March 12, 2010

To the People of California:

I am pleased to present the fourth annual report of the Citizens Financial Accountability Oversight Committee (CFAOC) to the California Institute for Regenerative Medicine (CIRM).

Proposition 71, passed by voters in November 2004, created CIRM to implement a $3 billion stem cell research program. It is the CFAOC’s responsibility to ensure that those public funds are spent efficiently and effectively on lifesaving medical research. The CFAOC was created by Proposition 71 to provide financial oversight and recommendations to CIRM. The CFAOC must meet annually to review the finances of CIRM and issue an annual report.

Six years ago, Californians showed their overwhelming support for stem cell research when they approved Proposition 71. Not only did California voters support stem cell research, they also said they were willing to pay for it – and committed more than $3 billion in public funds, which will be closer to $6 billion with bond financing, to pursue this promising research.

I, too, believe stem cell research holds the key to cures for chronic and life-threatening diseases that affect millions of Americans. The members of this committee not only have the opportunity, but the obligation, to provide expert fiscal review and guidance to the Institute for Regenerative Medicine. We must ensure CIRM’s fiscal practices are sound and that we fiercely protect the investment of public funds as we continue to make inroads into this revolutionary field of science and medicine.

Sincerely,

JOHN CHIANG
California State Controller
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## Committee Overview

### History of the Citizens Financial Accountability Oversight Committee
The Citizens Financial Accountability Oversight Committee (CFAOC) was created by Proposition 71, which was approved by voters in November 2004. Proposition 71 charged the CFAOC with reviewing the financial practices and performance of the California Institute for Regenerative Medicine (CIRM) and advising CIRM on its financial practices.

### Scope
The CFAOC’s six-member board, chaired by the California State Controller, must annually review the financial practices and performance of CIRM. As a part of its evaluation, CFAOC members review CIRM’s annual financial audit, the State Controller’s evaluation of that audit and the financial practices of CIRM.

### Committee Members

**The Honorable John Chiang,** Chair  
_**California State Controller**_

Controller John Chiang was elected in November 2006 to serve as California’s Chief Fiscal Officer.

The Controller is the chair of the Franchise Tax Board and, during even-numbered years, the State Lands Commission. He serves on 78 boards and commissions including CalPERS and CalSTRS, the nation’s first- and second-largest public pension funds.

As Controller, Chiang has moved swiftly to ensure California is on the road to prosperity while meeting its obligations to workers and retirees. Upon assuming office, Chiang immediately hired an independent actuary to determine, ahead of schedule, the costs of post-employment benefits as the first step in crafting California’s long-term plan to meet the State’s accounting and healthcare commitments.

The Controller brings extensive experience and fiscal leadership to the State Controller’s Office. Chiang was first elected to the Board of Equalization in 1998 where he served two terms, including three years as chair. He began his career as a tax law specialist with the Internal Revenue Service and previously served as an attorney in the State Controller’s Office.
Chiang is the son of immigrant parents, and graduated with honors from the University of South Florida with a degree in Finance. He received his law degree from the Georgetown University Law Center. Chiang and his wife, Terry Chi, live in Torrance, California.

**Daniel Brunner**  
*Retired, Appointed by the State Treasurer*

Daniel Brunner has more than 30 years experience in health care law, policy and corporate management in both the public and private sectors. Mr. Brunner co-founded Affordable Health Care Concepts in 1983. The Sacramento-based firm, which developed highly customized PPO networks on the West Coast, was the first to introduce the concept of competitive bidding among hospitals for patient services. It was acquired by First Health in 1987. Through January of 2005, he served as Executive Vice President of First Health and as a member of its Board of Directors.

Mr. Brunner served as General Counsel for the California Governor’s Office of Special Health Care Negotiations and was the Director of the Legislative Office at the Western Center on Law and Poverty, General Counsel and Deputy Director of Legal Affairs in the State Department of Benefit Payments and was on the faculty at UCLA and USC law schools.

Mr. Brunner earned a bachelor’s degree in accounting at UCLA. He obtained his law degree from California Western University and is a member of the California Bar. In addition, he served on the boards of directors of the Sacramento Theatre Company and Capitol Public Radio. He also serves on the board of visitors of the University of California, Davis, School of Medicine.

