

**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, 2007

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

JUNE 30, 2007

Table of Contents

	<i>Page(s)</i>
Independent Auditor's Report	1-2
Management's Discussion and Analysis (Required Supplementary Information)	3-7
Financial Statements:	
Statement of Net Assets and Governmental Fund Balance Sheet	8
Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance	9
Statement of Expenditures -- Budget and Actual – Stem Cell Fund.....	10
Notes to the Financial Statements.....	11-18
Supplemental Information:	
Dolby Grant - Schedule Revenues, Expenditures and Available Resources.....	19
Other Report:	
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	20-21



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To the Members of the
Independent Citizens 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, 2007, 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, 2007, and the respective changes in financial position thereof and the budgetary comparison for the Stem Cell 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 10, 2008, 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 United 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.

Macior Mini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 10, 2008

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

Management's Discussion and Analysis (Unaudited)

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, 2007. We encourage readers to consider the information presented here in conjunction with the Financial Statements that follow this discussion.

Financial Highlights

- The net assets deficit of CIRM at June 30, 2007 was \$22,203,251 compared to the end of the prior fiscal year deficit of \$15,204,115. Of that amount, \$46,429 was invested in capital assets and an unrestricted net asset deficit of \$22,249,680.
- CIRM's cash and investments balance at June 30, 2007 is \$180,152,735, an increase of \$177,501,161 from the balance at June 30, 2006.
- For fiscal year ended June 30, 2007 CIRM had program revenues of \$411,107, which represents a slight increase of \$61,107 from the prior year. Additionally, general revenues were \$4,567,783 for fiscal year 2007 representing an increase of \$4,494,067 from the prior year. Expenses for fiscal year 2007 were \$11,978,026, a \$6,107,418 decrease 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.

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

Management's Discussion and Analysis (Unaudited) (Continued)

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 fund with similar information presented for governmental activities. Both the governmental fund balance sheet and the governmental fund 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 government-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, 2007 CIRM's net assets deficit was \$22,203,251 and increase of \$6,999,136 over the prior year net assets deficit of \$15,204,115.

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

Management's Discussion and Analysis (Unaudited) (Continued)

Government-Wide Financial Analysis (Continued)

At June 30, 2007 \$22,249,680 of CIRM's net assets deficit are unrestricted. The remaining net assets of \$46,429 reflect its investment in capital assets.

For the year ended June 30, 2007, net assets deficit increased by \$6,999,136 primarily due expenses exceeding revenues. Although revenues increased by \$4,555,174 which was primarily due to an increase in investment earnings of \$4,490,878, expenses only decreased by \$6,107,418. This decrease in expenses is due to the net effect of a decrease in research grant expense of \$13,632,386, an increase in operational expenses of \$1,999,998 and an increase in interest expense in the amount of \$5,520,999.

Condensed Statement of Net Assets
(Amounts Expressed in Thousands)

	June 30,	
	2007	2006
Current and other assets	\$ 182,504,392	\$ 2,651,654
Capital assets	46,429	60,582
Total assets	182,550,821	2,712,236
Long-term liabilities	195,209,714	14,221,329
Other liabilities	9,544,358	3,695,022
Total liabilities	204,754,072	17,916,351
Net assets:		
Invested in capital assets	46,429	60,582
Unrestricted	(22,249,680)	(15,264,697)
Total net assets (deficit)	\$ (22,203,251)	\$ (15,204,115)

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

Management's Discussion and Analysis (Unaudited) (Continued)

Condensed Statement of Activities
(Amounts Expressed in Thousands)

