

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

Independent Auditor's Reports, Management's Discussion and
Analysis, Financial Statements
and Supplementary Information

For the Year Ended June 30, 2012

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

JUNE 30, 2012

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To the Members of the
Independent Citizens Oversight Committee of the
California Institute for Regenerative Medicine
San Francisco, 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, 2012, 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, 2012, 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 October 15, 2012, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise CIRM's financial statements as a whole. The supplementary information on page 22 is presented for purposes of additional analysis and is not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Macie Mini & O'Connell LLP

Sacramento, California
October 15, 2012

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, 2012. 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, 2012 were \$89,741,939 compared to the end of the prior fiscal year balance of \$267,714,854. Of that amount, \$118,014, net of accumulated depreciation, was invested in capital assets of CIRM and unrestricted net assets was \$89,623,925. See discussion below in Government-Wide Financial Analysis regarding the investment of CIRM grants.

- CIRM's cash and investments balance at June 30, 2012 is \$65,915,785, a decrease of \$190,651,488 from the balance at June 30, 2011.
- For fiscal year ended June 30, 2012, CIRM had program revenues of \$21,630, which represents an increase of \$19,432 from the prior year. Additionally, general revenues were \$61,507,743 for fiscal year 2012 representing an increase of \$12,729,695 from the prior year. Expenses for fiscal year 2012 were \$239,502,288, which represents a \$32,629,628 increase from the prior year.
- All financial assets of CIRM continue to be devoted to providing funds for medical research and facilities, and the operations of the Institute.

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.

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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 compensated 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 balance provide a column detailing the differences (adjustments) between the governmental fund 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, 2012, CIRM's net assets were \$89,741,939, a decrease of \$177,972,915 from prior year net assets of 267,714,854.

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

Government-Wide Financial Analysis (Continued)

At June 30, 2012, \$89,623,925 of CIRM's net assets are unrestricted. The remaining net assets of \$118,014 reflect its investment in capital assets net of accumulated depreciation.

For the fiscal year ended June 30, 2012, net assets decreased by \$177,972,915. In the fiscal year ended June 30, 2012 revenues increased due to the combination of an increase in investment earnings of \$1,217,954, increase in Proposition 71 revenue General Obligation (GO) bonds in the amount of \$3,652,290 an increase in loan proceeds of \$6,422,437, increase in donor receipts of \$19,432, and an increase in interest revenue of \$1,437,014. In addition, 2012 expenses increased by \$32,629,628 from 2011, primarily due to the net effect of an increase in research grants expense of \$33,273,492 and a decrease in state operations of \$643,864.

The recipients of CIRM's grants are required to use the granted funds to construct or acquire research facilities or to actually perform research. Expenditures of that type may be reported by the grant recipients as investments in capital assets of the grant recipients. CIRM will work with its grantees to ensure proper reporting of these capital expenditures. Grants made by CIRM are treated as expenses of CIRM rather than investments in capital assets of CIRM even though (i) the recipients of the grants may be required to use the granted funds in a manner that is treated as investments in capital assets of the grant recipients and (ii) as a condition of each grant, CIRM obtains certain rights to use, control or benefit from the discoveries or information developed by the grant recipients.

Condensed Government Wide Statement of Net Assets
(Amounts Expressed in Thousands)

	June 30,	
	2012	2011
Current and other assets	\$ 91,255	\$ 272,914
Capital assets	118	81
Total assets	91,373	272,995
Current and other liabilities	1,022	4,833
Long-term liabilities	609	447
Total liabilities	1,631	5,280
Net assets		
Invested in capital assets	118	81
Unrestricted	89,624	267,634
Total net assets	\$ 89,742	\$ 267,715

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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Management's Discussion and Analysis (Unaudited) (Continued)

Condensed Government Wide Statement of Activities
(Amounts Expressed in Thousands)

	Year Ended June 30,	
	2012	2011
Revenues:		
Program revenues:		
Operating grants and Contributions	\$ 22	\$ 2
General revenues:		
Proposition 71 (GO bonds)	50,825	47,173
Loan Proceeds	6,422	-
Interest on loans	1,933	496
Investment earnings	2,327	1,109
Total revenues	61,529	48,780
Expenses:		
State operations	12,575	13,219
Research grants	226,927	193,653
Total expenses	239,502	206,872
Decrease in net assets	(177,973)	(158,092)
Net assets, beginning of year	267,715	425,807
Net assets, end of year	\$ 89,742	\$ 267,715

For fund financial statement see pages 8 and 9. For fund budget to actual comparison see page 10.

