



**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD**

**FINANCIAL STATEMENTS
As of and for the Years Ended
June 30, 2013 and 2012,
and Independent Auditors' Report**

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD**

**Financial Statements
and Other Supplementary Information
June 30, 2013 and 2012**

(With Independent Auditors' Report Thereon)

Prepared by Board Staff

**AUDITED BY:
MOSS ADAMS LLP**

INTRODUCTORY SECTION

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STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

INTRODUCTORY SECTION

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**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD**

*Official Roster
As of June 30, 2013*

BOARD OF DIRECTORS

| NAME | TITLE |
|------------------------|-------------------|
| Ms. Mary Lou Cameron | Chairman |
| Mr. H. Russell Goff | Vice-Chairman |
| Mr. Delman Shirley | Secretary |
| Mr. J. Thomas McGuckin | Member |
| Mr. Bradley Day | Member |
| Ms. Hanna Skandera | Ex-officio Member |
| Mr. James B. Lewis | Ex-officio Member |

ADMINISTRATIVE STAFF

| | |
|---------------------|--------------------------------|
| Ms. Jan Goodwin | Executive Director |
| Mr. Rick Scroggins | Deputy Director |
| Mr. Chris Schatzman | General Counsel |
| Mr. Bob Jacksha | Chief Investment Officer |
| Ms. Sara Brownstein | Chief Financial Officer |
| Mr. Greg Trujillo | Information Technology Manager |
| Ms. Kathy A. Webb | Member Services Manager |

FINANCIAL SECTION

REPORT OF INDEPENDENT AUDITORS

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

Report on the Financial Statements

We have audited the accompanying Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position of the New Mexico Educational Retirement Board (the "ERB") as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the ERB's basic financial statements as listed in the table of contents. We have also audited the Schedule of Revenues, Appropriations and Expenses-Budget to Actual (Non-GAAP) for the New Mexico Educational Retirement Board presented as supplementary information, as defined by the Government Accounting Standards Board, in the accompanying financial statements as of and for the year ended June 30, 2013, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

ERB's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the plan net position of the ERB as of June 30, 2013 and 2012, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the Schedule of Revenues and Expenses - Budget and Actual, (Non-GAAP Basis) presents fairly the revenues and expenses on the basis of accounting as described in Note 1, for the year ended June 30, 2013.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, schedule of changes in the employers' net pension liability, schedule employers' net pension liability, schedule of employer contributions, and schedule of investment returns on pages 10 through 18 and 63 through 66 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.

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the ERB's basic financial statements. The schedule of cash accounts, schedule of administrative, consultant, and budgeted investment expenses, and the schedule of accountability in government act – performance measures are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The schedule of cash accounts, schedule of administrative, consultant, and budgeted investment expenses, and the schedule of accountability in government act – performance measures is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of cash accounts, schedule of administrative, consultant, and budgeted investment expenses, and the schedule of accountability in government act – performance measures is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 1, 2013 on our consideration of the ERB'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the ERB's internal control over financial reporting and compliance.

Mess Adams LLP

Albuquerque, New Mexico
November 1, 2013

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2013, 2012 and 2011**

Agency management prepared this Management's Discussion and Analysis (MD&A) of the financial position of the State of New Mexico Educational Retirement Board (ERB) for the fiscal years ended June 30, 2013 (FY13), June 30, 2012 (FY12), and June 30, 2011 (FY11). For more detailed information of ERB's FY13 and FY12 financial activities, the reader should review the financial statements, including the notes and required supplementary information.

FINANCIAL REPORTING REQUIREMENTS

The financial statements include the Statement of Fiduciary Net Position and the Statement of Changes in Fiduciary Net Position. The financial statements also include notes, which explain the history and purpose of ERB, significant accounting policies, investment details, statutory disclosures, and other required supplementary information. These financial statements have been prepared in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB).

FINANCIAL HIGHLIGHTS

- Net position restricted for pension benefits increased \$702.7 million in FY13 after decreasing \$99.6 million in FY12 when compared to FY11. The majority of ERB's net position restricted for pension benefits comprises the investment portfolio. Based on the FY13 to FY11 range, ERB experienced strong returns on its investment portfolio. However, there were lower investment portfolio returns for FY12 as compared to FY13 and FY11.
- Investment advisor and custodial fees increased \$4.46 million in FY13 after decreasing \$24.3 million in FY12 when compared to FY11. This is reflected in the following factors:
 - ❖ These fees are based on investment returns and portfolio balance, so robust returns with an increasing portfolio balance lead to higher advisor and custody fees.
 - ❖ During FY12, ERB adopted and implemented a revised asset allocation plan. The newly adopted asset allocation plan enacted the following: moved some assets from managers who are paid fees in the traditional manner to new managers whose fees are deducted from the managed assets. Therefore, the management fees are not reflected in the financial statements expense categories and ERB reported a lower investment return. These arrangements are common industry practice.
 - ❖ The increase in investment management fees for FY13 is consistent with the asset allocation plan, negotiated management fees, and performance of the investment portfolio.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

- Total cash and cash equivalents increased \$429.6 million as of June 30, 2013 after decreasing \$235.2 million in FY12 when compared to FY11. It is normal for the cash balance, as of a specific date, to fluctuate as ERB adjusts holdings. For example, at June 30, 2013, ERB was transitioning between fund managers. This transition explains the increased cash on hand at year-end. For FY11, the cash target allocation range was 0% to 5%. ERB was slightly over the 5% range in FY11. The cash balance was increased in anticipation of funding newly approved investment managers. ERB's cash target allocation range for FY13 and FY12 was between 0% and 10%. For FY13 and FY12, ERB has been in compliance with its' cash target allocation.
- Investment holdings increased \$261.3 million in FY13 after decreasing \$150.8 million in FY12 when compared to FY11. In FY12, ERB had a 2% net investment increase which was offset by net pension benefit payments. This resulted in an overall asset decrease. For FY13, the total fund posted a return of 11%. The portfolio return outperformed the fund's policy index return of 9.4%.
- Total receivables increased \$11.2 million in FY13 after decreasing \$38.1 million in FY12 when compared to FY11. The majority of changes are accounted for in investment sales. For FY12, a decrease indicates a smaller volume of investments were sold at or near fiscal year end and remained outstanding on June 30. Whereas, for FY13, the increase indicates that a larger volume of investments were sold at or near fiscal year end as compared to FY12. Securities sales and purchases in the United States equity markets are usually based on "trade date + 3 days," meaning the transaction will settle three business days after initiation. The number of days varies in other U.S. and foreign securities markets.
- Accounts payable decreased \$11.8 million in FY13 after increasing \$13.5 million in FY12 when compared to FY11. The change is primarily due the amount of investment advisor fees due at each year-end.
- Investment purchases payable increased \$10.1 million in FY13 after decreasing \$126.7 million in FY12 when compared to FY11. An increase/decrease indicates that a larger/smaller volume of investments were purchased at or near fiscal year end and remained outstanding on June 30. Securities sales and purchases are usually based on "trade date + 3 days," meaning the transaction will settle three business days after initiation.
- Employer and member contributions increased \$4.7 million in FY13 after decreasing \$12.1 million in FY12 when compared to FY11. The total employer and employee contributions rates did not change for FY11 through FY13. Therefore, the current year increase or prior year decrease is statistically insignificant and may be attributable to hiring and/or salary fluctuations.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

- Benefit payments to retirees increased \$57.1 million in FY13 after increasing \$52.8 million in FY12 when compared to FY11. These increases are accounted for by the consistent retiree population increase and the compounding COLA.
- Governmental Accounting Standards Board (GASB) 67 and GASB 68 Statements address accounting and financial reporting requirements for pension plans activities. ERB is a cost-sharing multiple employer pension plan as defined by GASB 67. The requirements for GASB 67 require changes in presentation of the financial statements, notes to the financial statements, and required supplementary information. Significant changes include an actuarial calculation of total and net pension liability, comprehensive footnote disclosure regarding the pension liability calculation and assumptions, and increased investment activity disclosures. The implementation of GASB 67 did not significantly impact the accounts receivable and investment balances, as they were already accounted for in accordance with GASB 67 requirements. Therefore, no restatement of the 2012 balances was necessary. GASB 68 applies the changes implemented at the pension plan level and segregates and divides the pension liability to each participating employer.
- Although GASB 67 is effective for fiscal years beginning after June 15, 2013, the New Mexico Educational Retirement Board has elected to reflect these changes in its June 30, 2013 financial statements. The table below represents the plan's fiduciary net position:

| | 1% Decrease 6.75% | Current Single Rate Assumption 7.75% | 1% Increase 8.75% |
|---------------------------------------|------------------------------|---|------------------------------|
| Plan membership net pension liability | \$ 8,286,923,513 | \$ 6,276,852,149 | \$ 4,599,162,126 |

Also, management is aware and planning for the new GASB 68 rule. GASB 68 is effective for fiscal years beginning after June 15, 2014. The New Mexico Educational Retirement Board will implement GASB 68 for FY15. Accordingly, the changes mandated by GASB 68 will be reflected in the New Mexico Educational Retirement Board financial statements for the year ended June 30, 2015.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

CONDENSED FINANCIAL INFORMATION

Statement of Fiduciary Net Position

| | FY13 | FY12 | FY11 | FY12-FY13 \$ Difference | FY11-FY12 \$ Difference | FY12-FY13 % Difference | FY11-FY12 % Difference |
|--|--------------------------|-------------------------|--------------------------|------------------------------------|------------------------------------|-----------------------------------|-----------------------------------|
| Assets | | | | | | | |
| Cash and Short Term Investments | \$ 746,623,052 | \$ 317,056,896 | \$ 552,278,318 | \$ 429,566,156 | \$ (235,221,422) | 135.49% | -42.59% |
| Receivables | 164,616,757 | 153,420,332 | 191,498,873 | 11,196,425 | (38,078,541) | 7.30% | -19.88% |
| Investment in State General Fund Investment Pool | 5,353,975 | 5,521,436 | 6,346,596 | (167,461) | (825,160) | -3.03% | -13.00% |
| Investments—at fair value | 9,439,289,300 | 9,177,972,688 | 9,328,773,209 | 261,316,612 | (150,800,521) | 2.85% | -1.62% |
| Capital assets, net of accumulated depreciation | 2,175,777 | 2,862,746 | 4,201,681 | (686,969) | (1,338,935) | -24.00% | -31.87% |
| Total assets | <u>\$ 10,358,058,861</u> | <u>\$ 9,656,834,098</u> | <u>\$ 10,083,098,677</u> | <u>\$ 701,224,763</u> | <u>\$ (426,264,579)</u> | <u>7.26%</u> | <u>-4.23%</u> |
| Liabilities | | | | | | | |
| Current liabilities | 166,129,255 | 167,669,129 | 494,307,120 | (1,539,874) | (326,637,991) | -0.92% | -66.08% |
| Long-term liabilities (compensated absences) | 230,803 | 203,800 | 228,616 | 27,003 | (24,816) | 13.25% | -10.85% |
| Total liabilities | <u>166,360,058</u> | <u>167,872,929</u> | <u>494,535,736</u> | <u>(1,512,871)</u> | <u>(326,662,807)</u> | <u>-0.90%</u> | <u>-66.05%</u> |
| Net position restricted for pensions | <u>\$ 10,191,698,803</u> | <u>\$ 9,488,961,169</u> | <u>\$ 9,588,562,941</u> | <u>\$ 702,737,634</u> | <u>\$ (99,601,772)</u> | <u>7.41%</u> | <u>-1.04%</u> |

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

CONDENSED FINANCIAL INFORMATION (CONTINUED)

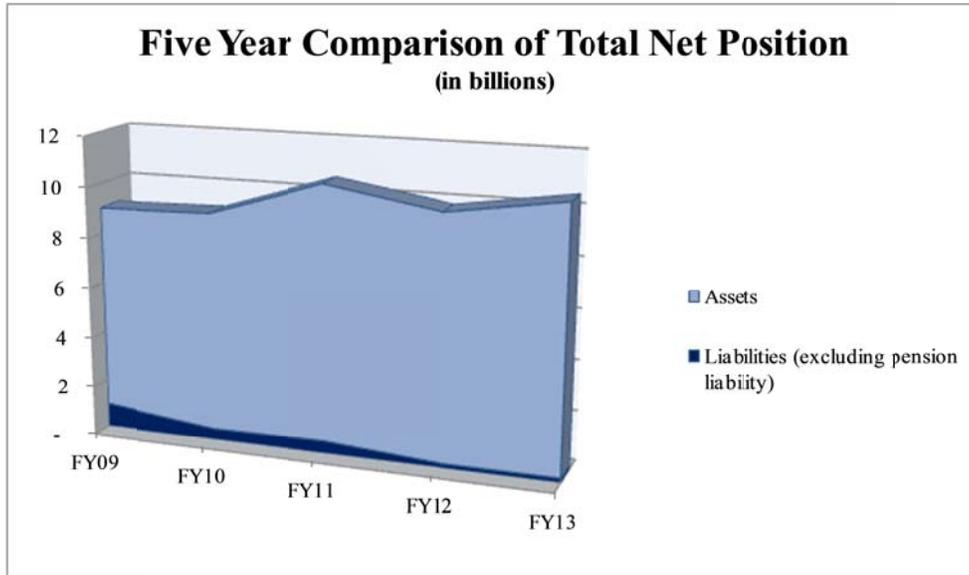
Statement of Changes in in Fiduciary Net Position

| | FY13 | FY12 | FY11 | FY12-FY13 \$ Difference | FY11-FY12 \$ Difference | FY12-FY13 % Difference | FY11-FY12 % Difference |
|---|--------------------------|-------------------------|-------------------------|------------------------------------|------------------------------------|-----------------------------------|-----------------------------------|
| Additions | | | | | | | |
| Contributions | \$ 548,442,717 | \$ 543,697,371 | \$ 555,775,940 | \$ 4,745,346 | \$ (12,078,569) | 0.87% | -2.17% |
| Investment income less investment expenses | 179,518,742 | 161,326,103 | 148,016,532 | 18,192,639 | 13,309,571 | 11.28% | 8.99% |
| Net change in fair value of investments | 837,193,133 | (565,488) | 1,396,479,035 | 837,758,621 | (1,397,044,523) | -148147.90% | -100.04% |
| Other income | 1,898,276 | 3,061,710 | 4,033,431 | (1,163,434) | (971,721) | -38.00% | -24.09% |
| Total additions | <u>1,567,052,868</u> | <u>707,519,696</u> | <u>2,104,304,938</u> | <u>859,533,172</u> | <u>(1,396,785,242)</u> | <u>121.49%</u> | <u>-66.38%</u> |
| Deductions | | | | | | | |
| Benefit payments | 811,665,051 | 754,554,951 | 701,771,592 | 57,110,100 | 52,783,359 | 7.57% | 7.52% |
| Refunds | 41,664,216 | 40,580,979 | 35,086,806 | 1,083,237 | 5,494,173 | 2.67% | 15.66% |
| Administrative expenses | 10,985,967 | 11,985,538 | 11,407,033 | (999,571) | 578,505 | -8.34% | 5.07% |
| Total deductions | <u>864,315,234</u> | <u>807,121,468</u> | <u>748,265,431</u> | <u>57,193,766</u> | <u>58,856,037</u> | <u>7.09%</u> | <u>7.87%</u> |
| Net increase (decrease) | 702,737,634 | (99,601,772) | 1,356,039,507 | 802,339,406 | (1,455,641,279) | -805.55% | -107.35% |
| Net position restricted for pensions | | | | | | | |
| Beginning of year | 9,488,961,169 | 9,588,562,941 | 8,232,523,434 | (99,601,772) | 1,356,039,507 | -1.04% | 16.47% |
| End of year | <u>\$ 10,191,698,803</u> | <u>\$ 9,488,961,169</u> | <u>\$ 9,588,562,941</u> | <u>\$ 702,737,634</u> | <u>\$ (99,601,772)</u> | <u>7.41%</u> | <u>-1.04%</u> |

