



JOHN CHIANG
California State Controller

October 28, 2008

To the People of California:

I am pleased to present the second 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.

Four 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,

Original signed by:

JOHN CHIANG
California State Controller

Contents

COMMITTEE OVERVIEW

History of the Citizens Financial Accountability Oversight Committee	3
Scope	3
Board Members.....	3
Oversight of the California Institute for Regenerative Medicine	7

SECOND ANNUAL MEETING

Meeting Details.....	7
Financial Presentations	7
Committee Actions	9
Committee Discussion	9
Public Comments	10

POST-MEETING UPDATES

Bureau of State Audits Report	12
-------------------------------------	----

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 76 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.

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 & COO, Genentech, Inc, 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, Ms. 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, Ms. 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, she 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.

Ms. 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".

Ms. 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 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.

Second Annual Meeting

Meeting Details

The second annual meeting of the Citizens Financial Accountability Oversight Committee was held on November 27, 2007, in the auditorium of the California Public Utilities Commission at 505 Van Ness Avenue in San Francisco. Five of the six members were in attendance. Jim Lott was absent.

Adoption of Conflict of Interest Code

The Committee approved a motion (4-0) to notice the Office of Administrative Law of the Committee's intent to comply with the Conflict of Interest Code pursuant to FPPC regulation 187512(c)(3). This code provides for the broadest economic disclosure as required by the Governor and the Legislature. It requires that Committee members file annual statements of economic interest that disclose all sources of income, all interest in real property and all investments.

Financial Presentations

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, best practice considerations and intellectual property regulations; and the Bureau of State Audits report on CIRM.

Independent Audit

Heather Jones with the independent audit firm, Macia, Gini & O'Connell (MCO) presented their audit covering Fiscal Year 2005-06. CIRM

ended 2006 with unrestricted net assets of -\$15,204,511 and its cash and investment balance was \$2, 651,574.

The audit offered an unqualified opinion, meaning the auditors found no material issues or errors with CIRM's financial practices.

MCO did comment that in the areas of financial reporting, debt compliance and grant compliance were opportunities for strengthening internal controls and operating efficiencies.

The MCO audit report can be found online at <http://sco.ca.gov/eo/cfaoc/meetings/yr2007/index.shtml>

State Controller's Office Review

Casandra Moore-Hudnall, Chief of Financial Audits of the State Controller's Office (SCO) reported on their review of the MCO audit. She emphasized that the objective of their review was to determine whether the audit was performed in accordance with generally accepted auditing standards set forth in *Government Auditing Standards (GAS)*. The SCO found that the audit was performed in accordance with the majority of the standards set forth in GAS.

However, she noted that MGO did not include the reference to the management report dated January 5, 2007, but stated that this was a technical issue. The SCO report can be found online at <http://sco.ca.gov/eo/cfaoc/meetings/yr2007/index.shtml>

The Chair emphasized that in order to have true transparency and accountability, the CFAOC must have the ability to provide a timely review of CIRM's financial activities and audits. He asked the CFAOC and CIRM staff to work together to come up with timely review of audits and called for a meeting in the spring of 2008 to review the FY 2006-07 audit.

Status Update of CIRM

Robert Klein, Chair ICOC, provided an update of CIRM's financial status. He stated that CIRM had just gone through an RFP process and will have the outside auditor in place within 60 days of the Controller closing the books. (The Controller keeps CIRM's books.)

Dr. Richard A. Murphy, Acting President of CIRM, described the mechanisms of the grants awards process. For each grant there are two or three internal reviewers whose recommendations are then made to the working group, which is made up of 15 scientists outside of California. Their recommendations go to the ICOC. He also reported that they have established a standards working group to look at ethical issues.

Mr. Klein reported that the \$150 million loan to the State has been repaid, and CIRM has also repaid their bond anticipation notes.

