

# **GILBERT ASSOCIATES, INC.**

Review Report

## **QUALITY CONTROL REVIEW**

For the Firm's Audit of the  
**California Institute for Regenerative Medicine (CIRM)**  
*for Period from Inception (November 2, 2004) to June 30, 2005*



**STEVE WESTLY**  
California State Controller

May 2006



**STEVE WESTLY**  
California State Controller

May 22, 2006

Kevin Wong  
Gilbert Associates, Inc.  
2880 Gateway Oaks Drive, Suite 100  
Sacramento, CA 95833

Dear Mr. Wong:

The State Controller's Office (SCO) completed a quality control review of Gilbert Associates, Inc. We reviewed the audit working papers for the firm's audit of the California Institute for Regenerative Medicine (CIRM) for the period from inception (November 2, 2004) to June 30, 2005.

As agreed to in an e-mail from you May 18, 2006, we will not conduct a formal exit conference. However, we provided you an opportunity to review and comment on our report. Following is our final review report.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

A handwritten signature in black ink, reading "Jeffrey V. Brownfield".

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

JVB/wm

cc: Zach Hall, President  
California Institute for Regenerative Medicine  
Robert L. Klein, Chairperson  
Independent Citizens' Oversight Committee  
Walter Barnes, Chief Administrative Officer  
California Institute for Regenerative Medicine

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# Review Report

## Summary

The State Controller's Office (SCO) completed a quality control review of Gilbert Associates, Inc.'s working papers for the audit of the California Institute for Regenerative Medicine (CIRM) for the period from inception (November 2, 2004) to June 30, 2005. The last day of fieldwork was May 22, 2006.

The firm's audit was performed in accordance with the standards and requirements set forth in U.S. generally accepted auditing standards (GAAS) and the California *Business and Professions Code*.

## Background

The California Institute for Regenerative Medicine (CIRM) is a California state agency formed pursuant to the provisions of Proposition 71 approved by California voters in November 2004. Proposition 71, the California Stem Cell Research and Cures Initiative, amended the California Constitution by adding an article thereto; amended a section of the California *Government Code*; and added sections to the California *Health and Safety Code*. The purpose of the legislation was the formation of the institute to:

- Make grants and loans for stem cell research, for research facilities, and for other vital research opportunities to realize therapies, protocols, and/or medical procedures that will result in, as speedily as possible, the diagnosis, treatment, and cure for, and/or substantial mitigation of, major diseases, injuries, and orphan diseases.
- Support all stages of the process of developing treatments and cures, from basic research and discovery through preclinical and translational research, to the conduct of successful clinical trials.
- Establish the appropriate regulatory standards and oversight bodies for research and facilities development.

Proposition 71 authorized the State to issue, under the oversight of the California Stem Cell Research and Cures Finance Committee, \$3 billion in state issued tax-exempt and taxable bonds to fund CIRM's operations, medical and scientific research, including therapy development through clinical trials and facilities. CIRM is authorized to receive a \$3 million loan from the General Fund and to issue Bond Anticipation Notes (BANS) to fund its initial grants and operational costs until the bonds can be issued. Both will be repaid with interest from the proceeds of bonds when they are issued.

The added *Health and Safety Code* Section 125290.30 requires the institute to "annually commission an independent financial audit of its activities from a certified public accounting firm, which shall be provided to the State Controller, who shall review the audit and annually issue a public report of that review."

Gilbert Associates, Inc. is an independent certified public accounting firm with offices located in Sacramento and Folsom, California. The firm consists of 64 employees, including 8 shareholders and 3 senior managers. This is the first year the firm has been the independent auditor for the California Institute for Regenerative Medicine.

### **Objectives, Scope, and Methodology**

The general objectives of our quality control review were to determine whether this audit was conducted in compliance with GAAS and the California *Business and Professions Code*.

We conducted the quality control review at the office of Gilbert Associates, Inc. We compared the audit work performed by the firm, as documented in the working papers, with the standards stated in the general objectives.

### **Conclusion**

Gilbert Associates, Inc.'s audit was performed in accordance with the standards and requirements set forth in GAAS and the California *Business and Professions Code*.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Gilbert Associates, Inc.

### **Views of Responsible Official**

We provided a discussion draft of this report to Kevin Wong and discussed the review results with him on May 22, 2006. Mr. Wong agreed with the review results presented in this report, and agreed that we could issue the report as final.

### **Restricted Use**

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.



JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, California 94250-5874**

**<http://www.sco.ca.gov>**

S06-CRM-001





**STEVE WESTLY**  
**California State Controller**

May 26, 2006

Zach Hall, President  
California Institute for Regenerative Medicine  
210 King Street, Third Floor  
San Francisco, CA 94107

Dear Mr. Hall:

The State Controller's Office has completed its review of the independent audit of the California Institute for Regenerative Medicine (CIRM) for the period from inception to June 30, 2005, and has issued the final report. The report concludes that Gilbert Associates, Inc. (Gilbert), the independent auditor, performed the audit in accordance with U.S. generally accepted auditing standards (GAAS) and in conformance with pertinent sections of the California *Business and Professions Code*.

However, during our review we identified three issues that we want to bring your attention. We discussed these issues with CIRM management and they have agreed to implement our recommendations.

First, we recommend that future audits be performed in accordance with the standards and requirements set forth in the *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS). GAGAS Section 1.04 states, in part:

The standards and guidance in this document apply to audits and attestation engagements of government entities, programs, activities, and functions, and of government assistance administered by contractors, nonprofit entities, and other nongovernmental entities. A number of statutes and other mandates require that auditors follow GAGAS. Where a statute or other mandate does not exist, auditors will find it useful to follow GAGAS in work regarding the use of government funds. . .

In addition, GAGAS Section 1.12 states, in part,

. . . Financial audits performed in accordance with GAGAS also provide information about internal control, compliance with laws and regulations, and provisions of contracts and grant agreements as they related to financial transactions, systems, and processes.

Therefore, we recommend that CIRM amend the Independent Consultant Agreement with Gilbert to require that, in the future, the audit be performed in accordance with GAGAS.

Second, we recommend that CIRM capitalize all individual assets with a purchase price of over \$5,000.

The Gilbert audit identified that a \$15,000 copier was purchased during the audit period. The firm determined that CIRM had charged the copier as a current expense instead of capitalizing it, although the copier's cost exceeded the University of California's (UC) procurement capitalization threshold of \$5,000. However, the firm considered the amount to be immaterial and did not require CIRM to prepare a reclassifying journal entry.

Governmental Accounting, Auditing, and Financial Reporting, Chapter 12, states, in part:

Capital assets are major assets that benefit more than a single fiscal period. . . . In no case should capitalization thresholds be less than \$5,000.

Governmental Accounting Standards Board (GASB) 34 requires government-wide financial statements that consist of a statement of net assets and a statement of activities. Those statements should measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains and losses using the economic resources focus and accrual basis of accounting.

GASB 34 requires that capital assets be reported at historical cost, and requires that they be depreciated over their estimated useful lives. In addition, capital assets should be reported net of accumulated depreciation in the statement of net assets. Also, depreciation expenses should be reported in the statement of activities.

We agree that, due to the immaterial amount, an adjusting journal entry was not necessary. However, in the future, CIRM should follow the UC system's capitalization policy. In addition, CIRM should establish a capital assets list and ensure that all assets over the capitalization threshold are tracked through an annual physical inventory.

Finally, we recommend that CIRM address Gilbert's decision to not provide us with copies of certain working papers that the firm considers proprietary.

The firm provided us access to all its working papers related to the CIRM audit, including those identified as proprietary. However, the firm would not provide copies of those working papers that they considered proprietary unless the Controller's Office signed a letter that agreed to treat the materials confidentially.

We were able to review the working papers considered proprietary at the firm's office and carefully referenced these papers where they were used to substantiate the conclusions of our review with the understanding that we could return to the firm's office to review the documentation if there was any question of adequacy. However, we disagree with the firm's contention that the documentation is proprietary to the extent that we cannot make copies for our records unless we sign a confidentiality letter and we believe that we have a valid requirement for the copies.



Proposition 71 requires the CIRM audit and there is nothing in the proposition, statute, etc. that make any working papers proprietary. The documentation of audit work serves to describe the audit procedures employed, the evidence collected, and conclusions drawn. As in any audit or review of this nature, we have two levels of review to ensure adequacy and accuracy of the particular conclusions. Common practice, therefore, is to include documentation in the working papers related to our review that will support the audit work and allow for an efficient review.

While we were able to complete the review in this instance, we are concerned that this year did not present the challenges that will exist in subsequent years when bonds and bond anticipation notes are issued, research grants are awarded and paid and a full year of operations will be subject to audit. In this case, having copies of requested working papers will be more important to allow all levels of our review to be conducted in a timely and adequate manner.

Therefore, we recommend that you work with Gilbert and your legal counsel to determine how to best address this issue to ensure that we are provided copies of all working papers upon request in subsequent reviews.

If you have any questions regarding these issues or the report in general, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,



JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/wm

*S06CRM001Ltr*

cc: Walter Barnes, Chief Administrative Officer  
California Institute for Regenerative Medicine  
Robert L. Klein, Chair  
Independent Citizens' Oversight Committee  
Casandra Moore-Hudnall, Chief  
Financial Audits Bureau  
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