issued our report thereon dated January 5, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered CIRM's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CIRM's financial statements are free of material misstatement, we performed tests of it's compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Independent Citizen's Oversight Committee and management and is not intended to be and should not be used by anyone other than this specified party.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 5, 2007