**Dr. Loren G. Lipson**  
*Retired, appointed by the State Controller*

Dr. Loren G. Lipson is a Professor Emeritus of Medicine at the Keck School of Medicine at the University of Southern California. A resident of Pasadena, Dr. Lipson has been a recognized leader in the field of medicine for 40 years. He has been appointed to academic posts at some of the country’s most prestigious universities, including the Harvard Medical School and the USC School of Medicine, where he served as Chief of the Division of Geriatric Medicine, Department of Medicine, from 1984-2004.

Dr. Lipson currently serves as a Geriatric Medicine and Long Term Care consultant to the U.S. Department of Justice, Civil Division; U.S. Department of Health and Human Services, Office of the Inspector General; California Department of Justice’s Bureau of Medi-Cal Fraud and Elder Abuse; California Department of Social Services; and the New Mexico Department of Justice, Medicaid Fraud Control Unit.
He was director of two USC Teaching-Nursing Home Programs, the Hollenbeck Home in Los Angeles and the Atherton Baptist Home in Alhambra.

A graduate of Johns Hopkins University School of Medicine, Dr. Lipson received his undergraduate degree in Chemistry from the University of California, Los Angeles.

Jim Lott  
*Executive Vice President, Hospital Association of Southern California, appointed by the Senate President Pro Tem*

Jim Lott is the Executive Vice President of the Hospital Association of Southern California where he is responsible for health care policy development, advocacy, and communications for hospitals serving Los Angeles, Orange, San Bernardino, Riverside, Santa Barbara and Ventura counties.

Prior to his move to Los Angeles, he served for five years as the President and Chief Executive Officer of the Hospital Council for San Diego and Imperial counties.

Mr. Lott served for ten years as Staff Director and Chief Consultant to the Senate Committee on Health and Human Services of the California Legislature. In that capacity, he was one of the principal architects of the health care finance reforms adopted by the California Legislature in 1982. Later, he worked on President Clinton’s Health Care Reform Task Force.

Mr. Lott received his undergraduate degree from Cal State L.A., his MBA degree from the University of Redlands, and has achieved candidate status for his doctorate in Education-Organizational Leadership at Pepperdine University. He serves on the boards of the Claremont Universities Consortium, the Los Angeles Economic Development Corporation, and L.A. Care Health Plan, for which he serves as chairperson.

Myrtle Potter  
*President & CEO, Myrtle Potter And Company, LLC, appointed by the ICOC Chair*

Myrtle Potter’s professional experience includes close to 30 years of successful operating and general management experience in large, global biotechnology, pharmaceutical and healthcare businesses. She served in executive roles at Genentech from 2000-2005, helping steer the company through one of the most profitable periods in its history.
While president of Commercial Operations and COO, Potter oversaw the successful launch of six products, including the blockbuster Avastin™. Prior to Genentech, Potter was president of Bristol-Myers Squibb’s multi-billion dollar U.S. Cardiovascular/Metabolics Business. During her tenure, this was the company’s largest source of sales, growth and profits.

For the 14 previous years, Potter worked at Merck where she established the new pharmaceutical company, Astra/Merck, Inc. (now Astra Zeneca). She also led the marketing of the prescription drug Prilosec® and set it on course to become the largest pharmaceutical product in the world.

In 2005, Potter established a number of real estate development businesses that operate under the Chapman name. These businesses specialize in commercial and residential real estate development in the United States and the Bahamas.

Potter has received numerous honors and accolades during her career, including recognition in 2006 by the American Diabetes Association as “Woman of the Year.” In 2004 and 2005, The Wall Street Journal named her as one of its “50 Women To Watch.” In 2003 and 2004, she was named to FORTUNE’s “Top 50 Most Powerful Women In Business” list and to Time magazine’s list of “Global Influentials.”

Potter serves as a member of the Board of Directors for Amazon.com, Medco and Eleuthera Properties Limited. She holds a Bachelor of Arts degree from the University of Chicago.

**Dr. Gurbinder Sadana**  
*Physician, Appointed by the Assembly Speaker*

Dr. Gurbinder Sadana is a long-time private practice physician and specialty consultant with offices in Pomona.

He has been in private practice in Pomona since 1983, and is a specialty consultant and advisor on asthma and related disease. He is also Medical Director of Critical Care Services at the Pomona Valley Hospital Medical Center in Pomona.

Dr. Sadana is a fellow of the American College of Chest Physicians and a member of the Society of Critical Care Medicine. He serves on the Board of Directors of the Pomona Valley Hospital Medical Center Foundation.