Financial Analysis of CIRM's Stem Cell Fund

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

As of the fiscal end of the June 30, 2012, the Fund reported ending fund balance of \$66,043,166 compared to the June 30, 2011, ending fund balance of \$252,754,790. The Fund's major sources of revenue are investment earnings and Proposition 71 (GO bonds). The Fund's major expenditures are research grants and state operations.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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Management's Discussion and Analysis (Unaudited) (Continued)

Stem Cell Fund Budgetary Highlights

The Stem Cell Fund budget projected total expenditures of \$298,502,406. Actual expenditures were less than budgeted projections by \$52,141,246 in the categories of research grants, and state operations (salaries and operating expenses). In October 2011, the State Treasurer issued \$50,825,000 in bonds under the California Stem Cell Research and Cures Act of 2004.

As of June 30, 2012 CIRM has disbursed a total of \$28,219,014 on three loan awards of \$50,512,676. During the fiscal year ended June 30, 2012, CIRM received \$6,422,437 in repayments of outstanding loans.

Capital Assets and Debt Administration

Capital Assets

CIRM's investment in capital assets increased from \$81,011 at June 30, 2011 to \$118,014 at June 30, 2012 (net of accumulated depreciation). Capital asset activity during the current fiscal year was due to an acquisition of \$69,516 and depreciation expense of \$32,513. See discussion above in Government-Wide Financial Analysis regarding the investment of CIRM grants.

Additional information on CIRM's capital assets can be found in Note 4 of this report.

Long-term Liabilities

During the year ended June 30, 2012, CIRM recognized a long-term obligation of \$608,543 for unused compensated leave. Additional information on CIRM's long-term liabilities can be found in Note 5 of this report.

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 FOR REGENERATIVE MEDICINE
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STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
JUNE 30, 2012

	Stem Cell Fund	Adjustments (Note 3)	Statement of Net Assets
Assets			
Cash and investments	\$ 65,915,785	\$ -	\$ 65,915,785
Accounts receivable	1,017,941	-	1,017,941
Prepaid expenses	39,000	-	39,000
Due from other State funds	93,338	-	93,338
Loans receivable	21,813,243	-	21,813,243
Interest receivable	2,376,059	-	2,376,059
Capital assets being depreciated, net	-	118,014	118,014
Total assets	\$ 91,255,366	118,014	91,373,380
Liabilities			
Accounts payable	\$ 939,994	-	939,994
Due to other State funds	82,904	-	82,904
Deferred revenue	24,189,302	(24,189,302)	-
Long term liabilities			
Due in more than one year	-	608,543	608,543
Total liabilities	25,212,200	(23,580,759)	1,631,441
Fund balance/net assets:			
Fund balance			
Nonspendable	39,000	(39,000)	-
Committed	66,004,166	(66,004,166)	-
Total fund balance	66,043,166	(66,043,166)	-
Total liabilities and fund balance	\$ 91,255,366		
Net assets			
Invested in capital assets		118,014	118,014
Unrestricted		89,623,925	89,623,925
Total		\$ 89,741,939	\$ 89,741,939

See accompanying notes to the financial statements.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 2012

	Stem Cell Fund	Adjustments (Note 3)	Statement of Activities
Revenues:			
Program revenues:			
Operating grants and contributions			
Private donor grants	\$ 21,630	\$ -	\$ 21,630
General revenues:			
Proposition 71 (GO bonds)	50,825,000	-	50,825,000
Collections on loans	6,422,437		6,422,437
Interest on loans	53,399	1,879,837	1,933,236
Investment earnings	2,327,070	-	2,327,070
Total revenues	59,649,536	1,879,837	61,529,373
Expenditures/expenses:			
Current:			
State operations	12,451,425	124,166	12,575,591
Research grants	233,909,735	(6,983,038)	226,926,697
Total expenditures/expenses	246,361,160	(6,858,872)	239,502,288
Deficit of revenues under expenditures	(186,711,624)	186,711,624	-
Change in net assets	-	(177,972,915)	(177,972,915)
Fund balance/net assets, beginning of year	252,754,790	14,960,064	267,714,854
Fund balance/net assets, end of year	\$ 66,043,166	\$ 23,698,773	\$ 89,741,939

See accompanying notes to the financial statements.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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STEM CELL FUND STATEMENT OF EXPENDITURES - BUDGET AND ACTUAL
FOR THE YEAR ENDED JUNE 30, 2012

	<u>Original/ Final Budget</u>	<u>Stem Cell Fund Actual</u>	<u>Variance with Final Budget Positive (Negative)</u>
Expenditures/expenses:			
Current:			
State operations*	\$ 16,193,975	\$ 12,451,425	\$ 3,742,550
Research grants	<u>282,308,431</u>	<u>233,909,735</u>	<u>48,398,696</u>
Total expenditures/expenses	<u>\$ 298,502,406</u>	<u>\$ 246,361,160</u>	<u>\$ 52,141,246</u>

* This figure represents actual Stem Cell Fund administrative overhead expenses, net of legal costs.
See Health and Safety Code Sections 125290.70(a)(1)(C), 125290.70(a)(2), and 125292.10 (u).