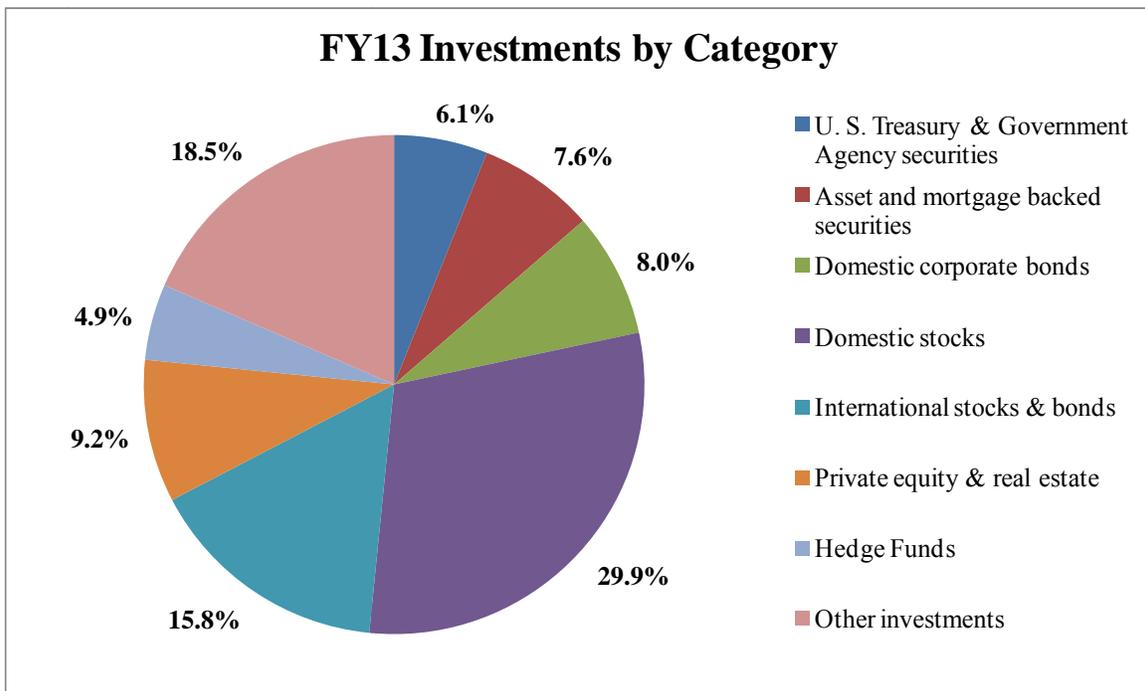
**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

COMPARATIVE SUMMARY STATEMENTS

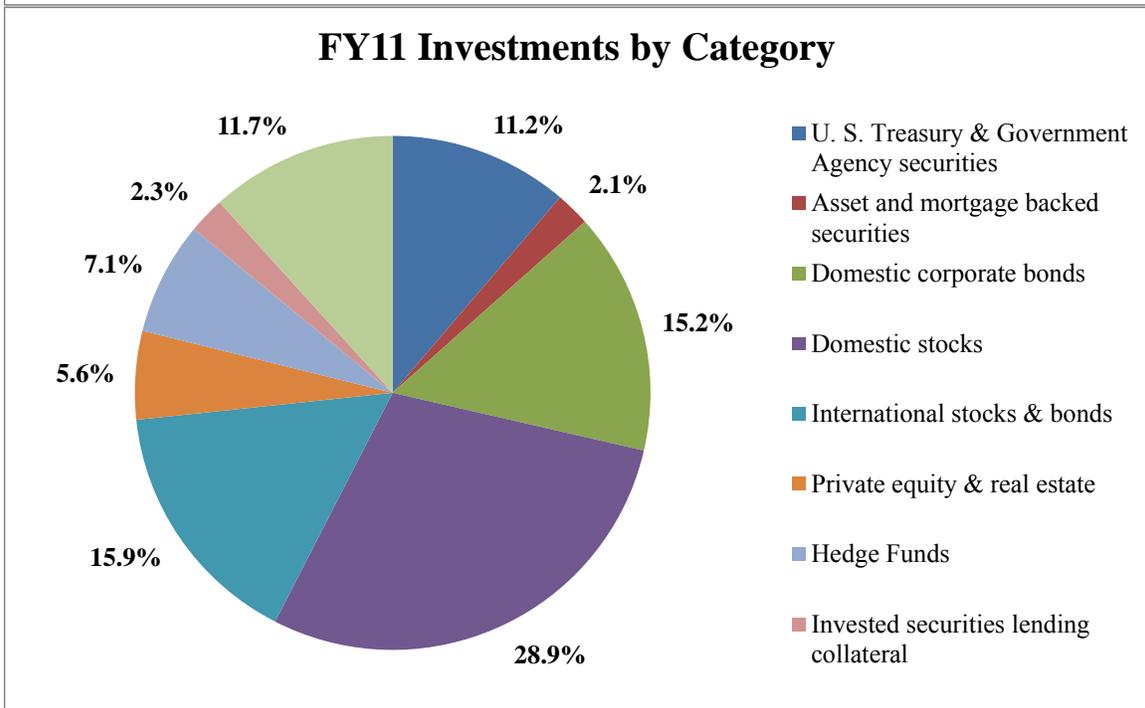
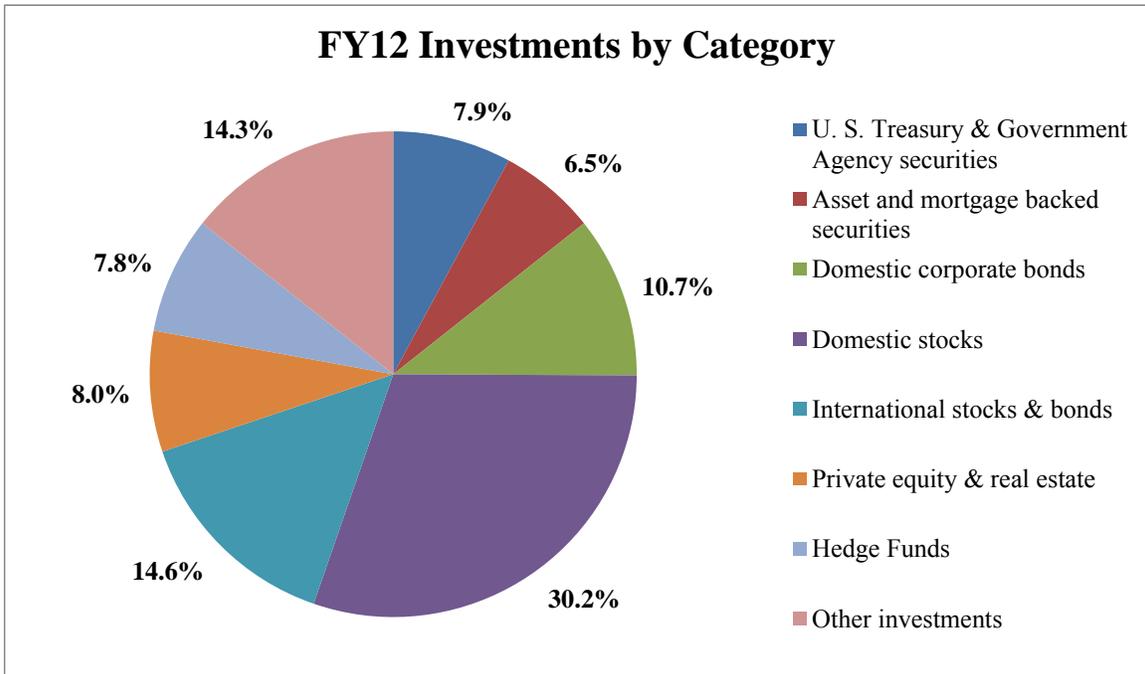
The following chart represents the total net position for the Educational Retirement Board over the last five years.



The following charts depict the changes in investment categories over the last three years.



**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**



**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

CAPITAL ASSETS

The net investment in Capital Assets at June 30, 2013, 2012 and 2011, is as follows:

| | Cost | Accumulated Depreciation | Book Value |
|--|----------------------|-------------------------------------|-----------------------|
| 2013 | | | |
| Land | \$ 248,172 | \$ - | \$ 248,172 |
| Depreciable land improvements | 19,361 | (5,721) | 13,640 |
| Integrated Retirement Information System | 9,156,963 | (9,156,963) | - |
| Building and building improvements | 3,365,714 | (1,616,025) | 1,749,689 |
| Furniture and equipment | 1,113,074 | (948,798) | 164,276 |
| Total | <u>13,903,284</u> | <u>(11,727,507)</u> | <u>\$ 2,175,777</u> |
| 2012 | | | |
| Land | \$ 248,172 | \$ - | \$ 248,172 |
| Depreciable land improvements | 19,361 | (5,022) | 14,339 |
| Integrated Retirement Information System | 9,156,963 | (8,650,910) | 506,053 |
| Building and building improvements | 3,365,714 | (1,514,134) | 1,851,580 |
| Furniture and equipment | 1,155,929 | (912,815) | 243,114 |
| Total | <u>13,946,139</u> | <u>(11,082,881)</u> | <u>\$ 2,863,258</u> |
| 2011 | | | |
| Land | 248,172 | - | \$ 248,172 |
| Depreciable land improvements | 19,361 | (4,322) | 15,039 |
| Integrated Retirement Information System | 9,156,963 | (7,448,865) | 1,708,098 |
| Building and building improvements | 3,365,714 | (1,401,117) | 1,964,597 |
| Furniture and equipment | 1,122,920 | (857,145) | 265,775 |
| Total | <u>\$ 13,913,130</u> | <u>\$ (9,711,449)</u> | <u>\$ 4,201,681</u> |

LONG-TERM DEBT

The only long-term liability activity relates to compensated absences reported in Note 10.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2013, 2012 and 2011**

CURRENTLY KNOWN FACTS AND CONDITIONS

Senate Bill 115 was signed into law on March 29, 2013. Below is a summary of the enacted legislation:

- Raises employer and employee contribution rates:
 - ❖ Employees with a salary over \$20,000 will have a contribution rate 10.1% in FY14 and 10.7% in FY15.
 - ❖ Employees with a salary below \$20,000 will have a contribution rate remaining at 7.9%.
 - ❖ The employer contribution will be 13.15% for all members.
- For new employees hired on or after July 1, 2013, there is a soft minimum retirement age of 55 meaning that ERB will calculate an actuarial reduction if member retires with 30 years and is younger than age 55.
- For new employees hired on or after July 1, 2013, the COLA begins at age 67, rather than age 65.
- For current retirees there is an immediate reduction of the COLA until the plan is 100% funded. The COLA reduction is based on the median retirement benefit (approximately \$18,000 for FY12) of all retirees excluding disability retirements. For a further description of the COLA changes please see Note 2.

ERB conducts an actuarial experience study every two years. The actuarial experience study, presented to the Board of Trustees on April 26, 2013, compiled data for the six-year period ending June 30, 2013. The Board of Trustees approved assumptions changes were included in the GASB 67 calculation and are the following:

- Lower wage inflation from 4.75% to 4.25%
- Lower payroll growth from 3.75% to 3.50%
- Minor changes to demographic assumptions
- Population growth per year from 0.75% to 0.50%

Changes were not made to the following assumptions:

- Investment return will remain at 7.75%
- Inflation will remain at 3.00%

FINANCIAL CONTACT

Any questions regarding the financial statements of ERB should be directed to the ERB Chief Financial Officer at (505) 476-6132 or by mail at 701 Camino de los Marquez Santa Fe, New Mexico 87505.

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENT OF FIDUCIARY NET POSITION
As of June 30, 2013 and 2012**

| | 2013 | 2012 |
|--|--------------------------|-------------------------|
| Assets | | |
| Cash | \$ 23,936 | \$ 21,301 |
| Short term Investments | 746,599,116 | 317,035,595 |
| Receivables | | |
| Contributions | 65,897,831 | 70,941,621 |
| Investment sales proceeds-brokers | 73,812,634 | 55,468,316 |
| Interest and Dividends | 24,271,724 | 26,127,712 |
| Other, net | 634,568 | 882,683 |
| Total receivables | <u>164,616,757</u> | <u>153,420,332</u> |
| Interest in State General Fund Investment Pool | <u>5,353,975</u> | <u>5,521,436</u> |
| Investments, at fair value | | |
| U. S. Treasury securities | 282,558,476 | 345,637,771 |
| Government agency securities | 289,974,464 | 376,212,714 |
| Asset and mortgage backed securities | 714,757,627 | 593,136,863 |
| Domestic corporate bonds | 757,378,340 | 986,267,569 |
| Non-U.S. corporate bonds | 245,228,240 | - |
| Domestic stocks | 2,824,846,950 | 2,774,109,793 |
| International stocks | 1,134,562,079 | 1,303,988,823 |
| Non-U.S. government bonds | 109,518,808 | 30,378,318 |
| Private equity | 670,818,353 | 577,114,685 |
| Hedge Funds | 463,853,968 | 715,935,010 |
| Private real estate | 199,274,198 | 160,562,922 |
| Other investments | 1,746,517,797 | 1,314,628,220 |
| Total investments | <u>9,439,289,300</u> | <u>9,177,972,688</u> |
| Capital assets, at cost, net of accumulated depreciation | <u>2,175,777</u> | <u>2,862,746</u> |
| Total assets | <u>\$ 10,358,058,861</u> | <u>\$ 9,656,834,098</u> |
| Liabilities | | |
| Accounts payable | \$ 3,473,970 | \$ 15,122,201 |
| Accounts payable school contributions | 514,809 | 681,409 |
| Accrued payroll and employee benefits | 105,889 | 154,904 |
| Accrued compensated absences | 230,803 | 203,800 |
| Refunds payable | 1,079,930 | 851,892 |
| Investment purchases payable | 160,921,030 | 150,839,658 |
| Funds held for others | 33,627 | 19,065 |
| Total liabilities | <u>166,360,058</u> | <u>167,872,929</u> |
| Net position restricted for pensions | <u>\$ 10,191,698,803</u> | <u>\$ 9,488,961,169</u> |

See Accompanying Notes to Financial Statements

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
Years Ended June 30, 2013 and 2012**

| | 2013 | 2012 |
|---|--------------------------|-------------------------|
| Additions | | |
| Contributions | | |
| Employer | \$ 299,657,530 | \$ 253,845,277 |
| Member | 248,785,187 | 289,852,094 |
| Total contributions | <u>548,442,717</u> | <u>543,697,371</u> |
| Investment income from investing activities | | |
| Net change in fair value of investments | 837,193,133 | (565,488) |
| Interest income | 47,709,542 | 57,717,052 |
| Dividend income | 147,230,301 | 114,419,138 |
| Total investing activity gain | <u>1,032,132,976</u> | <u>171,570,702</u> |
| Investing activity expenses: | | |
| Investment advisor fees | (14,684,190) | (10,300,540) |
| Custody fees | (736,911) | (664,384) |
| Total investing activity expenses | <u>(15,421,101)</u> | <u>(10,964,924)</u> |
| Net gain from investing activities | <u>1,016,711,875</u> | <u>160,605,778</u> |
| From securities lending activities | | |
| Securities lending income | - | 85,111 |
| Securities lending expenses: | | |
| Borrower rebates | - | (91,845) |
| Agent fees | - | 22,119 |
| Total securities lending expenses | <u>-</u> | <u>(69,726)</u> |
| Net income from securities lending activities | <u>-</u> | <u>154,837</u> |
| Total net investment gain | <u>1,016,711,875</u> | <u>160,760,615</u> |
| Miscellaneous income | | |
| Penalties | - | 6,049 |
| Interest on restoration of service | 1,744,359 | 1,914,431 |
| Other | 153,917 | 1,141,230 |
| Total miscellaneous income | <u>1,898,276</u> | <u>3,061,710</u> |
| Total additions | <u>1,567,052,868</u> | <u>707,519,696</u> |
| Deductions | | |
| Age and service benefit payments | 803,253,000 | 746,493,523 |
| Refunds to terminated members | 35,882,999 | 34,520,423 |
| Interest on refunds | 5,781,217 | 6,060,556 |
| Administrative expenses | 10,985,967 | 11,985,538 |
| Disability benefit payments | 8,412,051 | 8,061,428 |
| Total deductions | <u>864,315,234</u> | <u>807,121,468</u> |
| Changes in net position | <u>702,737,634</u> | <u>(99,601,772)</u> |
| Net position restricted for pensions | | |
| Beginning of the year | 9,488,961,169 | 9,588,562,941 |
| End of the year | <u>\$ 10,191,698,803</u> | <u>\$ 9,488,961,169</u> |

See Accompanying Notes to Financial Statements

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The Board’s financial statements are prepared using the economic resource measurement focus and the accrual basis of accounting. The New Mexico General Fund Appropriation Act establishes the modified accrual basis of accounting for governmental funds as the budgetary basis for the State. Prior-year encumbrances are not carried forward for single-year appropriations. Employer and member contributions are recognized as revenue in the period in which the member’s services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

Budgets and Budgetary Accounting—Formal budgetary integration is used as a management control device by the Board in administering the Plan. The budget for this State Agency is adopted on the modified accrual basis of accounting, except for accounts payable accrued at the end of the fiscal year that do not get accrued by the statutory deadline per Section 10-6-4 NMSA 1978, that must be paid out of the next year’s budget.

