

**CALIFORNIA INSTITUTE FOR
REGENERATIVE MEDICINE**

(A Component Unit of the State of California)

Report to Management

For the Fiscal Year Ended June 30, 2007

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

**REPORT TO MANAGEMENT
For the Fiscal Year Ended June 30, 2007**

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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, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered CIRM's internal controls over financial reporting (internal controls) as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CIRM's internal control.

The memorandum that accompanies this letter provides a status of prior year comments and recommendations. (We previously reported on CIRM's internal control in our report dated January 5, 2007). This letter does not affect our report dated January 10, 2008, 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 10, 2008

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Required Communications
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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 required communication letter dated October 22, 2007, 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 2007. 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 sensitive estimates in the financial statements.

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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 and recorded by CIRM, either individually or in aggregate, indicate matters that could have a significant effect on CIRM's financial reporting process.

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.

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Status of Prior Year Comments and Recommendations
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I. 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 (SCO) 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) prepare 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 was transferred to the Fund Balance-Clearing Account. It is not an adjusting entry; it is the required entry at June 30th.

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Management's Response (continued):

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.

Current Year Status:

The SCO did provide cash amounts in the State Treasury and capital asset information including current year depreciation. In addition, the SCO was also able to provide interest expense information for the \$153 million loan from the State General Fund but not for the bond anticipation notes.

II. 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:

CIRM does monitor the requirements for debt services and donor agreements information internally and provides the information to the SCO. 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.

Current Year Status:

CIRM did not develop a formal written policy for the monitoring of debt service and donor agreements. In October 2007 the CIRM repaid \$195 million of their \$198 million outstanding debt items (Loans from State General Fund and bond anticipation notes). Management anticipates repaying the remaining \$3 million debt outstanding in the near future and feels they no longer require a debt service monitoring function. CIRM is now being funded through the bonds established under Proposition 71.