	Fiscal Year Ended June 30,	
	2007	2006
Revenues:		
Program revenues:		
Operating grants and Contributions	\$ 411,107	\$ 350,000
General revenues:		
Investment earnings	4,564,594	73,716
Other	3,189	--
Total revenues	4,978,890	423,716
Expenses:		
State operations	6,230,135	4,226,166
Research grants	1,476	13,633,862
Debt Service:		
Interest	5,746,415	225,416
Total expenses	11,978,026	18,085,444
Increase (decrease) in net assets	(6,999,136)	(17,661,728)
Net assets, beginning of year	(15,204,115)	2,457,613
Net assets, end of year	\$ (22,203,251)	\$ (15,204,115)

Financial Analysis of CIRM's Fund

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, 2007 fiscal year, the Stem Cell Fund reported ending fund balance of \$181,931,865 compared to the June 30, 2006 ending fund balance deficit of \$817,952. CIRM's major source of revenues is investment earnings. CIRM's major expenditures are state operations and interest expense.

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

Management's Discussion and Analysis (Unaudited) (Continued)

Stem Cell Fund Budgetary Highlights

The Stem Cell Fund budget projected total expenditures of \$8,341,916. Actual expenditures were lower than budgeted projections by \$2,112,843 due to savings in meeting and travel costs.

Capital Assets and Debt Administration

Capital Assets

CIRM's investment in capital assets was \$46,429 at June 30, 2007 (net of accumulated depreciation). Capital asset activity during the current fiscal year was limited to depreciation expense as there were no capital asset additions or disposals during the year.

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, 2007, CIRM issued \$31,000,000 of bond anticipation notes, borrowed \$153,000,000 from the CA State General Fund and recognized a long-term obligation of \$(11.615) unused compensated leave. 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 October 2007, The State Treasurer issued \$250 million in bonds under the California Stem Cell Research and Cures Act of 2004. In addition to CIRM's cash reserves, funds from these new bonds were used to repay the "bond anticipation notes" (BANS) in the amount of \$43.8 million, of which \$1.8 million is accrued interest with a remaining balance of \$3 million still outstanding. The loan in the amount of \$159.8 million, which includes accrued interest of \$6.8 million, payable to the CA State General Fund is also repaid.

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, and 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, 2007

	Stem Cell Fund	Adjustments (Note 3)	Statement of Net Assets
Assets			
Cash and investments	\$ 180,152,735	\$ -	\$ 180,152,735
Accounts receivable	577	-	577
Due from other State funds	2,351,080	-	2,351,080
Capital assets being depreciated, net	-	46,429	46,429
Total assets	\$ 182,504,392	\$ 46,429	\$ 182,550,821
Liabilities			
Liabilities:			
Accounts payable	\$ 572,527	\$ -	\$ 572,527
Interest payable	-	5,971,831	5,971,831
Long term liabilities			
Due within one year	-	3,000,000	3,000,000
Due in more than one year	-	195,209,714	195,209,714
Total liabilities	572,527	204,181,545	204,754,072
Fund balance/net assets:			
Fund balance			
Unreserved	181,931,865	(181,931,865)	-
Total liabilities and fund balance	\$ 182,504,392		
Nets assets (deficit)			
Invested in capital assets		46,429	46,429
Unrestricted		(204,181,545)	(22,249,680)
Total		\$ (204,135,116)	\$ (22,203,251)

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, 2007

	Stem Cell Fund	Adjustments (Note 3)	Statement of Activities
Revenues:			
Program revenues:			
Operating grants and contributions			
Private donor grants	\$ 411,107	\$ -	\$ 411,107
General revenues:			
Investment earnings	4,564,594	-	4,564,594
Other	3,189	-	3,189
	4,978,890	-	4,978,890
Total revenues	4,978,890	-	4,978,890
Expenditures/expenses:			
Current:			
State operations	6,227,597	2,538	6,230,135
Research grants	1,476	-	1,476
Debt service:			
Interest	-	5,746,415	5,746,415
	-	5,746,415	5,746,415
Total expenditures/expenses	6,229,073	5,748,953	11,978,026
Excess of expenditures over revenues	(1,250,183)		
Other financing sources:			
Loan from the CA State General Fund	153,000,000	(153,000,000)	-
Bond anticipation notes issued	31,000,000	(31,000,000)	-
Total other financing sources:	184,000,000	(184,000,000)	-
Net change in fund balance	182,749,817	(182,749,817)	
Change in net assets	-	(189,748,953)	(6,999,136)
Fund balance (deficit)/net assets (deficit), beginning of year	(817,952)	(14,386,163)	(15,204,115)
Fund balance (deficit)/net assets (deficit), end of year	\$ 181,931,865	\$ (204,135,116)	\$ (22,203,251)