Each year the Legislature approves multiple-year appropriations, which the State considers as continuing appropriations. The Legislature authorizes these appropriations for two to five years; however, it does not identify the authorized amount by fiscal year. Consequently, the appropriation is budgeted in its entirety the first year the Legislature authorizes it. The unexpended portion of the budget is carried forward as the next year’s beginning budget balance until either the project period has expired or the appropriation has been fully expended. The budget presentations in these financial statements are consistent with this budgeting methodology.

Only administrative expenses and a small portion of interest income are budgeted, while significant revenues and non-administrative expenses are not. The budget is prepared on a non-GAAP basis, as it recognizes encumbrances and capital expenses as current expenses, excludes depreciation expense, and recognizes revenue when cash is received. Budgetary comparisons for the Plan are presented in the schedule of revenues and expenses—budget and actual (non-GAAP basis).

The Accountability in Government Act, Chapter 15, Laws of 1999, provides a general process for implementation of performance-based budgeting over a four-year period. The Board was included in performance-based budgeting for the first time in FY 2002. The Board developed performance measures which were approved by the State Budget Division (SBD), a division of the Department of Finance and Administration (DFA), and the Legislative Finance Committee (LFC), an interim committee of the New Mexico Legislature, and included in the General Appropriations Act. The Board is required to periodically report to the SBD and the LFC on these performance measures.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Board follows these procedures in establishing the annual budget:

- (1) By August 31, the Board's staff prepares a Budget Appropriation Request for the Board's approval to be presented to the next legislature. The Request includes proposed expenses and the means of financing them.
- (2) On September 1, the Budget Appropriation Request is submitted to the DFA and the LFC.
- (3) The DFA makes recommendations and adjustments to the Board's Budget Appropriation Request, which becomes the Governor's proposal to the Legislature.
- (4) The LFC holds hearings on the Budget Appropriation Request during the Legislature's interim period. Recommendations and adjustments are made prior to presenting the Budget Appropriation Request to the Legislature.
- (5) Both the DFA's and the LFC's recommended appropriation proposals are presented to the Legislature for approval of the final budget. The final budget approved by the Legislature is then sent to the Governor's office for final approval.
- (6) On May 1, the Board submits its Annual Operating Budget to the DFA and the LFC based on the final appropriation from the Legislature and approval by the Governor.
- (7) Per Section 9 of the General Appropriation Act of 2012, all agencies, including legislative agencies, may request category transfers among personal services and employee benefits, contractual services and other. Therefore, the legal level of budgetary control would be the appropriation program level (A-Code, P-Code, R-Code, and Z-Code). The A-Code pertains to capital outlay appropriations (general obligation/severance tax or state general fund). The P-Code pertains to operating funds. The R-Code pertains to American Recovery & Reinvestment Act (ARRA) funds. The Z-Code pertains to special appropriations.

Investments— Investments are recorded at fair value. The estimated fair value of investments is based on quoted market prices, except for certain alternative investments for which quoted market prices are not available. The estimated fair value of these alternative investments is based on the most recent valuations provided by the external investment managers, adjusted for cash receipts, cash disbursements, and securities distributions through June 30, 2013. The Board believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

There are certain market risks, credit risks, foreign exchange currency risks, or events that may subject the Plan's investment portfolio to economic changes occurring in certain industries, sectors, or geographic markets.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

The Board's investments in limited partnerships are valued at estimated fair value based on their proportionate share of the partnership's fair value as recorded in the partnership's financial statements. The limited partnerships allocate gains, losses, and expenses to the partners based on the ownership percentage as described in the partnership agreements. At June 30, 2013, the Board had commitments for additional future contributions to the limited partnerships totaling \$1.731 billion.

Net investment income includes net appreciation (depreciation) in the fair value of investments, interest income, dividend income, securities lending income, and investment expense, which includes management and custodial fees, securities lending expense, and all other significant investment-related costs.

Other investments, as presented in the Statement of Fiduciary Net Position, include investments in swap agreements, distressed debt, option agreements, real estate investment trusts, and timber partnerships.

The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of pension plan investments. Realized gains and losses on investments that had been held in more than one reporting period and sold in the current period were included as a change in the fair value reported in the prior period(s) and the current period.

For the fiscal year ending June 30, 2012, investment fees totaled \$78,715,507: \$13,279,066 was through the agency's operating budget and \$65,436,441 was deducted from investment account balances. For the fiscal year ending June 30, 2013, investment fees totaled \$125,478,811: \$17,665,292 was through the agency's operating budget and \$107,813,519 was deducted from investment account balances.

Capital Assets—Capital assets represent the cost of assets, net of accumulated depreciation, used for the administration of the Plan. Capital assets include the Board's administration building located in Santa Fe, New Mexico. The Board's capitalization policy, based on the requirements from Section 12-6-10 NMSA 1978, is to include all assets with a useful life of more than one year and costing greater than \$5,000. Assets with original cost less than \$5,000 but categorized as sensitive, primarily IT equipment, are also capitalized for tracking and control purposes. All additions are capitalized at historical cost as of the date of acquisition, and depreciation is calculated on a straight-line basis over the asset's estimated useful life with no salvage value.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Estimated useful lives are as follows:

| | |
|--|----------|
| Building and building improvements | 25 years |
| Depreciable land improvements | 10 years |
| Furniture and equipment | 10 years |
| Data processing equipment (including software) | 5 years |

Funds Held for Others—Payments from members pursuant to agreements to purchase service credits are recorded as funds held for others until the purchase agreements have been completed. Upon receipt of all payments necessary to complete the purchase agreement, service credit is recorded in the member's individual account and revenue is recognized in the appropriate revenue accounts for contributions, return of interest previously withdrawn, or interest charged on restoration of service.

Refunds Payable—Refunds payable represents amounts due to terminated members who have submitted a valid claim for refund, but who have not been paid on or before the end of the fiscal year.

New Accounting Pronouncements - Governmental Accounting Standards Board (GASB) 67, *Financial Reporting for Pension Plans* and GASB 68, *Accounting & Financial Reporting for Pensions (Employer)*, address accounting and financial reporting requirements for pension plans activities. The New Mexico Educational Retirement Board is a cost-sharing multiple employer pension plan as defined by GASB 67. The requirements for GASB 67 require changes in presentation of the financial statements, notes to the financial statements, and required supplementary information. Although GASB 67 is effective for fiscal years beginning after June 15, 2013, early adoption is permitted. The New Mexico Educational Retirement Board has elected early adopt and reflect these changes as of and for the year ended June 30, 2013. The implementation of GASB 67 did not significantly impact the accounts receivable and investment balances, as they were already accounted in accordance with GASB 67 requirements and therefore no restatement of their 2012 balances were necessary. New Mexico Educational Retirement Board's implementation consist of the assumptions and actuarial calculation of total and net pension liability, comprehensive footnote disclosures regarding the pension liability calculation and assumptions, and increased investment activity disclosures.

GASB 68 applies the changes implemented at the pension plan level and segregates and divides the pension liability to each participating employer. GASB 68 is effective for fiscal years beginning after June 15, 2014. The New Mexico Educational Retirement Board will implement the changes mandated by GASB 68 in the New Mexico Educational Retirement Board financial statements for the year ended June 30, 2015.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net Pension Liability of Plan Membership—The components of the net pension liability of the plan’s membership at June 30, 2013, were as follows:

| | |
|---|-------------------------|
| Total Pension Liability | \$ 16,468,550,952 |
| Plan fiduciary net position | <u>(10,191,698,803)</u> |
| Plan membership net pension liability | <u>\$ 6,276,852,149</u> |
| Plan fiduciary net position as a percentage of the total pension liability | 61.89% |

Actuarial assumptions—The total pension liability, net pension liability, and certain sensitivity information are based on an actuarial valuation performed as of June 30, 2012. The total pension liability was rolled-forward from the valuation date to the plan year ending June 30, 2013. The roll-forward liabilities were adjusted to reflect the impact of Senate Bill 115 that was signed into law on March 29, 2013 and the new assumptions adopted by the Board on April 26, 2013. Specifically, the liabilities measured as of June 30, 2013 were adjusted to incorporate the following changes:

- All members with annual salary of more than \$20,000 will contribute 10.10% during the fiscal year ending June 30, 2014 and 10.70%, thereafter,
- Members hired after June 30, 2013 will have a minimum unreduced retirement age of 55 and their COLA will be deferred until age 67,
- COLAs for most retirees are reduced until ERB attains a 100% funded status, and
- The new assumptions adopted by the Board on April 26, 2013 in conjunction with the six-year experience study period ending June 30, 2012.

For purposes of projecting future benefits, it is assumed that the full COLA is paid in all future years.

The actuarial methods and assumptions used to determine contribution rates included in the measurement are as follows:

| | |
|---------------------------|--|
| Inflation | 3.00% |
| Salary increases | Composed of 3.00% inflation, plus 1.25% productivity increase rate, plus step-rate promotional increases for members with less than 10 years of service. |
| Investment rate of return | 7.75% |
| Mortality | 90% of RP-2000 Combined Mortality Table with White Collar Adjustment, projected to 2014 using Scale AA (with one-year setback for females). |

The long-term expected rate of return on pension plan investments is determined annually using a building-block approach that includes the following: 1) Rate of Return projections are the sum of current yield plus projected changes in price (valuation, defaults, etc.), 2) application of key economic projections (inflation, real growth, dividends, etc.), and 3) structural themes (supply and demand imbalances, capital flows, etc.). These items are developed for each major asset class. Best estimates of geometric real rates of return for each

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

major asset class included in the pension plan's target asset allocation for 2012 and 2013 for 30-year return assumptions are summarized in the following table:

| <u>Asset Class</u> | <u>2012 Long-Term Expected Real Rate of Return</u> | <u>2013 Long-Term Expected Real Rate of Return</u> |
|-----------------------------------|--|--|
| Cash | 1.25% | 0.75% |
| Treasuries | 1.50% | 1.00% |
| IG Corp Credit | 4.50% | 3.00% |
| MBS | 3.25% | 2.50% |
| Core Bonds | 2.88% | 2.04% |
| TIPS | 1.75% | 1.50% |
| High-Yield Bonds | 7.00% | 5.00% |
| Bank Loans | 5.00% | 5.00% |
| Global Bonds (Unhedged) | 1.25% | 0.75% |
| Global Bonds (Hedged) | 1.49% | 0.93% |
| EMD External | 5.75% | 4.00% |
| EMD Local Currency | 0.07% | 5.00% |
| Large Cap Equities | 7.25% | 6.75% |
| Small/Mid Cap Equities | 7.50% | 7.00% |
| International Equities (Unhedged) | 7.75% | 7.75% |
| International Equities (Hedged) | 8.00% | 8.00% |
| Emerging International Equities | 9.75% | 9.75% |
| Private Equity | 9.75% | 9.00% |
| Private Debt | 9.50% | 8.50% |
| Private Real Assets | NA | 8.00% |
| Real Estate | 6.00% | 6.00% |
| Commodities | 4.75% | 5.00% |
| Hedge Funds Low Vol | 5.50% | 4.75% |
| Hedge Funds Mod Vol | 7.25% | 6.50% |

Discount Rate—A single discount rate of 5.52% was used to measure the total pension liability as of June 30, 2012. This single discount rate was based on the expected rate of return on pension plan investments of 7.75% and a municipal bond rate of 3.95% (based on the 20-year Bond Buyer GO 20-Bond Municipal Bond Index as of June 28, 2012). Based on the stated assumptions and the projection of cash flows, the pension plan's fiduciary net position and future contributions were sufficient to finance the benefit payments through fiscal year 2037. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the fiscal year 2037 and the municipal bond rate was applied to all benefit payments after that date.

A single discount rate of 7.75% was used to measure the total pension liability as of June 30, 2013. This single discount rate was based on the expected rate of return on pension plan investments of 7.75%. Based on the stated assumptions and the projection of cash flows, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. The main reason for the difference between the 2012 and 2013 projections is the combined impact of Senate Bill 115 and the favorable investment experience for the year ending June 30, 2013. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Reporting Entity— The Board is an agency of the State. The Plan administered by the Board is considered part of the State financial reporting entity and is a pension trust fund of the State. The Educational Retirement Act created a governing Board composed of 7 members (22-11-3 NMSA, 1978). The membership composition is as follows:

1. The Secretary of Public Education, or a designee of the secretary who is a resident of New Mexico; is a current employee of the Public Education Department; and possesses experience relevant to the financial or fiduciary aspects of pension or investment fund management;
2. The State Treasurer, or a designee of the Treasurer who is a resident of New Mexico; is a current employee of the State Treasurer's office; and possesses experience relevant to the financial or fiduciary aspects of pension or investment fund management;
3. One member to be elected for a term of four years by members of the New Mexico Association of Educational Retirees;
4. One member to be elected for a term of four years by the members of the National Education Association of New Mexico;
5. One member to be elected for a term of four years by the New Mexico members of the American Association of University Professors; and
6. Two members to be appointed by the governor for terms of four years each. Each member appointed shall have a background in investments, finance, or pension fund administration.

The Board has developed criteria to determine whether other state agencies, boards, or commissions that benefit the members of the Board should be included within its financial reporting entity as component units. The criteria include, but are not limited to, whether the Board exercises oversight responsibility; financial interdependency; selection of governing authority; designation of management; ability to significantly influence operations; and accountability for fiscal matters, scope of public service, and special financing relationships. Based on these criteria, management of the Board has determined that there are no component units that should be included in its financial reporting entity.

Participation—Membership in the Plan is a condition of employment. Employees of public schools, universities, colleges, junior colleges, technical-vocational institutions, state special schools, charter schools, and state agencies providing an educational program, who are employed more than 25% of a full-time equivalency, are required to be members of the Plan.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

The Board serves 231 employers in the State and has an active and inactive membership of 135,603 and 132,225 at June 30, 2013 and 2012, respectively. The status and number of all participants at June 30, 2013 and 2012 consisted of the following:

| | 2013 | 2012 |
|--|---------|---------|
| (1) Retirees and beneficiaries of deceased retirees currently receiving benefits | 39,088 | 37,337 |
| (2) Inactive members | 35,304 | 34,033 |
| (3) Current active members | 61,211 | 60,855 |
| | 135,603 | 132,225 |

Benefit Provisions - A member's retirement benefit is determined by a formula which includes three component parts: the member's final average salary (FAS), the number of years of service credit, and a 0.0235 multiplier. The FAS is the average of the member's salaries for the last five years of service or any other consecutive five-year period, whichever is greater.

A brief summary of Plan coverage provisions follows:

For members employed before July 1, 2010, a member is eligible to retire when one of the following events occurs:

- The member's age and earned service credit add up to the sum of 75 or more.
- The member is at least sixty-five years of age and has five or more years of earned service credit.
- The member has service credit totaling 25 years or more.