Dr. Ed Penhoet, Vice-Chair, CIRM, gave an update on the development of the intellectual property policies. Two policies have been developed, one for non-profits, and the other for for-profits. The policy for non-profits has been approved by the OAL and regulations have been drafted for for-profits, but not yet approved.

Bureau of State Audits Report

Doug Cordiner, Chief Deputy for BSA, presented the audit issued in February 2007. He presented all the recommendations and provided updates regarding actions taken by CIRM that were outlined in their six month response letter. Overall, CIRM is responding to the concerns raised, with one exception: asking the Attorney General for an opinion on whether the working groups are advisory bodies and, therefore, subject to the Political Reform Act (PRA). Mr. Klein responded that they did not need to seek that opinion as both the Court of Appeals and the Supreme Court found that the working groups were advisory bodies and advisory groups are not subject to the PRA. He also noted that at the time of the BSA report there had not been a final ruling.

The BSA report and CIRM's response can be found online at <http://www.sco.ca.gov/eo/cfaoc/meetings.shtml>

Committee Actions

CFAOC members voted on a motion to notice the Office of Administrative Law of the Committee's intent to comply with the conflict of interest code pursuant to FPPC regulation 187512(c) (3).

The Chair expressed concern about the media reports of recent activities by ICOC Board member Dr. John Reed that may constitute a potential conflict of interest. He stated that he wanted to make sure that the Committee encouraged a full examination, and instructed staff to draft a letter to the FPPC asking for a full review of the matter. (The letter was sent to the FPPC November 27, 2007.)

Committee Discussion

After recognizing a recent California Supreme Court decision affirming the constitutionality of CIRM and subsequent sale of \$250 million in bonds for research, the Chair announced he is directing his staff at the State Controller's Office to commence an audit of CIRM focusing on pre-allocation procedures, grants management, the financial risks of conflict of interest violations and CIRM's own expenditure practices and compliance with state law.

The Chair explained that the committee was created to oversee the finances of public stem cell research and yet, in three years since Proposition 71's passage, the committee had met only twice and was reviewing financial statements more than 18 months old.

According to the Chair, findings from a Bureau of State Audits report that highlighted several areas of concern, coupled with the rapidly increasing bond outlays, necessitated an audit to identify any process deficiencies and ensure the best use of funds.

Daniel Brunner and Myrtle Potter both complimented CIRM on the overall job they had done to date, recognizing the difficulties of launching such an ambitious enterprise. They also stressed the importance of transparency and ensuring their processes are above reproach.

Public Comments

John Simpson of the Foundation for Taxpayer and Consumer Rights (FTCR) addressed the CFAOC throughout the meeting. He expressed his appreciation that the Controller planned on speeding up the review of the audits. He congratulated CIRM on the public nature of the development of those standards, referring to it as the “gold standard of involving the public.” He also expressed concern about the decision not to disclose applicants who were denied grants. He expressly mentioned that lack of public disclosure around the \$227 million in grants for facilities. Mr. Klein clarified that the scientific portion of the review will not be disclosed, but those who make it to the second round for the facilities will be disclosed.

Mr. Simpson thanked the Chair for calling on the FPPC to investigate Dr. Reed’s potential conflict of interest and stated that FTCR had filed a formal complaint with the FPPC. He also said that they believed Dr. Reed should resign and that if he did not, the Controller, as the appointing authority for his seat, should remove him. Don Reed (no relation to Dr. Reed) testified that Dr. Reed acted appropriately and the attempt to blight his name is inappropriate.

CFAOC staff read into the record a letter from David Jenson, publisher of the *California Stem Cell Report* asking CFAOC to recommend to CIRM that it identify the applicants for its upcoming round of lab construction grants and to release the statements of economic interest from its panels, and grantee reviewers. Mr. Jensen said such disclosure will assure both scientists and the public of the fairness of the process.

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

**c/o State Controller's Office
Post Office Box 942850
Sacramento, California 94250-5874
<http://www.cfaoc.ca.gov>**