His Board Certifications include American Board of Internal Medicine, American Board of Internal Medicine/Critical Care Medicine, and American Board of Internal Medicine/ Pulmonary Medicine.

Dr. Sadana graduated from Gauhati Medical College in Gauhati, Assam, India in 1969, and he has completed extensive post-graduate education
including earning a Diploma in Chest Diseases from the University of Delhi, New Delhi, India.

Oversight of the California Institute for Regenerative Medicine

When Proposition 71 created CIRM, it also established two structures for providing oversight of the Institute and the taxpayer bond money. The Independent Citizens Oversight Committee (ICOC) consists of 29 members who are appointed by statewide elected officials and Legislative leaders. The ICOC is the board that governs CIRM. ICOC members include scientists, physicians, business people, university administrators and patient advocates. Proposition 71 required the Chair and the Vice Chairperson of ICOC be full- or part-time employees of the Institute.

The Citizens Financial Accountability Oversight Committee (CFAOC) is chaired by the State Controller and is responsible for reviewing CIRM’s annual financial audit, the Controller’s review of that audit and the financial practices of CIRM.

Fourth Annual Meeting

Meeting Details

The fourth annual meeting of the Citizens Financial Accountability Oversight Committee was held on April 14, 2009, at the State Controller’s Office at 300 Capitol Mall in Sacramento, and by videoconference at the State Controller’s Office 777 South Figueroa Street, Los Angeles, CA. Four of the six members were in attendance, Chair John Chiang was absent, and Deputy Controller Ruth Holton-Hodson chaired the meeting in his absence. Dr. Lipson was also absent.

Financial Presentations

On April 14, 2009, the Committee heard presentations regarding the independent audit of CIRM; the State Controller’s Office’s review of that audit; and a status update of CIRM’s financial statements, grants awards process, best practice considerations and intellectual property regulations. The Committee heard a presentation on bond sales from the State Treasurer’s Office, and discussed CIRM risk analysis, and the posting of the Statement of Economic Interest Form 700 and Form 800.

Independent Audit

Shelley Walker-Davey with the independent audit firm Macia, Gini & O’Connell (MGO) presented their audit covering Fiscal Year 2007-08. CIRM ended Fiscal Year 2007-08 with a net asset deficit of -$64,661,253 compared to the end of the prior fiscal year deficit of -$22,203,251. CIRM’s cash and investments balance was $210,058,084,
an increase of $29,905,349 from the balance of the prior fiscal year. CIRM had program revenues of $1,851, which represents a decrease of $409,256 from the prior year. Additionally, general revenues were $10,546,106 for fiscal year 2008, representing an increase of $5,978,323 from the prior year. Expenses for Fiscal Year 2008 were $303,005,959, a $291,027,933 increase from the prior year.

The audit offered a clean opinion, meaning the financial statements present fairly the financial position of the governmental activities and the major fund of CIRM as of June 30, 2008. The audit did not identify any deficiencies in internal controls on financial reporting.

The MGO audit report for Fiscal Year 2007-08 can be found online at http://www.sco.ca.gov/Files-EO/CFAOC/cirm2008supplemental.pdf

State Controller’s Office Review
Cassandra Moore-Hudnell, Chief of the Financial Audits Bureau in the State Controller’s Office (SCO), reported the SCO’s review of the MGO audit. She emphasized that the objective of the review was to determine whether the audit was performed in accordance with generally accepted auditing standards, Government auditing standards, and the California Business and Professions Code. The SCO found that the audit was performed in accordance with audit standards and requirements.

The SCO report can be found online at http://www.sco.ca.gov/Files-EO/CFAOC/SCOAuditReview-2.pdf

Status Update of CIRM
Margaret Ferguson of CIRM presented CIRM’s operating budget allocation and expenditures through February 2009. She gave a brief overview of CIRM’s 2008-09 budget allocations as approved by the ICOC in June 2008, and compared them to CIRM’s expenditures through February 2009.

Dr. John Robson of CIRM discussed CIRM’s cash flow situation and grant process. He stated due to the economic climate, raising money through general obligation bonds has become increasingly difficult, and the cash flow has been somewhat stagnant. He explained that CIRM is using a $158 million reserve from a previous bond sale to fund their current grants.