Chapter 288, Laws of 2009 changed the eligibility requirements for new members first employed on or after July 1, 2010. The eligibility for a member who either becomes a new member on or after July 1, 2010, or at any time prior to that date refunded all member contributions and then becomes reemployed after that date is as follows:

- The member's age and earned service credit add up to the sum of 80 or more.
- The member is at least sixty-seven years of age and has five or more years of earned service credit.
- The member has service credit totaling 30 years or more.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

- (1) A further requirement to be eligible to retire is that a member must have at least one year of employment after July 1, 1957, and at least five years of contributory employment. Eligible members who have one year of employment after July 1, 1957, but less than the required five years of contributory employment, may contribute to the fund for each year needed. The cost of such contributions is a sum equal to the prevailing combined contributions of the member and the local administrative unit in effect at the time the contributory employment is acquired, which was 20.3% as of June 30, 2013, times the average annual salary of the last five years, for each year of contributory employment needed, plus 3% compounded interest from July 1, 1957, to the date of payment.
- (2) *Forms of Payment* - The benefit is paid as a monthly life annuity with a guarantee that, if the payments made do not exceed the member's accumulated contributions plus accumulated interest, determined as of the date of retirement, the balance will be paid in a lump sum to the member's surviving beneficiary.
- (3) *Benefit Options* - There are three benefit options available.

Option A – Single Life Annuity - There are no reductions to the monthly benefit, and there is no continuing benefit due to a beneficiary or estate, except the balance, if any, of member contributions plus interest less benefits paid.

Option B - The single life annuity monthly benefit is reduced to provide for a 100% survivor's benefit. The reduced benefit is payable during the life of the member, with the provision that, upon death, the same benefit is paid to the beneficiary for his or her lifetime. If the beneficiary predeceases the member, the member's benefit is adjusted by adding back the amount by which the benefit was reduced at retirement due to the election of Option B retroactively to the time of retirement.

Option C - The single life annuity monthly benefit is reduced to provide for a 50% survivor's benefit. The reduced benefit is payable during the life of the member, with the provision that, upon death, the reduced 50% benefit is paid to the beneficiary for his or her lifetime. If the beneficiary predeceases the member, the member's benefit is adjusted by adding the amount by which the benefit was reduced at retirement due to the election of Option C retroactively to the time of retirement.

- (4) *Cost of Living Adjustment* –Retired members and surviving beneficiaries receiving benefits receive an automatic cost of living adjustment (COLA) to their benefit each July 1, beginning in the year the member attains or would have attained age 65 or on July 1 of the year following the member's retirement date, whichever is later.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012**

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Prior to June 30, 2013 COLA, the COLA adjustment is equal to one-half the change in the Consumer Price Index (CPI), except that the COLA shall not exceed 4% nor be less than 2%, unless the change in CPI is less than 2%, in which case, the COLA would equal the change in CPI, but never less than zero.

As of July 1, 2013, for current and future retirees the COLA is immediately reduced until the plan is 100% funded. The COLA reduction is based on the median retirement benefit of all retirees excluding disability retirements. Retirees with benefits at or below the median and with 25 or more years of service credit will have a 10% COLA reduction; their average COLA will be 1.8%. All other retirees will have a 20% COLA reduction; their average COLA will be 1.6%. Once the funding is greater than 90%, the COLA reductions will decrease. The retirees with benefits at or below the median and with 25 or more years of service credit will have a 5% COLA reduction; their average COLA will be 1.9%. All other retirees will have a 10% COLA reduction; their average will be 1.8%.

Members on disability retirement are entitled to a COLA commencing on July 1 of the third full year following disability retirement. A member on regular retirement who can prove retirement because of a disability may qualify for a COLA beginning July 1 in the third full year of retirement.

(5) *Disability Benefit:*

Eligibility - A member is eligible for a disability benefit provided (a) he or she has credit for at least 10 years of service and (b) the disability is approved by the Board.

Monthly Benefit - The monthly benefit is equal to 2% of FAS times years of service, but not less than the smaller of (a) one-third of FAS or (b) 2% of FAS times years of service projected to age 60.

Form of Payment - The disability benefit commences immediately upon the member's retirement. Disability benefits are payable as a monthly life annuity, with a guarantee that, if the payments made do not exceed the member's accumulated contributions, determined as of the date of retirement, the balance will be paid in a lump sum to the member's surviving beneficiary. If the disabled member survives to age 60, the regular optional forms of payment are then applied.

(6) *Disability Retirement* - A member with five or more years of earned service credit on deferred status may retire when eligible under the Rule of 75 or when the member attains age 65.

(7) The Educational Retirement Act, Section 22-11-1 to 22-11-53, NMSA 1978, assigns the authority to establish and amend benefit provisions to the Board.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Refund of Contributions - Members may withdraw their contributions only when they terminate covered employment in the State and certification of termination has been provided by their former employers. Interest paid to members when they withdraw their contributions following termination of employment is at a rate set by the Board. Interest is not earned on contributions credited to accounts prior to July 1, 1971, or those on deposit for less than one year.

Alternative Retirement Plan - The New Mexico legislature established the Alternative Retirement Plan (ARP) through the enactment of NMSA 1978, Sections 22-11- 47 through 52. In contrast to the regular defined benefit plan administered by the Educational Retirement Board (ERB), the ARP is a defined contribution plan. Beginning on July 1, 1991 at the State's six institutions of higher education, and July 1, 1999 at the State's eight community colleges (the colleges and universities are referred to as the "qualifying state educational institutions"), certain faculty and professional employees in eligible positions have the option of electing to participate in the ARP in lieu of participating in the regular defined benefit plan. Information about the ARP is provided to eligible employees by their employers. Eligible employees must make the election to participate in the ARP within 90 days of employment; those who do not elect to participate in the plan become members of the regular defined benefit plan. Except as described in Section 22-11-47(D), which allows an employee participating in the ARP the option of switching to the defined benefit retirement plan after 7 years of ARP participation, the decision to elect to participate in the ARP is irrevocable. ARP benefits are payable in accordance with the terms of the applicable contracts with vendors; provided, however, that retirement benefits shall, at the option of the employee, be paid in the form of a lifetime income, if held in an annuity contract, payments for a term of years, or a single-sum cash payment. Benefits are based upon contributions made and earnings on those contributions. Retirement, death, and other benefits, including disability benefits, cannot be paid from the Educational Retirement Fund and the ERB does not calculate or determine what benefits can be paid from an ARP account.

For the year ended June 30, 2013, employees participating in the ARP contributed 9.4% of their gross annual salaries. The colleges and universities are required to contribute 7.9% of participating employees' gross annual salary to the ARP vendor on behalf of the participant and 3% of gross annual salary to the Educational Retirement Fund to help offset the impact of the ARP on the defined benefit plan. Employees participating in the ARP do not accrue any right to benefits in the defined benefit plan as a result of that contribution being made to the Fund. The 3% fee remitted to ERB for the years ended June 30, 2013 and 2012 were \$4,684,962 and \$4,280,780 respectively. The colleges and universities are responsible for submitting the employers' and the employees' contributions directly to the ARP vendors annuity carriers.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012**

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Prior to August 31, 2011, the two vendors approved to offer ARP plans to the participants were Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA-CREF), and Variable Annuity Life Insurance Company (VALIC or AIG VALIC, now known as AIG Retirement). The ERB began a process to select new ARP vendors in the fall of 2010 and on April 29, 2011 selected TIAA-CREF and Fidelity Investments as the ARP vendors. New contracts with those vendors became effective September 1, 2011.

Employees are normally allowed to transfer between vendors once each year; however, after the award of new ARP contracts, employees were allowed an additional period in the fall of 2011 to transfer vendors.

In 2009, the New Mexico legislature created the Retirement Systems Solvency Task Force to study New Mexico public retirement plans and prepare solvency plans and recommendations. The Task Force asked the ERB to develop recommendations for changes to the defined benefit retirement plan to achieve an eighty percent (80%) funding level within thirty (30) years as recommended by the Governmental Accounting Standards Board. The ERB submitted recommendation changes to that plan to the New Mexico Legislature for consideration during its regular 2011 session. Because the changes might have had a material effect on the decisions of those ARP participants who elected to switch to the defined benefit plan pursuant to Section 22-11-47 (D), on December 12, 2010, the ERB adopted a resolution allowing those ARP participants that had elected to switch to the defined benefit plan pursuant to Section 22-11-47 (D) the option of electing to either return to the ARP during a 120 day period from May 1, 2011 to August 29, 2011 or to remain in the defined benefit plan. The 120 day period began on the first day of the month following the last day in April on which the Governor could take action on any legislation passed in the 2011 regular legislative session. In that same resolution the ERB also extended the 120-day period that ARP participants who were then or would become eligible to elect to become members of the defined benefit plan under Section 22-11-47 (D) on or before April 30, 2010 to run from May 1, 2011 to August 29, 2011 so that those ARP participants would be informed as to any changes to the defined benefit plan that might become law when there were considering whether to switch to the defined benefit plan.

NOTE 3. GENERAL FUND INVESTMENT POOL NOT RECONCILED

In June 2012, an independent expert diagnostic report revealed that the General Fund Investment Pool balances have not been reconciled at the business unit/fund level since the inception of the Statewide Human resources, Accounting, and management Reporting system (SHARE) system in July of 2006. The Diagnostic report is available in the Resources section of the Cash Control page of the New Mexico Department of Finance & Administration's website at: http://www.nmdfa.state.nm.us/Cash_Control.aspx. The document title is Current State Diagnostic of Cash Control.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

**NOTE 3. GENERAL FUND INVESTMENT POOL NOT RECONCILED
(CONTINUED)**

The General Fund Investment Pool is the State of New Mexico's main operating account. State revenues such as income taxes, sales taxes, rents and royalties, and other recurring revenues are credited to the General Fund Investment Pool. The fund also comprises numerous State agency accounts whose assets, by statute (Section 8-6-3 NMSA 1978), must be held at the State Treasury.

Under the direction of the State Controller/Financial Control Division Director, the Financial Control Division of the New Mexico Department of Finance & Administration (DFA/FCD) is taking aggressive action to resolve this serious problem. DFA/FCD has commenced the Cash Management Remediation Project (Remediation Project) in partnership with the New Mexico State Treasurer's Office, the New Mexico Department of Information Technology, and a contracted third party PeopleSoft Treasury expert.

The Remediation Project objective was to design and implement changes necessary to ensure ongoing completion of timely, accurate and comprehensive reconciliation of the Pool. DFA has or is in the process of implementing all the recommendations resulting for the Remediation Project and has made changes to the State's SHARE system configuration, cash accounting policies and procedures, business practices, and banking structure. This has enabled DFA to complete timely and accurate reconciliation of bank to book balances at the State and Business Unit level on a post-implementation basis, however it did not resolve historical reconciling items. Additional changes recommended by the Project continue to be cascaded through DFA and state agencies to support the Business Unit by Fund accounting requirements.

A plan to address historical reconciling items is being assessed and a separate initiative will need to be undertaken to resolve the historical reconciling items. Management considers it unlikely that this separate initiative will be successful in allocating all historical reconciling items to the State entities invested in the Pool. As a result, any remaining differences post specific allocation to Pool participants will be reported in the State General Fund.

The initial phase of the Remediation Project, completed on October 11, 2012, focused on developing a project plan and documenting current statewide business processes. The work product of the initial phase of the Remediation Project is a document entitled Cash Management Plan and Business Processes. This document is available on the Cash Control page of the New Mexico Department of Finance & Administration's website at: http://www.nmdfa.state.nm.us/Cash_Control.aspx.

In fiscal year 2012, DFA/FCD recorded a loss contingency of \$101.7 million in the General Fund based on its estimate of the effect of issues related to the reconciliation of the Pool, that estimate is still current. ERB believes the cash invested in the State Treasurer Overnight Pool is represented fairly and with no material misstatements due to the reconciliation done by ERB. ERB has established internal control procedures applying the State of New Mexico Manual of Model Accounting Practices (MAP). These procedures are designed to implement

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 3. GENERAL FUND INVESTMENT POOL NOT RECONCILED
(CONTINUED)

necessary and mandatory controls to avert accounting errors and violations of state and federal law and rules related to financial matters. In addition, ERB ensures that any disbursement of funds does not exceed the unencumbered funds at its disposal.

Incorporating the State's financial software system (SHARE) and monthly internal reporting and reconciliation throughout the fiscal year, ERB maintains optimum fiscal safeguards. This ensures that the cash balances in SHARE are correct to the extent that ERB has control (i.e., collection, depositing, reconciling, and documentation of outstanding items) of the cash, its receipts and transfers to the state general fund and other state agencies pursuant to state statute. Each deposit, payment voucher, investment, and any other item that affects cash is verified monthly against SHARE to ensure the amount was posted correctly into the State's general ledger system. Any discrepancies are noted immediately to the Department of Finance and Administration and State Treasurer's Office.

Pursuant to Section 6-5-2.1(J) NMSA 1978, the Department of Finance and Administration is responsible for the reconciliation of the General Fund Investment Pool on a monthly basis, and thus is not the responsibility of the Educational Retirement Board.

NOTE 4. INTEREST IN THE GENERAL FUND INVESTMENT POOL

State law (Section 8-6-3 NMSA 1978) requires the Board's cash be managed by the New Mexico State Treasurer's Office. Accordingly, the investments of the Board consist of an interest in the General Fund Investment Pool managed by the New Mexico State Treasurer's Office.

At June 30, 2013 and 2012, the Board had \$5,353,975 and \$5,521,436, respectively, invested in the General Fund Investment Pool.

Interest Rate Risk - The New Mexico State Treasurer's Office has an investment policy that limits investment maturities to five years or less on allowable investments. This policy is its means of managing exposure to fair value losses arising from increasing interest rates. This policy is reviewed and approved annually by the New Mexico State Board of Finance.

Credit risk - The New Mexico State Treasurer pools are not rated.

For additional GASB 40 disclosure information regarding cash held by the New Mexico State Treasurer, the reader should see the separate audit report for the New Mexico State Treasurer's Office for the fiscal year ended June 30, 2013.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 4. INTEREST IN THE GENERAL FUND INVESTMENT POOL
(CONTINUED)

Cash Deposits

In addition to the overnight investment at the New Mexico State Treasury, the Board invests in the Short-Term Investment Fund (STIF), held by J.P. Morgan. The STIF is used to facilitate more efficient trade procedures with the Board's external money managers. Net cash balances in each internal and external investment manager's portfolio are swept into the STIF at the end of each day. STIF investments and cash of \$746,623,052 and \$317,056,896 as of June 30, 2013 and 2012, respectively, are considered cash equivalents and are reported as cash and short term investments balances in the statement of fiduciary net position.

Custodial Credit Risk - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Board will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Board does not have a deposit policy for custodial credit risk. As of June 30, 2013 and 2012, there were no cash balances exposed to custodial credit risk. All cash is invested in a mutual fund consisting of 100% U.S. Treasury securities.

NOTE 5. REFUND OVERPAYMENTS

In June 2010, the Board adopted a revised method for computing interest due on refunds of contributions to members that have terminated employment and elected to withdraw their contributions and on refunds paid to a beneficiary of a deceased member, with an effective date of July 1, 2010. During implementation, a programming error resulted in 834 individuals receiving overpayments ranging from less than one dollar to \$306,264. The total amount overpaid was \$1,691,929. IRS regulations require that every reasonable effort be made to recover these funds and that interest be assessed on the overpayments. The agency has sent materials to all members overpaid by five dollars or more informing them of the overpayment, the interest due, and a summary of the tax consequences of the overpayment and subsequent repayment. The tax information was general in nature and individuals were advised in the letters sent by the agency to seek the advice of their own tax advisor about their particular tax situation. The Board accrued, as of June 30, 2011, a receivable for the total amount overpaid. During fiscal year 2013, ERB has estimated that \$158,756 of the refund overpayment will be uncollectible. Due to the uncertainty of the timing of collections and the total amount of interest that will finally be assessed, no receivable for interest due has been established. The Board will recognize interest in current year revenue when realized, and will charge any write-offs directly to expense in the year they occur. At June 30, 2013, the uncollected balance, including interest assessed, was \$401,111.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS

The Board is authorized to invest or reinvest the fund in accordance with the Uniform Prudent Investor Act (45-7-601 NMSA 1978).

