



JOHN CHIANG
California State Controller

December 17, 2010

To the People of California:

I am pleased to present the fifth 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 this committee'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 CIRM. 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

John Chiang was first elected in November 2006 to serve as Controller of the State of California, the eight-largest economy in the world. He was elected to serve a second term in November 2010.

Since taking office in January 2007, Controller Chiang took immediate action to make the State's finances more transparent and accountable to the public and to weed out waste, fraud and abuse of public funds.

He has led efforts to reform the State's public pension systems, helped local governments navigate difficult economic times, protected California's precious natural resources, returned more than \$1 billion in unclaimed property to the rightful owners, and launched financial and tax assistance seminars for California's working families, seniors, small businesses and non-profit organizations.

The Controller's aggressive audits have identified \$2.4 billion in taxpayer dollars that were denied, overpaid, subject to collection, or resulted in revenues, savings and cost avoidance.

As the State's chief fiscal officer, Chiang 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.

The son of immigrant parents, Chiang 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. Daniel Hollander

Director, Scientific and Medical Research Initiatives, The Broad Foundation, Professor of Medicine, UCLA, appointed by the ICOC Chair

Dr. Daniel Hollander, is the Director of the Scientific and Medical Research Initiatives of The Broad Foundation and a professor of medicine at the University of California, Los Angeles (UCLA) School of Medicine. Before joining The Broad Foundation, he was president/CEO of the Los Angeles Biomedical Research Institute at Harbor-UCLA Medical Center.

Dr. Hollander has held several academic leadership positions including Executive Dean and professor of medicine at the University of Kansas School of Medicine and head of the Division of Gastroenterology at the University of California, Irvine (UCI). While at UCI, he also served as Associate Dean for Research and Program Development, Associate Dean for Academic Affairs and Senior Associate Dean for Clinical Affairs. A graduate of the Baylor University College of Medicine, Dr. Hollander received his undergraduate degree from the University of California, Los Angeles. Dr. Hollander has since resigned from the CFAOC.

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.

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 provided that the Chair and the Vice Chairperson of ICOC shall 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.

Fifth Annual Meeting

Meeting Details

The fifth annual meeting of the Citizens Financial Accountability Oversight Committee was held on January 26, 2010, at the Ronald Reagan Building, 300 South Spring Street in Los Angeles. Five of the six members were in attendance, Daniel Brunner was absent. Dr. Daniel Hollander, the newest member of the Committee replacing Myrtle Potter, was in attendance. However, he has since resigned from the Committee.

Financial Presentations

On January 26, 2010 the Committee heard presentations regarding the independent audit of CIRM; the State Controller's Office's review of that audit; a status update of CIRM's financial statements, grants awards process, and risk analysis. The Committee heard a presentation from the Little Hoover Commission on their review of CIRM, and discussed and voted on the posting of the Statement of Economic Interest Form 700 and Form 800.

Independent Audit

David Livingston with the independent audit firm, Macia, Gini & O'Connell (MGO) presented their audit covering Fiscal Year 2008-09. CIRM ended Fiscal Year 2008-09 with net assets of \$294,677,818 compared to the end of the prior fiscal year deficit of -\$64,661,253. CIRM's cash and investments balance was \$368,343,685, an increase of \$158,285,601 from the balance of the prior fiscal year. CIRM had program revenues of \$960, which represents a decrease of \$891 from the prior year. Additionally, general revenues were \$5,024,348 for Fiscal Year 2009, representing a decrease of \$5,521,758 from the prior year. Expenses for Fiscal Year 2009 were \$150,686,237, a \$152,319,722 decrease 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, 2009. The audit did not identify any deficiencies in internal controls on financial reporting.

(1/26/10 minutes, p. 8-11)

The MGO audit report for FY 2008-09 can be found online at http://www.sco.ca.gov/Files-EO/CFAOC/Item_5-2_Auditor_Reports.pdf

State Controller's Office Review

Caroline Baez, Manager, Financial Audits Bureau, with the State Controller's Office (SCO), reported on 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.

(1/26/10 minutes, p. 12-13)

The SCO report can be found online at http://www.sco.ca.gov/Files-EO/CFAOC/Item_5-3_Quality_Control_Review.pdf

Status Update of CIRM

Margaret Ferguson of CIRM presented the final overview of CIRM's 2008-2009 operating budget and reported on the 2009-10 budget expenditures through December 31, 2009. She explained that CIRM spent 78 percent of its budget and left \$2.9 million of the total budget in savings for Fiscal Year 2008-2009. For 2009-10, CIRM had an overall budget of \$12.9 million, of which it spent \$4.8 million through December 21, 2009.