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 EXPENDITURES - BUDGET AND ACTUAL
FOR THE YEAR ENDED JUNE 30, 2007

	Original/ Final Budget	Stem Cell Fund	Variance with Final Budget Positive (Negative)
Expenditures/expenses:			
Current:			
State operations	\$ 8,341,916	\$ 6,227,597	\$ 2,114,319
Research grants	-	1,476	(1,476)
	\$ 8,341,916	\$ 6,229,073	\$ 2,112,843
Total expenditures/expenses	\$ 8,341,916	\$ 6,229,073	\$ 2,112,843

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, 2007

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.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007

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, 2007, the weighted average maturity of the PMIA was approximately 176 days. Neither the SMIF nor PMIA are rated by credit rating agencies. 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, 2007, \$180,054,000 was invested in SMIF and \$98,735 was held in the operating accounts of 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, 2007, there were no capital asset additions and depreciation expense totaled \$14,153, for an ending capital asset balance, net of accumulated depreciation of \$46,429.

E. COMPENSATED ABSENCES

The statement of net assets includes compensated absences of \$209,714, 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.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. 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).

G. 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.

H. 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. The legal level of budgetary control is the fund level.

I. 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.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007

**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, 2007, the differences included the following:

Fund balance (deficit)	\$ 181,931,865
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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	<u>(24,335)</u>
	46,429

Long-term liabilities are not due and payable in the current period, and therefore are not reported in the fund.

Bond anticipation notes	(45,000,000)
Loan from CA State General Fund	(153,000,000)
Accrued compensated absences	(209,714)
Interest payable	<u>(5,971,831)</u>

Net assets (deficit)	<u>\$ (22,203,251)</u>
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CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007

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	\$ 182,749,817
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Governmental fund does not report capital assets. In the statement of activities however, the cost of capital assets is allocated over their estimated useful lives as depreciation expense.

Depreciation expense	(14,153)
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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	11,615
Change in interest payable	(5,746,415)

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	(31,000,000)
Loan from CA State General Fund	<u>(153,000,000)</u>

Change in net assets	\$ <u>(6,999,136)</u>
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NOTE 4 – LONG TERM LIABILITIES

Loan from CA State General Fund - Pursuant to The Act, the State Director of Finance is authorized to loan to CIRM, from the CA State General Fund, amounts not to exceed the amount of the unsold bonds that have been authorized by the ICOC. At June 30, 2007, \$153,000,000 represents amount payable to the State's General Fund pursuant to the loan provisions outlined in the Act. \$3,000,000 of the \$153,000,000 is due within one year. Principal and interest are to be paid with net proceeds of the State general obligation bonds issued pursuant the Act. Included in the \$3 million is \$2,550,000 which was previously recorded as current liabilities in the Stem Cell Fund financial statements. As of June 30, 2007, interest of \$4,521,890 has accrued on the loan pursuant to the California Government Code.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 4 – LONG TERM LIABILITIES (continued)

Bond Anticipation Notes - Bond anticipation notes in the amount of \$31,000,000 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, 2007, interest payable totaled \$1,449,941.

Compensated absences – At June 30, 2007 compensated absences total \$209,714, which represent vested unpaid vacation and annual leave.