The Uniform Prudent Investor Act does the following:

- A. Sets a higher standard of care and prudence for investments, above and beyond the previous standard and guiding principles of law;
- B. Applies to the trust as a whole, rather than individual investments;
- C. Requires investment strategy to be based on suitable risk and reward strategies;
- D. Requires diversification unless the trustees reasonably determine it is not in the best interest of the fund.

Asset Allocation Policy—The pension plan’s policy in regard to the allocation of invested assets is established and may be amended by the Educational Retirement Board of Directors. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the pension plan. The following was the Educational Retirement Board’s adopted asset allocation policy:

| <u>Asset Class</u> | <u>After 9/20/2012 Target Allocation</u> | <u>Prior to 9/20/2012 Target Allocation</u> |
|----------------------------------|--|---|
| EQUITIES | | |
| <i>Domestic Equities</i> | | |
| Large Cap Equities | 20% | 23% |
| Small/Mid Cap Equities | 2% | 2% |
| <i>International Equities</i> | | |
| Developed | 5% | 5% |
| Emerging Markets | 10% | 10% |
| TOTAL EQUITIES | 37% | 40% |
| FIXED INCOME | | |
| Opportunistic Credit | 20% | 20% |
| Core Bonds | 7% | 5% |
| Emerging Market Debt | 2% | 2% |
| TOTAL FIXED INCOME | 29% | 27% |
| ALTERNATIVES | | |
| Real Estate/REITS | 5% | 5% |
| Real Assets | 7% | 7% |
| Private Equity | 8% | 7% |
| Absolute Return | 3% | 8% |
| Global Tactical Asset Allocation | 5% | 5% |
| Risk Parity | 5% | 0% |
| TOTAL ALTERNATIVES | 33% | 32% |
| CASH | 1% | 1% |
| TOTAL | 100% | 100% |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Rate of Return—For the year ended June 30, 2013, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 11.12 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Investments of the Board are as follows as of June 30:

Investment Description

| Investments: | 2013 | 2012 |
|---|-------------------------|-------------------------|
| (held by the Board's agent in the Board's name) | | |
| U.S. government and agency securities | \$ 572,532,940 | \$ 721,850,485 |
| Non-US government bonds | 109,518,808 | 30,378,318 |
| Asset- and mortgage-backed securities | 692,017,167 | 593,136,863 |
| Non-US asset-backed securities | 22,740,459 | - |
| Domestic corporate bonds | 757,378,340 | 986,267,569 |
| Non-US corporate bonds | 245,228,240 | - |
| Domestic stocks | 2,824,846,950 | 2,774,109,793 |
| International stocks | 1,134,562,079 | 1,303,988,823 |
| Hedge Funds of Funds | 463,853,968 | 715,935,010 |
| Private Equity | 670,818,353 | 577,114,685 |
| Private Real Estate | 199,274,198 | 160,562,922 |
| Infrastructure | 116,052,810 | 99,554,625 |
| Natural Resources | 48,890,160 | 27,440,752 |
| Other investments | 1,581,574,828 | 1,187,632,843 |
| Total | <u>\$ 9,439,289,300</u> | <u>\$ 9,177,972,688</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Foreign Currency Risk—Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. Foreign currency risk is present in the Board’s investment in foreign equity securities. Managers of these assets are given discretion to hedge this risk. The Board’s exposure to foreign currency risk as of June 30, 2013 was \$1,451,831,846. The Board’s exposure to foreign currency risk as June 30, 2012 was \$1,265,825,419.

Exposure to foreign currency risk as of June 30, 2013 is as follows:

| Currency | Equity Securities | Cash (overdraft) |
|---|-------------------------|-----------------------|
| Australian Dollar | \$ 31,982,137 | \$ 153,383 |
| Brazilian Real | 76,289,449 | 243,540 |
| British Pound Sterling | 140,848,446 | (5,968,354) |
| Canadian Dollar | 3,457,884 | 328,511 |
| Chilean Peso | 247,115 | - |
| Chinese Yuan Renminbi | 19,030 | - |
| Colombian Peso | 2,678,948 | - |
| Czech Koruna | 4,796,272 | 52,531 |
| Danish Krone | 5,690,398 | (14,859) |
| Euro | 268,885,759 | 7,362,938 |
| Hong Kong Dollar | 181,672,431 | 2,751,963 |
| Hungarian Forint | 11,039,091 | 155,500 |
| Indian Rupee | 58,565,752 | 370,029 |
| Indonesian Rupiah | 33,443,062 | 54 |
| Israeli Shekel | 2,092,366 | 11,285 |
| Japanese Yen | 113,834,989 | 7,787 |
| Malaysian Ringgit | 16,253,070 | - |
| Mexican Peso | 19,059,786 | 133,195 |
| Romanian Leu, New | 708,909 | - |
| Taiwan Dollar, New | 54,219,803 | 1,416,346 |
| Turkish Lira, New | 47,101,447 | 55,644 |
| New Zealand Dollar | - | 1,610 |
| Nigerian Naira | 2,797,236 | - |
| Norwegian Krone | 5,448,046 | (85,750) |
| Peruvian Nuevo Sol | 2,332,307 | - |
| Philippine Peso | 1,358,743 | - |
| Polish Zloty | 22,538,302 | 60,114 |
| Russian Ruble | 13,487,050 | 143,826 |
| Singapore Dollar | 12,625,599 | 58,568 |
| South African Rand | 45,724,796 | 171,001 |
| South Korean Won | 174,895,731 | 133 |
| Swedish Krona | 9,723,172 | 67,237 |
| Swiss Franc | 43,407,409 | 33,512 |
| Thai Baht | 37,097,566 | - |
| Total foreign exposure | <u>1,444,322,102</u> | <u>7,509,744</u> |
| Investments not subject to foreign currency risk | 7,994,967,198 | 739,089,372 |
| Total Investments | <u>\$ 9,439,289,300</u> | <u>\$ 746,599,116</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Exposure to foreign currency risk as of June 30, 2012 is as follows:

| Currency | Equity Securities | Cash (overdraft) |
|---|-------------------------|-----------------------|
| Australian Dollar | \$ 27,312,319 | \$ 98,077 |
| Brazilian Real | 79,836,366 | 345,689 |
| British Pound Sterling | 107,244,423 | (8,305) |
| Canadian Dollar | 5,582,611 | 167,339 |
| Chilean Peso | 243,508 | - |
| Chinese Yuan Renminbi | 8,970 | - |
| Columbian Peso | 3,399,833 | - |
| Czech Koruna | 2,794,517 | 122,162 |
| Danish Krone | 4,297,022 | - |
| Euro | 196,857,544 | 1,621,470 |
| Hong Kong Dollar | 163,002,497 | 299,793 |
| Hungarian Forint | 6,025,532 | 125,459 |
| Indian Rupee | 46,309,429 | 731,519 |
| Indonesian Rupiah | 34,881,226 | 57 |
| Israeli Shekel | 2,838,227 | 11,542 |
| Japanese Yen | 91,771,697 | 54,247 |
| Malaysian Ringgit | 15,556,369 | - |
| Mexican Peso | 10,816,986 | 35,757 |
| Taiwan Dollar, New | 62,781,683 | 1,968,587 |
| Turkish Lira, New | 52,534,234 | 81,784 |
| New Zealand Dollar | 409,240 | - |
| Norwegian Krone | 4,635,102 | 48,688 |
| Peruvian Nuevo Sol | 2,563,612 | - |
| Philippine Peso | 670,941 | - |
| Polish Zloty | 24,114,797 | 316,633 |
| Russian Ruble | 8,616,880 | - |
| Singapore Dollar | 9,146,762 | 39,388 |
| South African Rand | 68,513,450 | 1,094,142 |
| South Korean Won | 163,400,160 | 43,186 |
| Swedish Krona | 3,683,162 | - |
| Swiss Franc | 29,359,514 | 51,786 |
| Thai Baht | 29,368,961 | (1,155) |
| Total foreign exposure | <u>1,258,577,574</u> | <u>7,247,845</u> |
| Investments not subject to foreign currency risk | <u>7,919,395,114</u> | <u>309,787,750</u> |
| Total Investments | <u>\$ 9,177,972,688</u> | <u>\$ 317,035,595</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Custodial Credit Risk—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the Board will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Board’s investment policy limits holding of securities by counterparties to those involved with securities lending. In 2012, the Board ended its practice of securities lending.

All investments except securities lending collateral are held by J.P. Morgan (Dallas, Texas). Investments in securities lending collateral were held by ClearLand Securities, a division of Wells Fargo Bank (Los Angeles, California).

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board does not have a policy for interest rate risk management. However, interest rate risk is managed through duration, by operating within defined risk parameters versus a benchmark index.

As of June 30, the Board’s exposure to interest rate risk is summarized as:

The Board uses the weighted average method to determine the duration of its investments.

| Investment Type | Amount | | Duration (In Years) | |
|--------------------------------------|-------------------------|-------------------------|---------------------|-------|
| | 2013 | 2012 | 2013 | 2012 |
| U.S. Treasury Securities | \$ 276,356,253 | \$ 261,391,999 | 6.05 | 10.13 |
| U.S. Government & Agency Obligations | 62,066,857 | 76,320,510 | 6.17 | 5.38 |
| International Government Obligations | 61,262,317 | 77,724,848 | 5.48 | 5.05 |
| Corporate Obligations | 1,035,566,130 | 994,115,882 | 4.03 | 3.99 |
| Asset & Mortgage-Backed Securities | 378,794,011 | 508,611,020 | 2.56 | 1.41 |
| Short-Term Investments | 124,396,288 | 149,851,923 | 0.01 | 0.00 |
| Overall | <u>\$ 1,938,441,856</u> | <u>\$ 2,068,016,182</u> | 3.68 | 4.13 |

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is managed through diversification and by operating within defined parameters versus a benchmark index. Excluding those investments issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk, the Board’s credit quality distribution for investments with credit risk exposure as of June 30, 2013 and 2012, is summarized below. The investments were rated and categorized according to Standard & Poor’s rating standards.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/13

| Investment Type | Rating | Fair Market Value | |
|---|--|--------------------|-------------|
| Asset Backed Securities | A- | \$ 326,704 | |
| | A+ | 3,396,227 | |
| | AA- | 2,752,095 | |
| | AA+ | 1,373,085 | |
| | AAA | 1,166,787 | |
| | B | 1,475,147 | |
| | B- | 726,309 | |
| | B+ | 843,752 | |
| | BB | 625,056 | |
| | BB- | 2,803,920 | |
| | BB+ | 1,646,159 | |
| | BBB- | 754,798 | |
| | BBB+ | 3,508,673 | |
| | CC | 4,541 | |
| | CCC | 2,914,298 | |
| | CCC- | 526,249 | |
| | D | 370,349 | |
| | NR | 10,731,333 | |
| | Commercial Mortgage-Backed /REMIC | AA | 171,868 |
| | | AA+ | 25,172,635 |
| B | | 774,283 | |
| BB | | 837,668 | |
| BBB | | 1,111,448 | |
| BBB- | | 393,258 | |
| BBB+ | | 2,066,226 | |
| CC | | 1,193,566 | |
| CCC | | 3,625,969 | |
| D | | 3,203,620 | |
| NR | | 1,230,638 | |
| Commercial Mortgage-Backed /REMIC | | A | 4,272,389 |
| | A- | 2,069,348 | |
| | A+ | 6,462,388 | |
| | AA | 4,779,333 | |
| | AA- | 1,734,784 | |
| | AAA | 20,849,127 | |
| | BB | 52,709 | |
| | BB- | 483,384 | |
| | BB+ | 465,894 | |
| | BBB | 2,136,980 | |
| | BBB- | 9,537,378 | |
| | BBB+ | 13,792,415 | |
| | CCC | 491,375 | |
| | D | 1,842,392 | |
| | NR | 7,729,662 | |
| | Mortgage-Backed Securities | AA+ | 205,715,824 |
| Total Asset & Mortgage Backed Securities | | <u>358,142,043</u> | |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/13 (continued)

| Investment Type | Rating | Fair Market Value |
|---|-------------------------------|-------------------------|
| Corporate Bonds | A | \$ 41,111,424 |
| | A- | 75,261,961 |
| | A+ | 14,506,159 |
| | AA | 4,762,359 |
| | AA- | 9,051,938 |
| | AA+ | 7,068,655 |
| | AAA | 346,441 |
| | B | 53,906,046 |
| | B- | 81,556,774 |
| | B+ | 19,718,930 |
| | BB | 5,464,875 |
| | BB- | 1,574,050 |
| | BB+ | 8,870,611 |
| | BBB | 83,111,389 |
| | BBB- | 53,644,216 |
| | BBB+ | 54,296,843 |
| | C | 1,276,843 |
| | CC | 4,273,315 |
| | CCC | 23,169,923 |
| | CCC- | 23,869,704 |
| CCC+ | 87,221,268 | |
| D | 3,000,820 | |
| NR | 124,050,538 | |
| Corporate Convertible Bonds | NR | 12,581 |
| Common Stock | N/A | 60,019,213 |
| Preferred Stock | N/A | 15,031 |
| Total Domestic Corporate Securities | | <u>841,161,907</u> |
| Bank Loans | B | 22,271,989 |
| | B- | 25,129,006 |
| | B+ | 7,399,821 |
| | CCC | 16,730,614 |
| | CCC+ | 17,394,221 |
| | NR | 61,994,639 |
| Total Bank Loans | | <u>150,920,290</u> |
| Municipal/Provincial Bonds | A | 5,790,728 |
| | A- | 4,048,878 |
| | A+ | 84,012 |
| Total Government Agencies | | <u>9,923,618</u> |
| Government Bonds | A | 8,520,138 |
| | A- | 37,227,454 |
| | A+ | 837,154 |
| | AA- | 3,978,722 |
| | AA+ | 25,587,621 |
| | AAA | 2,821,180 |
| | BB | 5,992,772 |
| | BBB | 3,065,909 |
| | BBB- | 1,314,939 |
| | BBB+ | 8,860,780 |
| | NR | 38,215,442 |
| | Total Government Bonds | |
| Other Investments Not Rated | NR | 4,707,917 |
| Other Investments Not Subject To Credit Risk | | 7,938,011,414 |
| TOTAL | | <u>\$ 9,439,289,300</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/12

| Investment Type | Rating | Fair Market Value |
|---|-----------------------------------|-------------------|
| Asset Backed Securities | A | \$ 6,481,154 |
| | A- | 3,486,107 |
| | A+ | 7,586,633 |
| | AA+ | 1,335,370 |
| | AAA | 5,250,990 |
| | B | 799,582 |
| | B- | 816,659 |
| | B+ | 1,786,186 |
| | BB | 761,276 |
| | BB- | 2,243,570 |
| | BB+ | 2,855,789 |
| | BBB | 917,905 |
| | BBB- | 4,223,663 |
| | BBB+ | 13,485,639 |
| | CC | 357,574 |
| | CCC | 3,926,372 |
| | CCC- | 1,195,641 |
| | D | 700 |
| | N/R | 5,579,412 |
| | Commercial Mortgage-Backed | A |
| A- | | 1,820,684 |
| A+ | | 13,258,324 |
| AA | | 1,050,010 |
| AA- | | 725,516 |
| AA+ | | 175,192 |
| AAA | | 31,354,048 |
| B- | | 143,836 |
| BB- | | 454,214 |
| BB+ | | 167,130 |
| BBB | | 2,158,214 |
| BBB- | | 1,915,987 |
| BBB+ | | 5,767,079 |
| D | | 2,053,844 |
| N/R | | 13,844,257 |
| Mortgage-Backed Securities | AA+ | 315,772,461 |
| Total Asset & Mortgage Backed Securities | | 458,761,090 |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/12 (continued)