Mr. Lott asked for an explanation of the significant savings. Ms. Ferguson explained that the savings came from several different sources, the most significant being salaries and benefits. CIRM saved \$1.5 million by filling only 7 of 13 positions they had allocated in the budget. There also were savings of approximately \$500,000 in travel expenses directly related to the unfilled positions. Mr. Lott asked how the many unfilled positions affected CIRM's ability to meet its goals. Dr. John Robson, Vice President of Operations for CIRM, stated that the core work was being handled, but with the 50-person cap, CIRM needed to make sure they were hiring the very best people, who are not easy to find. Positions also were being reserved for a Vice President of Research and Development and that officer's staff. Dr. Lipson questioned the size of the contract budget. Dr. Robson responded that also was influenced by the 50-person cap and CIRM decided to contract out for CIRM's information technology. Chair Chiang asked if CIRM had done a study on the cost differential between contracting out and having internal

information technology staff if they had the ability to add employees to perform those functions. CIRM has not done a study.

Dr. Robson gave an overall update of CIRM's financial situation. He stated that the Treasurer's Office completed two bond sales that benefited CIRM. The first bond totaled \$505 million, CIRM used some of it to pay off loans from the Pooled Money Investment Account (PMIA), and ended with a net increase in funds of \$297 million. The second bond sale totaled \$161 million, which also went to pay off the PMIA and ended with a net increase of \$118 million. Robson stated that, with no additional bond income, CIRM expects to have \$56 million remaining in their bond fund at the end of Fiscal Year 2011. He reported that, to date, the Treasurer's Office had raised approximately \$916,500,000 in bond sales. Dr. Robson then discussed CIRM's five grant programs that were approved and funded for 2009-10. The total commitment for Fiscal Year 2009-10 was \$389 million, bringing CIRM's total commitments to a little more than \$1 billion dollars. Dr. Lipson posed several questions related to CIRM funding, whether any was going outside of California and what the state receives from successful projects. CIRM staff responded that CIRM only funds the California component of the research and the state will receive royalties as defined in the Intellectual Property regulations. Dr. Lipson stated that he thought that grants to industry should be repaid in full plus interest and some intellectual property that is derived. Dr. Lipson also expressed concern about potential conflicts-of-interest in the grants award process, and questioned how the public would know if companies were being discriminated against without publishing the names of applicants. CIRM staff described their conflict of interest practices and system to preserve the anonymity of the applicants. They stated their goal has been to strike a balance between the need to assure decisions are made on the merits with the need to protect the identity of potential applicants. Mr. Lott recommended that the board set up an internal compliance subcommittee to focus on compliance with policies, procedures and processes.

Dr. Robson gave an update on CIRM's Risk Analysis. He identified the major risks that CIRM faces. One risk is that CIRM's funding programs will not adapt quickly to changes in the science. To mitigate this risk, CIRM updated their strategic plan and plans to have a group of scientists, funding agencies, patient advocates and ethicists provide an external review of all their programs by the fall. The second major risk is that CIRM will not fund the best proposals as a result of the science changing so quickly. In order to avoid this risk, the applications go through a four-step review process, including a review by the working group of scientists, all of whom are from outside of California. The third risk is the funded programs may not meet their intended goals. Dr. Robson assured the CFAOC that CIRM does all it can to make sure every program meets its goals, including site visits and rigorous review of

annual reports. Three awards have been terminated because they were not making sufficient progress towards their goals.

Chair Chiang asked how organizations that had received facilities funding were doing in getting matching funds in light of the economic downturn. Mr. Robson stated that only three projects were delayed but now are on track and under way. Each was delayed by only a year from the original proposal.

Chair Chiang also asked for an update on the grants management system. Dr. Robson said the process has been long but they are making headway this year. The most significant area CIRM struggles with is the post-award component. They are implementing an electronic system to manage their portfolio. Chair Chiang also asked how CIRM was proceeding in meeting its operational goals. Dr. Robson responded that they are on target to finish the grants management installation, and then develop oversight of the large research programs. That has not yet been done because the VP position for research and development has not been filled.

Chair Chiang stated that he thought it was very important that the public see what is being accomplished so that they feel there is a return on their investment. Transparency is critical. Dr. Robson summarized the measures that CIRM is taking to help the public better understand what CIRM is accomplishing and to relieve any misunderstanding that they are not accomplishing their goals. He stated they are having an economic impact study done to show the direct economic impact of the funding they provided to a particular program, the jobs that were created, tax revenues produced from those funds, and also the increased productivity that would result from the treatment if it is successful. He also stated that they are soliciting input from Board members with extensive communications experience to work with CIRM's communication division to make the public more aware of the work and accomplishments of CIRM.