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, 2012

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. During the year ended June 30, 2012, CIRM received a total of \$50,825,000 in Proposition 71 revenue, which consisted of GO bond sales of \$50,825,000 as a part of the \$3 billion approved funding for stem cell research.

CIRM was established to support stem cell research for the development of life-saving regenerative medical treatments and cures.

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/ 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
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

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, 2012, the weighted average maturity of the PMIA was approximately 270 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, 2012, \$65,698,000 was invested in SMIF and \$217,785 was held in the operating accounts of the State Treasury.

In years prior to the fiscal year ended June 30, 2012 CIRM recorded an amount due to other State funds (General Fund) for interest earned on its Surplus Money Investment Funds (SMIF) from general obligation bond proceeds. The liability was determined based on CIRM's interpretation of Health and Safety Code Section 125291.70, which states in part that "premium and accrued interest on bonds sold shall be reserved in the fund and shall be available for transfer to the General Fund..." However, in the fiscal year ended June 30, 2012, CIRM's legal counsel concluded that Section 125291.70 does not refer to SMIF interest, but rather accrued interest added to bond transactions to cover the period of time between the date bonds are sold and the date they are delivered to the bond holder. Both the California Attorney General and State Treasurer's Offices agree with this analysis. As a result, the accrued SMIF interest previously recorded as accounts payable to the General Fund belongs to CIRM to be used for any purpose consistent with the requirements of Proposition 71. Accordingly, for the fiscal year ended June 30, 2012, the SMIF accrued interest totaling \$1,704,909, was reversed and recorded as investment earnings in CIRM's financial statements.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. LOANS RECEIVABLE

During the fiscal year ended June 30, 2010, CIRM awarded a \$19,999,933 research loan, to be disbursed over a four year period. The applicable interest rate for this loan is 8.25%, calculated as simple interest, from the date of each loan disbursement. Repayment of the loan principal and accrued interest is due February 11, 2020, the last day of the 10-year loan period. CIRM disbursed \$4,993,627 on this loan during the year ended June 30, 2010, \$7,568,869 during the year ended June 30, 2011, and an additional \$6,999,704 during the year ended June 30, 2012, for a total loan disbursement of \$19,562,200.

CIRM also awarded a \$5,665,887 research loan and disbursed \$2,267,709 during the fiscal year ended June 30, 2011. No funds were disbursed on this loan during the year ended June 30, 2012, however, a repayment in the amount of \$16,666 was received. This loan is to be disbursed over a three year period. The applicable interest rate for this loan is LIBOR plus 2%, calculated from the date of each disbursement. Repayment of the loan principal and accrued interest is due March 31, 2016, the last day of the 5-year loan period.

During the fiscal year ended June 30, 2012, CIRM awarded an additional research loan in the amount of \$24,846,856 and disbursed \$6,405,771. This loan is to be disbursed over a three year period. Repayment of the loan principal and accrued interest is due July 31, 2016, the last day of the 5-year loan period. The applicable interest rate for this loan is LIBOR plus 2%, calculated from the date of each disbursement. On November 14, 2011, the loan recipient elected to terminate the research study and loan agreement. The loan disbursement amount was repaid in full, along with interest of \$53,399.

For the remaining two loans, various contingencies could affect the amount and schedule for repayment. A total of \$2,376,059 of interest receivable associated with loans has been recorded as of June 30, 2012. The interest receivable balance has been offset by deferred revenue in the Stem Cell Fund as it does not represent available financial resources.

E. 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, 2012, there were acquisitions of \$69,516 and depreciation expense of \$32,513, for an ending capital asset balance, net of accumulated depreciation, of \$118,014. The year-end balance consisted entirely of equipment.

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, 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. COMPENSATED LEAVE

The statement of net assets includes unused compensated leave of \$608,543, which represents vested unpaid vacation and annual leave. Unused sick leave balances are not accrued as they do not vest to employees. Unused compensated leave is not considered fund liabilities as it 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 balance:

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

The remaining balance of net assets is reported as unrestricted net assets.