| Investment Type | Rating | Fair Market Value |
|--|---------------|--------------------------|
| Collateralized Debt/Loan Obligations | A | 60,101 |
| | A- | 92,480 |
| | A+ | 1,665,380 |
| | AA+ | 4,631,465 |
| | AAA | 442,036 |
| | B | 744,931 |
| | B- | 1,229,816 |
| | BB | 1,242,814 |
| | BBB | 1,072,871 |
| | BBB- | 386,843 |
| | BBB+ | 1,674,463 |
| | CC | 2,080,667 |
| | CCC | 2,100,374 |
| | CCC+ | 401,696 |
| | D | 3,166,414 |
| | N/R | 7,364,618 |
| Total Collateralized Debt Obligations | | <u>28,356,969</u> |
| Corporate Bonds | A | 29,888,576 |
| | A- | 83,359,970 |
| | A+ | 21,324,728 |
| | AA | 3,893,387 |
| | AA- | 10,929,638 |
| | AA+ | 8,575,238 |
| | AAA | 231,027 |
| | B | 93,485,187 |
| | B- | 91,377,063 |
| | B+ | 36,374,060 |
| | BB | 8,559,250 |
| | BB- | 7,338,815 |
| | BB+ | 12,990,973 |
| | BBB | 90,640,573 |
| | BBB- | 53,440,692 |
| | BBB+ | 35,400,565 |
| | CCC | 32,305,253 |
| | CCC- | 4,337,475 |
| | CCC+ | 30,853,231 |
| N/R | 82,222,217 | |
| Corporate Convertible Bonds | BB- | 1,439,569 |
| | N/R | 12,341 |
| Common Stock | N/R | 16,353,889 |
| Preferred Stock | N/R | 14,584 |
| Total Domestic Corporate Securities | | <u>755,348,301</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/12 (continued)

| Investment Type | Rating | Fair Market Value |
|---|-------------------------------|-------------------------|
| Bank Loans | B | 22,246,350 |
| | B- | 12,255,452 |
| | B+ | 9,347,219 |
| | BB- | 5,517,485 |
| | CCC | 9,515,113 |
| | CCC+ | 3,430,992 |
| | N/R | 65,668,603 |
| Total Bank Loans | | <u>127,981,214</u> |
| Municipal/Provincial Bonds | A | 69,037 |
| | A- | 3,074,588 |
| | A+ | 2,285,936 |
| | AA | 410,300 |
| | AA- | 388,935 |
| | AA+ | 466,765 |
| | N/R | 482,172 |
| Total Government Agencies | | <u>7,177,733</u> |
| Government Bonds | A | 20,910,486 |
| | A- | 17,537,090 |
| | A+ | 243,508 |
| | AA- | 3,832,216 |
| | AA+ | 32,040,946 |
| | AAA | 2,211,682 |
| | B+ | 44,168 |
| | BB | 702,771 |
| | BB+ | 6,079,534 |
| | BBB- | 19,758,925 |
| | BBB+ | 6,405,865 |
| | N/R | 32,103,561 |
| | Total Government Bonds | |
| Other Investments Not Rated | N/R | 2,751,511 |
| Other Investments Not Subject To Credit Risk | | 7,655,725,118 |
| TOTAL | | <u>\$ 9,177,972,688</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 6. INVESTMENTS (CONTINUED)

Cash Balances —The Board earns interest on all monies held at the custodial agent bank. When a security purchase transaction fails to be completed due to the broker not delivering the purchased security on settlement date the cash remains with custodial agent bank. When this occurs, the Board’s money is invested overnight in a Short-Term Investment Fund (STIF).

Concentration Risk—Concentration risk is identified by the amount of investment in any one issuer that represents 2% or more of fiduciary net position. As of June 30, 2013 and 2012, with the exception of U.S. Government and Agency securities, the Board was not exposed to any concentration risk greater than 2%.

NOTE 7. DERIVATIVE INSTRUMENTS

Derivatives are generally defined as contracts or securities whose value depend on, or derive from, the value of an underlying asset, reference rate, or index.

The Board has adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which addresses the recognition, measurement, and disclosure of derivative instruments. This note describes the Board’s investment derivative instruments measured at fair value in the Statement of Fiduciary Net Position and Statement of Changes in Fiduciary Net Position.

The Board’s investment policies do allow for certain portfolio managers to trade in certain derivatives for hedging purposes. Golden Tree Asset Management did so in fiscal year 2013. The amounts held in hedging derivatives were not material during the year and at June 30, 2013.

The notional or contractual amounts of derivatives indicate the extent of the Board’s involvement in the various types and uses of derivative financial instruments and do not measure the Board’s exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and other terms of the derivatives.

The following table summarizes the aggregate notional or contractual amounts for the Board’s derivative financial instruments as of June 30, 2013 and 2012.

| | Notional Amounts in Thousands | |
|---|--------------------------------------|-------------|
| | 2013 | 2012 |
| Futures contracts - long | 4,430 | 6,335 |
| Futures contracts - short | (15,500) | (55,735) |
| Foreign exchange forward contracts, net | 403,280 | 283,918 |
| Options - puts purchased | - | 6,408 |
| Options - puts sold | - | (6,408) |
| Swaps - credit default swap | 7,870 | 1,060 |
| Swaps - index swap | 284 | 4,341 |
| Swaps - interest rate swap | - | 139 |
| Swaps - zero coupon | - | - |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 7. DERIVATIVE INSTRUMENTS (CONTINUED)

The fair values of derivative instruments outstanding as of June 30, 2013 and 2012 are classified by type and by the changes in fair value of the derivative instrument in the following table.

| Dollar Amounts in Thousands | | | | |
|---|---|-------------|------------------------------------|-------------|
| Derivative Type | Unrealized Gain/(Loss) as of June 30, 2013 | | Fair Value at June 30, 2013 | |
| | Classification | Gain/(Loss) | Classification | Amount |
| Futures | Investment Income | \$ 14 | Investment | \$ (87) |
| Options - purchased | Investment Income | 6 | Investment | - |
| Options - sold | Investment Income | 141 | Investment | - |
| Swaps - Credit Default Swap Index | Investment Income | 183 | Investment | 76 |
| Swaps - Interest Rate Swaps | Investment Income | 21 | Investment | - |
| Swaps - Index | Investment Income | 12 | Investment | 29 |
| Unrealized Gain/(Loss) as of June 30, 2012 | | | | |
| Derivative Type | Classification | Gain/(Loss) | Classification | Amount |
| Futures | Investment Income | \$ (101) | Investment | \$ (61,082) |
| Options - purchased | Investment Income | (350) | Investment | 42 |
| Options - sold | Investment Income | 203 | Investment | (13) |
| Swaps - Credit Default Swap Index | Investment Income | (108) | Investment | (108) |
| Swaps - Interest Rate Swaps | Investment Income | (21) | Investment | (21) |
| Swaps - Index | Investment Income | 17 | Investment | 17 |

Risks — There are certain risks inherent in investments in derivatives. The Board is exposed to credit risk in the event of non-performance by counterparties to financial instruments. The fund managers that are authorized to invest in derivatives are given specific parameters as to the types of derivatives invested in and ratings of the counterparties they are allowed to enter into contracts with to ensure transactions are entered into with only high quality institutions. The board is exposed to market risk; the risk that changes in market conditions may make an investment less valuable. Exposure to market risk is managed within risk limits set by management through buying and selling of specific instruments or by entering into offsetting positions. As discussed in Note 6, foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. Managers of these assets are given discretion to hedge this risk.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 7. DERIVATIVE INSTRUMENTS (CONTINUED)

The Plan invests in the following types of Derivative Instruments.

Foreign Currency Exchange Contracts—The Board may enter into forward contracts to purchase and sell foreign currencies in the normal course of its investing activities to manage the currency exposure associated with the Board’s foreign equity and fixed income investments. The terms of these contracts generally do not exceed one year. The credit risk associated with these contracts is minimal as they are entered into with a limited number of highly rated counterparties. The following tables summarize the Board’s foreign exchange contracts by currency as of June 30, 2013 and 2012, currency amounts in thousands.

Fiscal Year Ending 6/30/2013

| Currency | Buys | Unrealized Gain/(Loss) | Sells | Unrealized Gain/(Loss) |
|------------------------|-------------------|-----------------------------------|-------------------|-----------------------------------|
| Australian Dollar | \$ 3,205 | \$ (96) | \$ 3,146 | \$ 390 |
| Brazilian Real | 5,734 | (209) | 3,617 | 144 |
| British Pound Sterling | - | - | 5,589 | 22 |
| Canadian Dollar | 275 | (3) | 1,917 | 49 |
| Chilean Peso | 825 | (3) | 1,639 | 21 |
| Chinese Yuan Renminbi | 1,164 | 32 | 1,165 | (22) |
| Colombian Peso | 1,178 | (72) | - | 46 |
| Euro | 3,091 | (50) | 39,029 | (17) |
| Hungarian Forint | 6,206 | (114) | 6,530 | 28 |
| Indian Rupee | - | (1) | - | 1 |
| Indonesian Rupiah | - | (5) | 1,646 | (6) |
| Japanese Yen | 9,836 | (361) | 9,876 | 113 |
| Malaysian Ringgit | 184 | (8) | - | - |
| Mexican Peso | 18,153 | (514) | 12,248 | 424 |
| Romanian Leu, New | 429 | (7) | - | - |
| Taiwan Dollar, New | 1,555 | (5) | 1,528 | 6 |
| Turkish Lira, New | 3,017 | (42) | - | 72 |
| Peruvian Nuevo Sol | - | - | 239 | 2 |
| Philippine Peso | 2,266 | (68) | 3,151 | 143 |
| Polish Zloty | 3,867 | (44) | 814 | 68 |
| Russian Ruble | 6,834 | (114) | 10,980 | 458 |
| Singapore Dollar | 4,299 | (67) | 5,035 | 111 |
| South African Rand | 4,155 | (53) | 4,259 | 16 |
| South Korean Won | 6,794 | (74) | 6,794 | 121 |
| Thai Baht | - | 7 | 1,738 | (5) |
| US Dollar | 118,483 | - | 80,788 | - |
| Total | \$ 201,550 | \$ (1,871) | \$ 201,728 | \$ 2,185 |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 7. DERIVATIVE INSTRUMENTS (CONTINUED)

Fiscal Year Ending 6/30/2012

| Currency | Buys | Unrealized Gain/(Loss) | Sells | Unrealized Gain/(Loss) |
|------------------------|-------------------|-----------------------------------|-------------------|-----------------------------------|
| Australian Dollar | \$ 318 | \$ 8 | \$ 10,044 | \$ (291) |
| Brazilian Real | 5,084 | 50 | 5,687 | (105) |
| British Pound Sterling | - | - | 2,085 | (14) |
| Canadian Dollar | - | (5) | 2,801 | 45 |
| Chinese Yuan Renminbi | 1,896 | - | 4,056 | 9 |
| Colombian Peso | 4,913 | 62 | 4,618 | (46) |
| Egyptian Pound | - | - | - | - |
| Euro | 6,771 | 36 | 48,440 | 164 |
| Hungarian Forint | - | - | 2,328 | (54) |
| Indian Rupee | 175 | 1 | 531 | (1) |
| Indonesian Rupiah | 398 | 5 | - | - |
| Japanese Yen | - | - | 652 | 3 |
| Malaysian Ringgit | 2,284 | 11 | - | - |
| Mexican Peso | 3,790 | 145 | 431 | (14) |
| Taiwan Dollar, New | - | - | 713 | (1) |
| Turkish Lira, New | 702 | 5 | 9,058 | (72) |
| Peruvian Nuevo Sol | 262 | - | - | - |
| Philippine Peso | - | - | 2,261 | (32) |
| Polish Zloty | 2,947 | (13) | 4,519 | (46) |
| Russian Ruble | 1,372 | 29 | - | - |
| Singapore Dollar | 2,143 | 20 | 1,993 | (23) |
| South African Rand | 1,632 | 53 | 529 | (12) |
| South Korean Won | - | - | 2,248 | (51) |
| Thai Baht | 1,718 | (7) | 321 | - |
| US Dollar | 95,213 | - | 30,630 | - |
| Total | \$ 131,618 | \$ 400 | \$ 133,945 | \$ (541) |

Futures Contracts—The Board enters into futures contracts in the normal course of its investing activities to manage market risk associated with the Plan’s equity and fixed income investments and to achieve overall investment portfolio objectives. These contracts involve elements of market risk in excess of amounts recognized in the Statement of Fiduciary Net Position. The credit risk associated with these contracts is minimal as they are traded on organized exchanges and settled daily.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 7. DERIVATIVE INSTRUMENTS (CONTINUED)

During 2013, the Board was a party to futures contracts held for trading purposes for U.S. Treasury bonds and 90 day Euro dollar fixed income futures. Upon entering into a futures contract, the Board is required to deposit either in cash or securities an amount (initial margin) equal to a certain percentage of the nominal value of the contract.

Subsequent payments are then made or received by the Board, depending on the daily fluctuation in the value of the underlying contracts. Cash Collateral in the amount of \$1,800,000 as of June 30, 2013 was held in a Money Market fund by the custodial bank. U.S. Treasury Securities owned and included in the investments of the Board, with a value of approximately \$712,002 as of June 30, 2012, were held by the Plan's broker as performance security on futures contracts.

FY 13

Summary of Outstanding Futures Contracts

| | <u>No. of Contracts</u> | <u>Notional Amount</u> |
|---------------------------|-------------------------|------------------------|
| Futures Contracts - Long | 134 | \$ 4,430,000 |
| Futures Contracts - Short | 107 | \$ 15,500,000 |
| | | <u>Fair Value</u> |
| Margin Deposit | | \$ 1,800,000 |

FY 12

Summary of Outstanding Futures Contracts

| | <u>No. of Contracts</u> | <u>Notional Amount</u> |
|---------------------------|-------------------------|------------------------|
| Futures Contracts - Long | 116 | \$ 6,335,000 |
| Futures Contracts - Short | 567 | \$ 55,735,000 |
| | | <u>Fair Value</u> |
| Margin Deposit | | \$ 712,002 |

Options – An option contract is a contract in which the writer of the option grants the buyer of the option the right to purchase from (call option), or sell to (put option), the writer of a designated instrument at a specified price within a specified period of time. Both written and purchased options were used by the Board during 2012. When the Board purchases or writes an option, an amount equal to the premium paid or received by the plan is recorded as an asset or liability and is subsequently adjusted to the current market value of the option purchased or written. Gain or loss is recognized when the option contract expires or is closed. As of June 30, 2012, no written or purchased options remained open. On June 30, 2012, the value of open written and purchased options was approximately \$13,284 and \$42,174, respectively. As of June 30, 2013 there were no open written or purchased options.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 7. DERIVATIVE INSTRUMENTS (CONTINUED)

Swap Contracts — Swap contracts are executed on a number of different bases. The two types employed by the Board on June 30, 2013 and June 30 2012, were interest rate swap contracts and credit default swap contracts. An interest rate swap contract is an agreement between two parties to exchange periodic interest payments. One party agrees to make payments to the other based on a fixed rate of interest in exchange for payments based on a variable rate. The Board employs interest rate swap contracts to adjust fixed income portfolio durations. A credit default swap contract is similar to an insurance policy, with the credit risk of an individual issuer or a basket of issuers (the “reference asset”) the insured factor. Under such a contract, two parties enter into an agreement whereby the first party pays the second party a fixed periodic payment for the specified life of the contract (analogous to an insurance premium). The other party makes no payment unless a credit event related to the reference asset occurs. If such an event takes place, the second party is obligated to make a payment to the first party. The size of the payment is linked to the decline in the reference asset’s market value following determination of the occurrence of a credit event.

Hedge Funds — The use of other derivatives is allowed under the Hedge Fund Investment Policy. These investments are under the management of the Hedge Fund managers who are employed in the “Hedge Fund”, “Emerging Market Debt,” and “Opportunistic Credit” classifications.