(1/26/10 minutes, p. 18-78)

Committee Discussion

The Little Hoover Commission Report

The Committee heard from Stuart Drown, the Executive Director of The Little Hoover Commission (LHC), who presented the LHC's recent report on CIRM, entitled "Stem Cell Research: Strengthening Governance to Further the Voters' Mandate." LHC focused their attention on the governance of CIRM, with the goal of providing recommendations to enhance the governance to propel CIRM's success. LHC framed their study around the future of CIRM, trying to answer specific governance questions regarding how long CIRM will exist, what will happen if the bond money runs out, how will CIRM raise money to continue its work, and how can the public be sure future actions are in compliance with Prop71.

LHC concluded that the ICOC's 29-member board is too large, and that the board lacked truly independent voices to balance out those of interested board members. LHC opined there is no compelling reason to have institutions that receive the funds so heavily represented on the ICOC. The length of the founding board member terms is not conducive to adding fresh perspectives about the agency's future, especially when the politics and science of stem cells is changing so quickly and multiple appointing authorities cloud accountability. Having the ICOC Chair involved in day-to-day operations presents a conflict when the board is supposed to be independent and provide oversight. The 50-person staffing cap is arbitrary and only leads to greater reliance on outside contractors. The LHC report also found that CIRM's internal grants review process added another layer of opacity to the loan process and the organization should be striving for more transparency.

The main recommendations were to shrink the board from 29 members to 15, add four independent business people and scientists to provide independent voices, have the Governor make more of the appointments with confirmation by the Senate, and shrink the terms to four years, but allow existing board members to serve out their terms. LHC also recommended that the board appoint the Chair and end the co-CEO approach, getting the Chair and board out of the day-to-day management of CIRM. Concerns about accountability and oversight will not diminish until steps are taken to restructure the governance. They also recommended that the ICOC have a leadership-succession plan, and a transition plan for CIRM should bond funding run out or the Institute is caught in a dire cash-flow situation. Finally, the LHC recommended removing the 50-person cap on employees.

LHC felt that the CFAOC has provided a solid foundation in its work, and encouraged the Committee to continue to ask the kinds of questions it already has been asking. To address the concern that the CFAOC does not have the statutory authority to go beyond a review of the financial audit, LHC recommended that the Legislature clarify the statutory authority of the Committee to enhance its oversight powers to be able to ask the big questions regarding major issues of transparency and accountability.

CIRM responded by saying they agreed to a number of LHC recommendations such as posting vote tallies and actual conflicts of interest associated with each vote on each application, beginning a succession planning process, and looking at the 50-person cap. However, there are a number of other recommendations CIRM determined were unnecessary, and claimed their process handled fine, such as board removal of a member, eliminating the cap on the scientific working group and not expanding the performance audit capacity of CFAOC. CIRM also raised the point that many of the changes proposed could not be accomplished legislatively, but would have to go back to the people for a vote.

Mr. Lott asked if the LHC had actually found any evidence of a conflict of interest, or whether their findings were simply perceptions. Drown clarified that they had not found evidence of conflicts of interest. Chair Chiang congratulated the LHC on their study, and thanked them for their statements about the CFAOC. He affirmed that CFAOC's statutory authority is limited to reviewing the annual financial audit, reviewing the State Controller's report of the audit, reviewing CIRM's financial practices, and providing recommendations regarding CIRM's financial practices and performance. He stated he would like the CFAOC to review CIRM's programmatic and strategic performance, and emphasized how important the oversight is for CIRM as they continue to develop. He stated that the Attorney General's Office advised CFAOC that it can take action on the recommendations of the LHC report to the extent that it believes those recommendations could affect CIRM's financial practices and performance.

Committee Actions

Chair Chiang made a recommendation that the Committee endorse the following LHC recommendations and formally advise CIRM to implement the proposed recommendations and support legislation where statutory recommendations are required to improve efficiency and transparency for distributing grants. He stated that transparency is important to preserve the integrity and the strength of the public resolve. The CFAOC and CIRM governing boards should use their authority to enhance oversight, and the ICOC should be planning for CIRM's future. The Chair again emphasized the importance of public participation to the fullest extent possible. Mr. Lott made a motion to endorse the recommendations, and Dr. Lipson seconded. The motion passed unanimously.

To address public concerns about government transparency, especially when it comes to conflict of interest and spending public dollars, Chair Chiang stated that his office posts on the Controller's public website the Statements of Economic Interest Form 700s and travel expense claims that he and his senior staff submit. He stated that he would also like to require that CFAOC members' statements of economic interest and travel expenses be posted on the CFAOC and CIRM web pages. He also recommended that CIRM do the same for ICOC members and executive staff. Dr. Lipson made a motion and Mr. Lott second. Dr. Hollander expressed concern that, since members are voluntary participants, posting the information may not necessarily be helpful and could be detrimental. Mr. Lott confirmed that the information was available to the public now through the FPPC. The motion passed with all members in favor except Dr. Hollander.

Public Comments

No public comment was made at the meeting on January 26, 2010.

**Citizens Financial Accountability Oversight Committee
to the
California Institute for Regenerative Medicine**

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