To be in conformance with generally accepted accounting principles, CIRM must report fund balance consistent with the Government Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Type Definitions*. GASB Statement No. 54 establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental funds. GASB Statement No. 54 requires that the fund balances be classified into categories based upon the type of restrictions imposed on the use of the funds. CIRM evaluated its fund balance at June 30, 2012 and classified the balance into the following categories:

Nonspendable:

This category includes elements of the fund balance that cannot be spent because they are (1) not in spendable form, such as prepaid items, inventories and long-term receivables for which the payment of proceeds are not restricted or committed with respect to the nature of the specific expenditures of that fund or (2) legally or contractually required to be maintained intact.

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, 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Committed:

Two criteria determine the Committed fund balance:

- Use of funds is constrained by limits imposed by the government's highest level of decision making (for CIRM, this is the Independent Citizens Oversight Committee (ICOC)).
- Removal or modification of use of funds can be accomplished only by formal action of the ICOC that established the constraints.

Both commitments and modification or removal must occur prior to the end of the reporting period; that is, the fiscal year being reported upon. For CIRM, resources in this category would include funding that has been set aside for previously executed legally enforceable contracts but that has not yet been spent, including multi-year contracts, if such contracts have been approved by the ICOC and if cancellation of such contracts would require ICOC approval.

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 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. CIRM is not a part of the State's annual budget, but instead is continuously appropriated. Budgetary savings in the amount of \$3,742,550 in state operations represents savings in salaries and operating expenses. The budgetary saving in the amount of \$48,398,696 represents savings in grant research payments and direct legal salaries and operating expenses.

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.

CALIFORNIA INSTITUTE FOR REGENERATIVE MEDICINE
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

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

The fund balance of the Stem Cell Fund differs from net assets 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, 2012, the differences included the following:

Fund balance		\$ 66,043,166
Capital assets used in the governmental activities are not financial resources, and therefore are not reported in the governmental fund.		
	Capital assets	252,558
	Less: accumulated depreciation	<u>(134,544)</u>
		118,014
Certain long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the fund.		
		24,189,302
Long-term liabilities are not due and payable in the current period, and therefore are not reported in the fund.		
	Accrued unused compensated leave	<u>(608,543)</u>
Net assets		<u>\$ 89,741,939</u>

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

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

The net change in fund balance for the 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 \$ (186,711,624)

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	(32,513)
Additions to capital assets	69,516

Disbursements of loan proceeds are reported in governmental fund as expenditures, as these represent the use of current financial resources. However, in the governmental-wide statements, such amounts are not reported as expenses, but instead, are recorded as long-term receivables.	6,983,038
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Revenue in the statement of activities recognized as revenue for amounts that are deferred in the governmental fund, as amounts do not represent current financial resources	1,879,837
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Certain 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 unused compensated leave	(161,169)
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Change in net assets \$ (177,972,915)

NOTE 4 – CAPITAL ASSETS

Information on changes in capital assets is presented below:

	June 30, 2011	Increases	Decreases	June 30, 2012
Capital assets:				
Equipment	183,042	69,516	-	252,558
Accumulated depreciation:	(102,031)	(32,513)	-	(134,544)
Total capital assets, net	\$ 81,011	\$ 37,003	\$ -	\$ 118,014

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

NOTE 5 – LONG TERM LIABILITIES

Unused Compensated leave – At June 30, 2012, unused compensated leave was \$608,543, which represents vested unpaid vacation and annual leave.

Changes in long-term liabilities are summarized below:

	Balance July 1, 2011	Additions	Reductions	Balance June 30,	Due Within One Year	Due in more than One Year
Unused Compensated leave	\$ 447,374	\$ 561,722	\$ (400,553)	\$ 608,543	\$ -	\$ 608,543

NOTE 6 – OFFICE LEASE

Effective November 2005, 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 through November 2015. 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, 2012, which is not recorded in the financial statements.

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, 2012. The State Controller's Office provided expedited claim schedule processing and California leave accounting system (CLAS) services, the Department of General Services provided accounting services, the Department of Justice provided legal support, and the Office of the State Chief Information Officer provided accounting system support. Amounts paid for these services for the year ended June 30, 2012 are summarized below:

State Controller's Office	\$ 15,179
Department of General Services	178,000
Department of Justice	6,025
Office of the State Chief Information Officer	<u>3,796</u>
Total	<u>\$ 203,000</u>

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

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 eight 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. There is no cost to CIRM for this plan.