Asset Backed Securities—In accordance with investment policy and fiduciary principles, the Plan invests in various forms of asset backed securities that fit the previous definition of derivative securities. The securities are held for investment purposes. The assets are as follows:

| | 2013 | 2012 |
|---------------------------------------|--------------|--------------|
| Asset backed securities | \$18,862,108 | \$29,665,212 |
| Collateralized mortgage obligations | 41,616,321 | 21,048,837 |
| Commercial mortgage backed securities | 76,699,558 | 79,898,408 |
| Collateralized debt/loan obligations | 19,149,599 | 40,803,326 |

NOTE 8. SECURITIES LENDING

The Board or its designated agent may enter into contracts for the temporary exchange of securities for the use by brokers/dealers, banks, and other recognized institutional investors for periods not to exceed one year, for a specified fee or consideration. Securities lent include fixed income securities and domestic equities. No such contract shall be entered into unless the contract is fully secured by a collateralized, irrevocable letter of credit running to the Board; cash; or equivalent collateral of at least 102% of the market value of the securities plus accrued interest temporarily exchanged. This collateral shall be delivered to the State fiscal agent or its designee contemporaneously with the transfer of funds or delivery of the securities.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 8. SECURITIES LENDING (CONTINUED)

Such contract may authorize the Board to invest cash collateral in instruments or securities that are authorized fund investments and may authorize payment of a fee from the Plan or from income generated by the investment of cash collateral to the borrower of securities providing cash as collateral. The Board may apportion income derived from the investment of cash collateral to pay its agent in securities lending transactions.

Securities lending was ended during fiscal year 2012. The Board received net securities lending income totaling \$154,837 for the fiscal year ended June 30, 2012. There were no significant violations of legal or contractual provisions nor any borrower or lending agent default losses.

NOTE 9. CAPITAL ASSETS

Capital assets relate to all assets of the Board that are used in operations and have useful lives extending beyond a single reporting period. Depreciation expense was \$695,347 and \$1,407,977 for the years ended 2013 and 2012, respectively. Capital asset activity for the years ended June 30, 2013 and 2012 is as follows:

| | Beginning Balance | Additions | Deletions | Ending Balance |
|---|------------------------------|------------------|------------------|---------------------------|
| 2013: | | | | |
| Land | \$ 248,172 | \$ - | \$ - | \$ 248,172 |
| Depreciable land improvements | 19,361 | - | - | 19,361 |
| Building and building improvements | 3,365,714 | - | - | 3,365,714 |
| Furniture and equipment | 1,124,917 | 8,496 | 50,839 | 1,082,574 |
| Other assets (Art in Public Places) | 30,500 | - | - | 30,500 |
| Integrated Retirement Information System (IRIS) | 9,156,963 | - | - | 9,156,963 |
| | <hr/> | | | |
| Total | 13,945,627 | 8,496 | 50,839 | 13,903,284 |
| | <hr/> | | | |
| Accumulated depreciation: | | | | |
| Depreciable land improvements | 5,022 | 699 | - | 5,721 |
| Building and building improvements | 1,514,134 | 101,891 | - | 1,616,025 |
| Furniture and equipment | 912,815 | 86,704 | 50,721 | 948,798 |
| Integrated Retirement Information System (IRIS) | 8,650,910 | 506,053 | - | 9,156,963 |
| | <hr/> | | | |
| Total | 11,082,881 | 695,347 | 50,721 | 11,727,507 |
| | <hr/> | | | |
| Capital assets—net | \$2,862,746 | \$ 686,851 | \$ 118 | \$ 2,175,777 |
| | <hr/> | | | |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 9. CAPITAL ASSETS (CONTINUED)

| | Beginning Balance | Additions | Deletions | Ending Balance |
|---|------------------------------|------------------|------------------|---------------------------|
| 2012: | | | | |
| Land | \$ 248,172 | \$ - | \$ - | \$ 248,172 |
| Depreciable land improvements | 19,361 | - | - | 19,361 |
| Building and building improvements | 3,365,714 | - | - | 3,365,714 |
| Furniture and equipment | 1,092,420 | 71,298 | 38,801 | 1,124,917 |
| Other assets (Art in Public Places) | 30,500 | - | - | 30,500 |
| Integrated Retirement Information System (IRIS) | 9,156,963 | - | - | 9,156,963 |
| | <hr/> | | | |
| Total | 13,913,130 | 71,298 | 38,801 | 13,945,627 |
| | <hr/> | | | |
| Accumulated depreciation: | | | | |
| Depreciable land improvements | 4,322 | 700 | - | 5,022 |
| Building and building improvements | 1,401,117 | 113,017 | - | 1,514,134 |
| Furniture and equipment | 857,145 | 92,215 | 36,545 | 912,815 |
| Integrated Retirement Information System (IRIS) | 7,448,865 | 1,202,045 | - | 8,650,910 |
| | <hr/> | | | |
| Total | 9,711,449 | 1,407,977 | 36,545 | 11,082,881 |
| | <hr/> | | | |
| Capital assets—net | \$4,201,681 | \$ 1,336,679 | \$ 2,256 | \$ 2,862,746 |
| | <hr/> | | | |

NOTE 10. ACCRUED COMPENSATED ABSENCES

Qualified employees are entitled to accumulate vacation leave according to a graduated leave schedule of 80 to 160 hours per year, depending upon the length of service and the employee's hire date. A maximum of 30 working days (equivalent to 240 hours) of such accumulated vacation leave can be carried forward into the beginning of the next calendar year. Any excess accumulated vacation leave is forfeited.

When employees terminate employment with the State, they are compensated for accumulated vacation leave as of the termination date, up to a maximum of 240 hours. All balances up to 240 hours for each employee have been recorded at their current pay rate as of June 30, 2013 and 2012.

Qualified employees are entitled to accumulate sick leave at the rate of one day for each calendar month of service. There is no limit to the amount of sick leave an employee can accumulate. Once per fiscal year, in either January or July, employees may elect to be paid for accrued sick leave in excess of 600 hours but less than 720 hours at 50% of their current hourly rate.

In the case of retiring employees, they may be paid for accrued sick leave in excess of 600 hours but less than 1,000 hours at 50% of their current hourly rate. All sick leave balances in excess of 600 hours but less than 720 hours for each employee have been recorded as a liability at 50% of their current hourly rate.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 10. ACCRUED COMPENSATED ABSENCES (CONTINUED)

The following table provides a summary for the fiscal years ended June 30, of the change in accrued compensated absences:

| | 2013 | 2012 |
|--|-------------------|-------------------|
| Balance payable—beginning of fiscal year | \$ 203,800 | \$ 228,616 |
| Additions | 212,462 | 177,855 |
| Deletions | (185,459) | (202,671) |
| Balance payable—end of fiscal year | <u>230,803</u> | <u>203,800</u> |
| Amount due within one year, estimated at 97% | <u>\$ 223,879</u> | <u>\$ 197,686</u> |

Funds used to liquidate this liability will come from the ERB Retirement Plan based on the appropriated budget.

NOTE 11. LEASES

The Board leases mailing and copier equipment, office space, and storage space under operating leases. Operating leases do not give rise to property rights or lease obligations; therefore, the amounts of the Board’s lease agreements are not reflected on the Statement of Fiduciary Net Position. Leases are subject to future appropriations and are cancelable by the Board at the end of each fiscal year with 30 days’ written notice to the lessor. The following table summarizes the Board’s future minimum lease payments:

| Years Ending June 30, | |
|------------------------------|-------------------|
| 2014 | \$ 74,109 |
| 2015 | 72,177 |
| 2016 | 74,048 |
| 2017 | 62,220 |
| 2018 | 82,034 |
| Total | <u>\$ 364,588</u> |

Lease expense was \$75,876 and \$80,618 for the fiscal years ended June 30, 2013 and 2012, respectively.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 12. RETIREMENT PLANS

Employees of the Board who do not possess a teaching or administrative certificate have the option of participating in the Educational Employees Retirement Plan or the Public Employees Retirement Plan. Some employees of the Board have elected to participate in the Educational Employees' Retirement Plan (the ERB plan) through the Educational Retirement Act, while others have elected to participate in the Public Employees Retirement Plan (the PERA Plan) through the Public Employees Retirement Act (PERA) of the State.

Public Employees Retirement Association (PERA). Certain full-time employees elect to participate in a public employee retirement system authorized under the Public Employees Retirement Act (Chapter 10, Article 11, NMSA 1978). The Public Employees Retirement Association (PERA) is the administrator of the plan, which is a cost-sharing multiple-employer defined benefit retirement plan. The plan provides for retirement benefits, disability benefits, survivor benefits, and cost-of-living adjustments to plan members and beneficiaries. PERA issues a separate, publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to PERA, P.O. Box 2123, Santa Fe, NM 87504-2123. The report is also available on PERA's website at www.pera.state.nm.us.

Funding Policy. Plan members are required to contribute 8.92% of their gross salary. The Educational Retirement Board is required to contribute 15.09% of the gross covered salary. The contribution requirements of plan members and the Educational Retirement Board are established in State statute under Chapter 10, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The plan members and Board's contributions to PERA for the fiscal years ending June 30, 2013, 2012, and 2011 were \$661,881, \$656,229, and \$648,196 respectively, which equal the amount of the required contributions for each fiscal year.

Educational Retirement Board. Certain full-time employees elect to participate in a public employee retirement system authorized under the Educational Retirement Act (Chapter 22, Article 11, NMSA 1978). The Educational Retirement Board (ERB) is the administrator of the plan, which is a cost-sharing multiple-employer defined benefit retirement plan. The plan provides for retirement benefits, disability benefits, survivor benefits, and cost-of-living adjustments to plan members (certified teachers, and other employees of State public school districts, colleges and universities) and beneficiaries. ERB issues a separate, publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to ERB, P.O. Box 26129, Santa Fe, NM 87502. The report is also available on ERB's website at www.nmerb.org.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012**

NOTE 12. RETIREMENT PLANS (CONTINUED)

Funding Policy.

Member Contributions

Plan members whose annual salary is \$20,000 or less are required by statute to contribute 7.9% of their gross salary. Plan members whose annual salary is over \$20,000 are required to make the following contributions to the Plan: 9.4% of their gross salary in fiscal year 2013; 10.1% of their gross salary in fiscal year 2014; and 10.7% of their gross salary in fiscal year 2015 and thereafter.

Employer Contributions

In fiscal year 2013, the Educational Retirement Board was required to contribute 12.4% of the gross covered salary for employees whose annual salary is \$20,000 or less, and 10.9% of the gross covered salary for employees whose annual salary is more than \$20,000.

In the future, the Educational Retirement Board will contribute the following percentages of the gross covered salary of employees: 13.15% of gross covered salary in fiscal year 2014; and 13.9% of gross covered salary in fiscal year 2015.

The contribution requirements of plan members and the Educational Retirement Board are established in State statute under Chapter 22, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The Board's contributions to ERB for the fiscal years ending June 30, 2013, 2012, and 2011 were \$7,190, \$4,380, and \$11,792, respectively, which equal the amount of the required contributions for each fiscal year.

NOTE 13. POST-EMPLOYMENT BENEFITS – STATE RETIREE HEALTH CARE PLAN

Plan Description: The Educational Retirement Board contributes to the New Mexico Retiree Health Care Fund, a cost-sharing multiple-employer defined benefit post employment healthcare plan administered by the New Mexico Retiree Health Care Authority (RHCA). The RHCA provides health care insurance and prescription drug benefits to retired employees of participating New Mexico government agencies, their spouses, dependents, and surviving spouses and dependents. The RHCA Board was established by the Retiree Health Care Act (Chapter 10, Article 7C, NMSA 1978). The Board is responsible for establishing and amending benefit provisions of the healthcare plan and is also authorized to designate optional and/or voluntary benefits like dental, vision, supplemental life insurance, and long-term care policies.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 13. POST-EMPLOYMENT BENEFITS – STATE RETIREE HEALTH CARE PLAN (CONTINUED)

Eligible retirees are: (1) retirees who make contributions to the fund for at least five years prior to retirement and whose eligible employer during that period of time made contributions as a participant in the RHCA plan on the person's behalf, unless that person retires before the employer's RHCA effective date, in which the event the time period required for employee and employer contributions shall become the period of time between the employee's effective date, and the date of retirement; (2) retirees defined by the Act who retired prior to July 1, 1990; (3) former legislators who served at least two years; (4) former governing authority members who served at least four years.

The RHCA issues a publicly available stand-alone financial report that includes financial statements and required supplementary information for the post employment healthcare plan. That report and further information can be obtained by writing to the Retiree Health Care Authority at 4308 Carlisle NE, Suite 104, Albuquerque, NM 87107.

Funding Policy. The Retiree Health Care Act (Section 10-7C-13, NMSA 1978) authorizes the RHCA Board to establish the monthly premium contributions that retirees are required to pay for healthcare benefits. Each participating retiree pays a monthly premium according to a service based subsidy rate schedule for the medical plus basic life plan plus an additional participation fee of five dollars if the eligible participant retired prior to the employer's RHCA effective date or is a former legislator or a former governing authority member. Former legislators and governing authority members are required to pay 100% of the insurance premium to cover their claims and the administrative expenses of the plan. The monthly premium rate schedule can be obtained from the RHCA or viewed on their website at www.nmrhca.state.nm.us.

The employer, employee and retiree contributions are required to be remitted to the RHCA on a monthly basis. The statutory requirements for the employer and employee contributions can be changed by the New Mexico State Legislature. Employers that choose to become participating employers after January 1, 1998, are required to make contributions to the RHCA fund in the amount determined to be appropriate by the board.

The Retiree Health Care Act (Section 10-7C-15, NMSA 1978) is the statutory authority that establishes the required contributions of participating employers and their employees. For employees that were members of an enhanced retirement plan (state police and adult correctional officer member coverage plan 1; municipal police member coverage plans 3, 4 or 5; municipal fire member coverage plan 3, 4 or 5; municipal detention officer member coverage plan 1; and members pursuant to the Judicial Retirement Act) during the fiscal year ended June 30, 2013, the statute required each participating employer to contribute 2.5% of each participating employee's annual salary; and each participating employee was required to contribute 1.25% of their salary. For employees that were not members of an enhanced retirement plan during the fiscal year ended June 30, 2013, the statute required each participating employer to contribute 2.0% of each participating employee's annual salary; each

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012**

NOTE 13. POST-EMPLOYMENT BENEFITS – STATE RETIREE HEALTH CARE PLAN (CONTINUED)

participating employee was required to contribute 1.0% of their salary. In addition, pursuant to Section 10-7C-15(G) NMSA 1978, at the first session of the Legislature following July 1, 2013, the legislature shall review and adjust the distributions pursuant to Section 7-1-6.1 NMSA 1978 and the employer and employee contributions to the authority in order to ensure the actuarial soundness of the benefits provided under the Retiree Health Care Act.

The Educational Retirement Board's contributions to the RHCA for the years ending June 30, 2013, 2012 and 2011 were \$55,678, \$50,399, and \$46,063 for employer contributions and \$27,836, \$24,541, and \$23,031 in employee contributions, respectively, which equal the required contributions for each year.