Changes in long-term liabilities are summarized below:

	Balance July 1, 2006	Additions	Balance June 30, 2007	Due Within One Year
Loan from CA State General Fund	\$ -	\$ 153,000,000	\$ 153,000,000	\$ 3,000,000
Bond anticipation notes	14,000,000	31,000,000	45,000,000	-
Compensated absences	221,329	(11,615)	209,714	-
Total long-term liabilities	<u>\$ 14,221,329</u>	<u>\$ 183,988,385</u>	<u>\$ 198,209,714</u>	<u>\$ 3,000,000</u>

NOTE 5 – OFFICE LEASE

Effective November 2007, 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, 2007, which is not recorded in the financial statements.

NOTE 6 – OPERATING GRANTS AND CONTRIBUTIONS

The Act authorized CIRM to receive gifts that may be used for its operations. In January 2007, CIRM received a grant of \$250,000 from the Community Incentive Funds (CIF) of the San Francisco Foundation to support scientific activities of the institute in 2007. 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 by June 30, 2007.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 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, 2007. The State Controller's Office provided administrative and accounting support, the Department of Justice provided legal support, and the Stephen P. Teale Data Center provided information technology support. Amounts paid for these services for the year ended June 30, 2007 are summarized below:

State Controller's Office	\$ 186,449
Department of Justice	507,995
Stephen P. Teale Data Center	<u>3,469</u>
 Total	 <u>\$ 697,913</u>

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 may elect to begin to earn retirement credit as a CalPERS member.

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 (CIRM 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, 2007 were hired after the implementation of ARP, most CIRM employees participate in this program and are not eligible to participate in CalPERS.

CalPERS issue 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.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
(A Component Unit of the State of California)
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 9 – SUBSEQUENT EVENT

In October 2007, the State Treasurer issued the first annual sale of bonds authorized under the Act. According to the Act, all interim debt, which include bond anticipation notes and commercial paper notes issued by CIRM in its initial period of research, or first five years the Act takes effect, will be repaid with bond sales authorized under the Act to minimize debt service costs to the State General Fund. The proceeds from the first annual sale of bonds was transferred to CIRM and reported as operating grant revenue. CIRM repaid its bond anticipation notes in amount of \$43,855,578 which included principal payments of \$42 million and accrued interest of \$1,855,578, resulting in a remaining outstanding bond anticipation note balance of \$3 million. CIRM also repaid its \$153 million payable to the CA State General Fund, which \$150 million was intended to be used for temporary funding for research grants, and a \$3 million dollar loan to use for operations. Accrued interest on these loans, in the amount of \$6,880,396, was paid in full.

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, 2007

	Dolby Grant
Revenues:	
Investment earnings	\$ 33,289
Total revenues	33,289
Expenditures:	
Current:	
Operating expenses	
Interagency and external agreements	747,037
ICOC meetings	49,159
Scientific meetings	4,901
Workgroup meetings	44
Other travel	5,818
Furniture and equipment	133,457
Information technology	11,727
Dues, memberships and publications	3,562
Office supplies	9,981
Recruitment/Outreach	3,423
Publications	392
Printing	3,094
Telephone	13,601
Postage	3,639
Training	100
Facilities operations	5,121
Other	1,157
Total expenditures	996,213
Excess of expenditures over revenues	(962,924)
Available resources, beginning of year	2,688,568
Available resources, end of year	\$ 1,725,644

Note: During the fiscal year ending June 30, 2007 management determined that expenditures accrued in the prior year were not intended to be funded by the Dolby grant and were subsequently paid from State funds. As a result, the beginning available resources balance is restated.



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To the Members of the
Independent Citizens 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, 2007, which collectively comprise CIRM's basic financial statements and have issued our report thereon dated January 10, 2008. 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. Accordingly, we do not express an opinion on the effectiveness of the CIRM's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the organization's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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 its 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*.

We noted certain matters that we reported to management of CIRM, in a separate letter dated January 10, 2008.

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

Macior Mini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 10, 2008