At the 47th month of employment employees have a one-time opportunity to transfer the ARP money to CalPERS and receive retirement service credit. During this period the employee has a window to exercise a one-time opportunity that includes three elections to (1) elect to transfer the funds in the ARP account to CalPERS and receive CalPERS service credit for ARP covered employment at no extra cost, or (2) request a lump-sum distribution from the ARP account, which may subject the employee to additional taxes and penalties for early withdrawal, or (3) transfer the funds in the ARP account to a DPA administered Savings Plus Program 401(k) retirement savings account. Participant's failure to designate an option will result in automatic enrollment in option 3.

NOTE 9 – PENSION PLAN

Plan Description

Eligible employees of CIRM participate in the California Public Employee's Retirement System (CalPERS), which is included in the State of California's Comprehensive Annual Financial Report as a fiduciary component unit. CalPERS administers the Public Employees' Retirement Fund (PERF). PERF as an agent multiple-employer defined benefit retirement plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Department and agencies within the State of California, including CIRM, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for this plan. This report is available online at www.calpers.ca.gov.

The pension plan provides retirement benefits, survivor benefits, and death disability benefits based upon the employee's years of credited service, age and final compensation. Vesting occurs after five or ten years of credited service depending on the benefit tier. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit payable monthly for the remainder of their lives. Benefit provisions and all other requirements are established by State statute.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

NOTE 9 – PENSION PLAN (CONTINUED)

Funding Policy

For the year ended June 30, 2012, the State had elected to contribute the full employer retirement contribution for State Miscellaneous Tier 1 and State Miscellaneous Tier 2 active members. CIRM is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERF Board of Administration. The required employer contribution rates for July 2011 through June 2012 were 18.175% for State Miscellaneous Tier 1 and 17.025% for State Miscellaneous Tier 2. CIRM's contribution requirement for the year ended June 30, 2012 was \$937,523. The employee contribution rates for State Miscellaneous Tier 1 is 8% of salary above \$513 per month for employees covered by social security and 9% of salary above \$317 per month for employees not covered by social security. State Miscellaneous Tier 2 employees do not contribute. The contribution requirements of the plan members are established by State statute and collective bargaining and the employer contribution rates are established and may be amended by CalPERS. Additional information is reported at a statewide level in the State of California's Comprehensive Annual Financial Report.

The following table shows CIRM's required contributions (annual pension cost) and the percentage contributed for the past three fiscal years:

Period Ended	Annual Pension Cost (APC)	Percentage of APC Contributed
June 30, 2010	\$ 560,776	100%
June 30, 2011	\$ 760,049	100%
June 30, 2012	\$ 937,523	100%

NOTE 10 – OTHER POST-EMPLOYMENT BENEFITS

The State also provides post-retirement health care benefits, in accordance with Section 22754(g) of the State Government Code, to all employees who retire from the State. The employer contribution for health premiums maintains the average 100/90 percent contribution formula established in the Government Code. Under this formula, the State averages the premiums of the four largest health benefit plans in order to calculate the maximum amount the State will contribute toward the retiree's health benefits. The State also contributes 90 percent of this average for the health benefits of each of the retiree's dependents. Employees vest for this benefit after serving 10 years with the state. With 10 years of service credit, employees are entitled to 50 percent of the State's full contribution. This rate increases by 5 percent per year and with 20 years of service, the employee is entitled to the full 100/90 formula. The post-retirement health care benefits are funded by the State's General Fund on a pay-as-

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2012

NOTE 10 – OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

you-go basis. Refer to the State's Post-Employment Benefits Other than Pension disclosure in the June 30, 2012, Comprehensive Annual Financial Reports for disclosure. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

SUPPLEMENTARY INFORMATION

CALIFORNIA INSTITUTE FOR 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, 2012

	Dolby Grant
Revenues:	
Investment earnings	\$ 10,829
Expenditures:	
Current	
Operating	767,854
Excess of expenditures over revenues	(757,025)
Available resources, beginning of year	3,007,419
Available resources, end of year	\$ 2,250,394

To the Members of the
Independent Citizens Oversight Committee of the
California Institute for Regenerative Medicine
San Francisco, 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 of the governmental activities and major fund of the California Institute for Regenerative Medicine (CIRM) as of and for the year ended June 30, 2012, which collectively comprise CIRM's basic financial statements and have issued our report thereon dated October 15, 2012. 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

Management of CIRM is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered CIRM's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of CIRM's 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 *deficiency in internal control* 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 *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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*.

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

Macinn Sini & O'Connell LLP

Sacramento, California

October 15, 2012