NOTE 14. RISK MANAGEMENT

With the exception of investment losses, the Board is exposed to various business risks of loss for which it carries insurance through the Risk Management Division of the New Mexico General Services Department. In the event of a claim being filed, the Board is responsible for only a small deductible payment in amounts that vary according to the type of claim.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 15. STATUTORY DISCLOSURES

Section 2.2.2.10P(2) of the Audit Rule 2011, 2.2.2 NMAC entitled, “Requirements for Contracting and Conducting Audits of Agencies” requires that state agencies disclose all special, deficiency, and specific appropriations. The Board received the following specific appropriations:

ERB LAND & BUILDING PROJECT

Laws of 2009, Chapter 125, Section 41

| | |
|---|---------------------|
| Appropriation | \$ 2,500,000 |
| Expended in FY 2012, 2011 and 2010 | (44,697) |
| Outstanding Encumbrance at end of FY 2012 | (49,211) |
| Un-encumbered balance rebudgeted in FY 2013 | <u>\$ 2,406,092</u> |

| | |
|--|---------------------|
| Un-encumbered balance carried forward | \$ 2,406,092 |
| Outstanding encumbrance from FY 2012 added back in | 49,211 |
| Expended in FY 2013 | - |
| Outstanding Encumbrance at end of FY 2013 | (49,211) |
| Un-encumbered balance not rebudgeted in FY 2014 | <u>\$ 2,406,092</u> |

IRIS ENHANCEMENT PROJECT

Laws of 2011, Chapter 179, Section 7, Item 3

| | |
|--|-------------------|
| Appropriation | \$ 3,500,000 |
| Expended in FY 2012 and 2013 | (1,690,535) |
| Outstanding Encumbrance at end of FY 2013 | (1,420,144) |
| Un-encumbered balance rebudgeted in FY2014 | <u>\$ 389,321</u> |

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 and 2012

NOTE 16. INVESTMENT PLACEMENT AGENTS

Placement agents act as intermediaries on behalf of investment managers to solicit investments in a fund. Other terms used to describe the function performed by placement agents include finder, solicitor, marketer, consultant, and broker. Large investment managers may have in-house marketing or placement agent groups, while smaller investment managers may forgo the overhead associated with maintaining such operations and retain independent firms or individuals as placement agents as needed. Some placement agents are part of a large corporation and represent that corporation's investment managers, as well as independent managers. Other placement agents are independent firms or individuals.

NMSA 1978, Section 22-11-54 requires recipients of investments by the ERB to disclose the identity of, and the fee, commission, or retainer paid to, any third-party marketer or placement agent who rendered services on behalf of the recipient in obtaining the investment. The disclosure requirements do not apply to investments in publicly traded equities or fixed-income securities. Any person who knowingly withholds the required disclosure is guilty of a fourth degree felony, punishable by a fine of not more than \$20,000, imprisonment for a definite term not to exceed eighteen months, or both. The ERB informs all investment managers and placement agents soliciting investments of the disclosure requirement and the penalty for failing to disclose. The ERB adopted a policy regarding placement agent disclosures in December 2009. In September 2011, the ERB adopted an Amended and Restated Policy Regarding Placement Agent Disclosures. A copy of this policy can be found at ERB's website (<http://www.nmerb.org/pdfs/placementagentpolicy.pdf>).

The ERB does not have any direct contractual relationships with placement agents and has not directly paid fees for such services. In addition, the ERB's investment consultants and advisors do not receive any compensation other than advisory fees paid by the ERB and do not accept compensation from investment fund managers or their placement agents.

REQUIRED SUPPLEMENTARY INFORMATION

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF CHANGES IN THE EMPLOYERS' NET PENSION LIABILITY**

(Unaudited)

Fiscal year ending June 30,

| | <u>2013</u> |
|--|--------------------------|
| Total Pension Liability | |
| Service Cost | \$ 348,266,697 |
| Interest | 1,202,676,449 |
| Benefit Changes | 10,093,494 |
| Difference between actual & expected experience | - |
| Assumption Changes | (5,035,689,829) |
| Benefit Payments | (811,665,051) |
| Refunds | (41,664,216) |
| Net Change in Total Pension Liability | <u>(4,327,982,456)</u> |
| Total Pension Liability - Beginning | <u>20,796,533,408</u> |
| Total Pension Liability - Ending (a) | <u>\$ 16,468,550,952</u> |
| | |
| Plan Fiduciary Net Position | |
| Contributions - Employer | \$ 299,657,530 |
| Contributions - Member | 250,529,546 |
| Net Investment Income | 1,016,865,792 |
| Benefit Payments | (811,665,051) |
| Refunds | (41,664,216) |
| Administrative Expense | (10,985,967) |
| Other | - |
| Net Change in Plan Fiduciary Net Position | <u>702,737,634</u> |
| | |
| Plan Fiduciary Net Position - Beginning | <u>9,488,961,169</u> |
| Plan Fiduciary Net Position - Ending (b) | <u>\$ 10,191,698,803</u> |
| | |
| Net Pension Liability - Ending (a) - (b) | <u>\$ 6,276,852,149</u> |

Notes to Schedule:

The change in total pension liability due to assumption changes includes the impact of the new assumptions adopted by the Board on April 26, 2013 as well as the change in the single discount rate between June 30, 2012 and June 30, 2013. The covered employee payroll is the actual payroll, imputed from the total employer contributions, for the fiscal year ending June 30, 2013.

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF THE EMPLOYERS' NET PENSION LIABILITY**

(Unaudited)

Fiscal year ending June 30,

| | 2013 |
|---|-------------------------|
| Total Pension Liability | \$ 16,468,550,952 |
| Plan Fiduciary Net Position | <u>10,191,698,803</u> |
| Net Pension Liability | <u>\$ 6,276,852,149</u> |
| Plan Fiduciary Net Position as a Percentage of a Total Pension Liability | 61.89% |
| Covered Employee Payroll | \$ 2,706,170,349 |
| Net Pension Liability as a Percentage of Covered Employee Payroll | 231.95% |

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF THE EMPLOYER CONTRIBUTIONS**

(Unaudited)

| FY Ending June 30 | Actuarially Determined Contribution | Actual Contribution | Contribution Deficiency (Excess) | Covered Payroll | Actual Contribution as a % of Covered Payroll |
|------------------------------|--|--------------------------------|---|------------------------|--|
| 2013 | \$480,700,326 | \$299,657,530 | \$181,042,796 | \$2,706,170,349 | 11.07% |

Notes to Schedule:

The change in total pension liability due to assumption changes includes the impact of the new assumptions adopted by the Board on April 26, 2013 as well as the change in the single discount rate between June 30, 2012 and June 30, 2013 and the impact of the implementation of GASB 67. The covered employee payroll is the actual payroll, imputed from the total employer contributions, for the fiscal year ending June 30, 2013.

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF INVESTMENT RETURNS**

(Unaudited)

| <u>FY Ending June 30</u> | <u>Annual Money-Weighted Rate of Return, Net of Investment Expense</u> |
|-------------------------------------|---|
| 2013 | 11.12% |
| 2012 | 1.87% |
| 2011 | 19.30% |

OTHER SUPPLEMENTARY INFORMATION

*Significant revenues and non-administrative expenses are not budgeted (see Note 1).

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF REVENUES AND EXPENSES
BUDGET AND ACTUAL (NON-GAAP BASIS)
For the Year Ended June 30, 2013

| | Original Budget | Final Budget | Actual Budgetary Basis | Variance— Final Budget Favorable (Unfavorable) |
|--|----------------------|-------------------|------------------------------|---|
| REVENUES: | | | | |
| Other state funds | \$ 37,823,300 | 37,823,300 | 37,823,300 | - |
| TOTAL BUDGETED REVENUE | <u>\$ 37,823,300</u> | <u>37,823,300</u> | <u>37,823,300</u> | <u>-</u> |
| EXPENSES: | | | | |
| Personal services and employee benefits | \$ 4,888,600 | 4,888,600 | 4,366,501 | 522,099 |
| Contractual services | 32,097,700 | 32,097,700 | 20,622,004 | 11,475,696 |
| Other costs | 837,000 | 837,000 | 723,216 | 113,784 |
| TOTAL EXPENSES | <u>\$ 37,823,300</u> | <u>37,823,300</u> | <u>25,711,721</u> | <u>12,111,579</u> |

RECONCILIATION OF GAAP BASIS TO BUDGETARY BASIS:

| | |
|---|------------------------|
| Revenue GAAP basis | \$ 1,567,052,867 |
| Net depreciation in investment value | 837,193,133 |
| Investment advisor and custody fees | (15,421,101) |
| Current-year revenue not needed for budgeted expenses | <u>(2,351,001,599)</u> |
| Revenue (non-GAAP) budgetary basis | <u>\$ 37,823,300</u> |
| Expenses GAAP basis—administrative | \$ 10,985,967 |
| Depreciation expense | (695,347) |
| Investment advisor and custody fees | <u>15,421,101</u> |
| Expenses (non-GAAP) budgetary basis | <u>\$ 25,711,721</u> |

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF CASH ACCOUNTS
As of June 30, 2013 and 2012**

**Educational Employees' Retirement Fund
Pension Trust Account
Fund 605**

| | <u>2013</u> | <u>2012</u> |
|--|-----------------------|-----------------------|
| Petty cash | \$ 100 | \$ 100 |
| Qualified Excess Benefit Arrangement Trust Checking Account at Wells Fargo Bank | 23,836 | 21,201 |
| Short-term investment accounts: | | |
| Overnight repurchase agreement pool—State Treasurer | 5,353,975 | 5,521,436 |
| Short-Term Investment Fund—STIF | <u>746,599,116</u> | <u>317,035,595</u> |
| Balance per financial statements | <u>\$ 751,977,027</u> | <u>\$ 322,578,332</u> |
| Pledged collateral for Wells Fargo demand deposit account: | | |
| Total amount on deposit at June 30 | \$ 23,836 | \$ 21,201 |
| Less Federal Deposit Insurance Corporation coverage | <u>(23,836)</u> | <u>(21,201)</u> |
| Total uninsured public funds | <u>\$ -</u> | <u>\$ -</u> |

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF ADMINISTRATIVE, CONSULTANT, AND BUDGETED INVESTMENT EXPENSES
For the Year Ended June 30, 2013**

| | <u>2013</u> |
|--|----------------------|
| Personal Services and Benefits | |
| Salaries | \$ 3,072,614 |
| Benefits | 1,293,887 |
| Total Personal Services and Benefits | <u>4,366,501</u> |
| Consultant Services | |
| Medical Review Board Fees | 18,825 |
| Audit Fees | 95,581 |
| Legal Fees | 1,362,304 |
| Information Technology Fees | 1,423,811 |
| Other Consultant Services Fees | 56,192 |
| Total Consultant Services Expenses | <u>2,956,713</u> |
| Budgeted Investment Expenses | |
| Custodial Expenses | 736,911 |
| Investment Manager Expenses | |
| Domestic Equity | 2,117,078 |
| Domestic Fixed Income | 8,303,233 |
| Non-US Equity | 3,778,024 |
| Non-US Fixed Income | 485,855 |
| Investment Consulting Expenses | 1,666,008 |
| Other Investment Expenses | 578,183 |
| Total Budgeted Investment Expenses | <u>17,665,292</u> |
| Other Administrative Expenses | |
| Building and Maintenance | 139,669 |
| Dues and Subscriptions | 39,219 |
| Employee and Board Travel | 100,724 |
| Inventory and Supplies | 208,375 |
| IT Equipment | 52,408 |
| Training and Education | 32,002 |
| Telecommunication Services | 108,593 |
| Utilities | 28,995 |
| Other Miscellaneous Expenditures | 13,231 |
| Total Other Administrative Expenses | <u>723,216</u> |
| Total Administrative, Consultant & Budgeted Investment Expenses | <u>\$ 25,711,722</u> |

**STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF ACCOUNTABILITY IN GOVERNMENT ACT
PERFORMANCE MEASURES
As of June 30, 2013
(Unaudited)**

| Type | Description | Target | Actual |
|-------------|--|---------------|---------------|
| Outcome | Average number of days to process refund requests | 15 | 7 |
| Outcome | Percentage of member satisfaction with seminars and trainings | 95% | 98% |
| Outcome | Average rate of return over a cumulative five-year period | 7.75 % | 5.80 % |
| Output | Number of benefit estimates and purchase of service requests computed annually | 7,500 | 6,009 |
| Output | Number of member workshops conducted | 30 | 26 |
| Outcome | Funding period of UAAL in years | ≤ 30 | 92 |

ADDITIONAL INFORMATION

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

We have audited, in accordance with the 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, the Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position of the New Mexico Educational Retirement Board (the “ERB”) as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the ERB’s basic financial statements, and have issued our report thereon dated November 1, 2013. We have also audited the Schedule of Revenues, Appropriations and Expenses-Budget to Actual (Non-GAAP) for the New Mexico Educational Retirement Board presented as supplementary information, as defined by the Government Accounting Standards Board, in the accompanying financial statements as of and for the year ended June 30, 2013, as listed in the table of contents.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered ERB’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ERB’s internal control. Accordingly, we do not express an opinion on the effectiveness of ERB’s internal control.

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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ERB's financial statements are free from 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2013-1, and 2013-2.

ERB's Response to Findings

ERB's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. ERB's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

The Members of the State of New Mexico
Educational Retirement Board
and
Mr. Hector H. Balderas
New Mexico State Auditor

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Mess Adams LLP

Albuquerque, New Mexico
November 1, 2013

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS
For the Year Ended June 30, 2013

| | |
|---|----------|
| 2009-1 Unfunded Accrued Actuarial Liability | Resolved |
| 2012-1 Procurement Card – Purchase Limits | Resolved |

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended June 30, 2013**

**A. OTHER MATTERS AS REQUIRED BY THE NEW MEXICO STATE AUDIT
RULE**

2013-1 Timely Deposits – Non-compliance

CONDITION

In 2 out of 3 items tested, we noted that ERB did not deposit cash receipts before the close of the next business day. We noted that these two instances occurred within the first half of the fiscal year. These 2 instances consisted of the deposit amounts of \$2,929, which was deposited within 3 days of receipt and \$3,694, which was deposited within 2 days of receipt. We reviewed the cash receipt log and did not note any instances of noncompliance after January 1, 2013.

CRITERIA

According to 6-10-3 NMSA 1978, State agencies receiving money in cash or by check, draft or otherwise for or on behalf of the State or agency are required before the close of the next succeeding business day after the receipt of the money to deliver or remit it to the State Treasurer.

EFFECT

The ERB was not in compliance with New Mexico State Statutes during the year.

CAUSE

The ERB did not have appropriate controls in place to ensure timely deposits.

RECOMMENDATION

We recommend that policies and procedures be implemented to ensure that receipt of money is deposited within the statutory requirement.

MANAGEMENT RESPONSE

Management became aware of the situation regarding untimely deposits in December 2012. Management modified the internal procedures to deposit all cash receipts by the close of the next succeeding business day.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2013**

**A. OTHER MATTERS AS REQUIRED BY THE NEW MEXICO STATE AUDIT
RULE**

2013-2 Financial Close & Reporting Untimely Reconciliations – Non-compliance

CONDITION

During our review of ERB's internal controls over financial close and reporting, we noted that the December 2012 bank reconciliation was not reconciled until after June 30, 2013.

CRITERIA

NMAC 2.20.5.8.C (4)

Cash account records are reconciled timely each month to the division's reports and to the state treasurer's reports."

EFFECT

During our review we did not note any errors, however untimely reconciliations may lead to increased risk of a misstatement.

CAUSE

The ERB did not provide adequate time to performing certain accounting functions.

RECOMMENDATION

We recommend that appropriate procedures be implemented to ensure cash reconciliations are performed in a timely manner.

MANAGEMENT RESPONSE

During fiscal year 2013, the accounting department experienced staff shortages. The staff shortages required Management to prioritize tasks. The cash reconciliation was a task that received a lower priority. As of the date of this report, the accounting department is sufficiently staffed and has completed the cash reconciliation through September 2013.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
EXIT CONFERENCE
Year Ended June 30, 2013**

Board staff prepared the Management's Discussion & Analysis ("MD&A"), financial statements, statements, schedules, and notes for the fiscal years ended June 30, 2013 and 2012. The contents of this report were discussed during an exit conference with the Audit Committee of the Board of Directors and management of ERB on November 1, 2013. The following individuals attended this exit conference:

Educational Retirement Board

Members of the Audit Committee –
Mary Lou Cameron, Audit Committee Chairperson
Paul Aguilar, Audit Committee Member
Brad Day, Audit Committee Member

Agency Management –
Jan Goodwin, Executive Director
Rick Scroggins, Deputy Director
Sara Brownstein, Chief Financial Officer

Moss Adams LLP

Lisa Todd, Senior Manager

The contents of this report will be presented to the ERB Board of Directors as part of the regular board meeting.