Dr. Robson then discussed CIRM’s projections moving forward. He emphasized this will be a tough balancing act to fund the new and existing programs while still being fiscally responsible. He stated that they have approved new programs that are waiting to be funded.
Ms. Potter asked how CIRM would handle deciding which programs should be awarded grants if CIRM faces a bad cash flow situation. Chair Holton-Hodson asked which existing programs would be affected by cuts, as well. Dr. Robson explained that CIRM has created an internal priority list and if they have to cut budgets to certain program areas, they will use the priority list to determine which grants to approve or put on hold. He further explained that no ongoing grants will be cut or downsized; their preference is to trim back new programs until the normal cash flow returns.

Chair Holton-Hodson asked about the legal services CIRM employs. Specifically, she asked about the workload breakdown between the internal and external legal services and whether CIRM’s 50- person staff limit was the reason for a large number of external legal contracts. Ian Sweedler, the interim general counsel at CIRM, stated CIRM’s large number of external contracts is due to the need for specialization in legal matters that range from isolated incidents to routine issues. The 50- employee cap requires CIRM to take a close look at duties that require full-time attention versus those that are short, as-needed projects. This, he said, determines whether CIRM needs to employ external contracts.

CIRM is embarking on a loan program in the hopes of bringing in some biotech companies that would not participate in the grant programs due to reservations they have about the intellectual property restrictions. Intellectual property restrictions placed on grants, as opposed to loans, are basically two different revenue-sharing models, and some biotech companies prefer the loan approach. Ms. Potter stated that she thought this was a very good idea.

Mr. Robson also reported that it was too early to know exactly how the federal stimulus money would affect California stem cell research, but it is something they would be working with the NIH on in the future. However, CIRM was very pleased about the federal government lifting restrictions on stem cell research. He also stated that CIRM has set up collaborative agreements with some other countries, where the scientists in other countries can work together with scientists in California and share the financial burden, with opportunity to grow.

**Committee Actions**

The Committee took no formal action at the meeting on April 14, 2009.

**Committee Discussion**

**$3 Billion General Obligation Bond Sale**

The Committee heard a presentation from Blake Fowler with the Public Finance Division of the State Treasurer’s Office on the $3 billion General Obligation Bond sale. This would be accomplished through the sale of two bonds, a taxable bond and a Build America Bond. He expected to see from the sale that CIRM’s $250 million loan from the Pooled Money Investment Account (PMIA) would be paid down in full. Also, it is likely CIRM would receive funds for the remaining major facilities grants. The Department of Finance will give direction on the distribution of the funds.
Chair Holton-Hodson asked whether the Treasurer’s Office would pursue a private bond sale if the bond sale did not raise enough money. Mr. Fowler explained that private bonds are something to consider and they have completed two private bond sales, both with public agencies. These are known as Mandatory Tender Bonds.

Ms. Potter asked if each investor of the bonds set up different terms or if there was some standardized measure with regard to private bond sales. Mr. Fowler stated they have established a fairly standardized document and method for setting the interest rate that was used in both private transactions.

Mr. Brunner asked whether, in the event the bond sale went well, there a time frame for holding the next sale. Mr. Fowler explained they were generally related to the release of the Governor’s budget. He believed they would not be able to do another sale until early July.

Chair Holton-Hodson asked about the interest rate of private bond sales. Mr. Fowler described the private transactions completed to date and stated the interest rate was set one percent higher than similar public bonds with the same maturity. These bonds usually end up costing a little more because of the nature of the bonds and because the State is paying a higher interest rate.

Mr. Fowler explained that these private bond sales are public documents just as any public bond sale.

**CIRM Risk Analysis**

On April 14, 2009, Chair Holton-Hodson asked whether CIRM has a system in place to measure risk. Dr. Robson explained that it is difficult to put performance measurements in place since they are a rather new organization and science can always turn in a new direction that may not have been mapped out.

The Committee discussed this issue with the CIRM general counsel and communications officers. CIRM measures potential success of the grantee beforehand and also throughout the life of the grant. They have a Request for Proposal (RFP) out for help with developing benchmarks for benefits to the State. They also plan to have an outside review team in 2010 to look at progress towards their strategic plan. The Committee decided they would like to have a regular update of the risk assessment process at the CFAOC meetings.

**Form 700 and Form 800**

The Committee decided to discuss and vote on the posting of Form 700 and Form 800 for ICOC and CFAOC members at the next meeting.
Public Comments

John Simpson with Consumer Watchdog addressed the CFAOC throughout the meeting. He felt that both the audits were very well done. He asked questions about CIRM’s external legal contracts and sale of private bonds; both his questions were addressed in CIRM’s presentation.
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