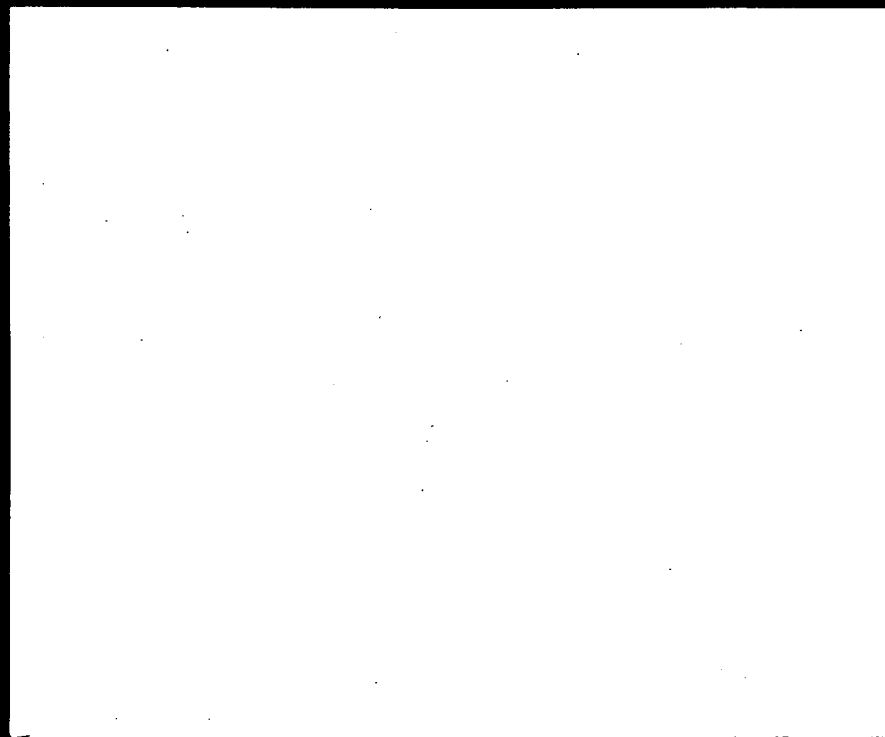


# State of New Mexico

## Educational Retirement Board

*Striving to serve the needs of all  
of our members ... all of the time*



Comprehensive Annual Financial Report  
Fiscal Year Ended June 30, 2002

The Educational Retirement Board is proud of New Mexico's multicultural heritage. In this 2002 Annual Report we are saluting women from all cultures throughout New Mexico's history. Here are some New Mexico women who made a difference:

- Susie Rayos Marmon (1877-1988) on page 5
- Nina Otero-Warren (1881-1965) on page 11
- Myrtle Attaway Farquhar (1900-1972) on page 19
- Florence Hawley Ellis (1917-1991) on page 39
- Graciela Olivarez (1928-1987) on page 73



“Sister Sister” by Patricia M. Ryan

*“We need to help students and parents cherish and preserve the ethnic and cultural diversity that nourishes and strengthens this community - and this nation”*  
Cesar Chavez



## **Mission of the Educational Retirement Board**

The New Mexico Educational Retirement Board is a statutory entity that provides secure retirement benefits for our active and retired members from school districts, higher education and educational agencies.

We strive to make our members' retirement experience optimal by:

- Prudently managing the financial assets of the fund;
- Providing prompt, courteous and accurate responses to members' inquiries;
- Counseling members on an individual basis related to retirement issues;
- Educating members about both the financial and personal aspects of retirement;
- Educating members about ways to advocate for improving benefits; and
- Soliciting member input for improving services.

We are consistently building the skills, capacities, and competencies of our employees in order to provide our members caring and quality service.

## Table of Contents

### Introduction

Letter to Members, Retiree's and Friends	6
Educational Retirement Board of Trustees	7
Educational Retirement Board Overview	8
Administrative Organization	9
Consultants and Professional Services	10

### Plan Summary

Membership	12
Participating Employers	13
Growth of Retired Participants	14
History of Contribution Rates	14
Summary of Plan Provisions	15
Membership Data	18

### Financial Status

Independent Auditor's Report	20
Statement of Plan Net Assets	21
Statement of Changes in Plan Net Assets	22
Notes to Financial Statements	23

### Actuarial Report

Letter of Transmittal	40
Executive Summary	42
Actuarial Information and Narrative	43
Actuarial Exhibits	47

### Investment Section

Investment Overview	74
Investment Performance Review	75
Asset Allocation	76
Fixed Income	77
Domestic and International Equities	77
Securities Lending Program	78



## INTRODUCTION

Letter to Members, Retiree's and Friends	6
Board of Trustees	7
Educational Retirement Board Overview	8
Administrative Organization	9
Consultants and Professional Services	10

**Susie Rayos Marmon (1877-1988):** A great educator who taught at Isleta, New Mexico. After a career spanning 30 years, she retired in the 1960s and became active in tribal affairs.

Throughout her life she continued to stress the importance of education for the American Indian. The Susie Rayos Marmon Elementary School bears her name.



## Introduction

### Letter to Members, Retiree's and Friends

Dear Members, Retirees and Friends:

We are pleased to present the Comprehensive Annual Report for the fiscal year ended June 30, 2002. This year marks the completion of our 43rd year of service to the educators of New Mexico. We are proud of our accomplishments in providing excellent retirement benefits, sound financial management and a high degree of service to our members.

This report contains:

- 1 An introductory section of general information about the Board and the organization.
- 2 A plan summary, which gives a description of membership and benefits.
- 3 A financial section containing the financial statements and audit report.
- 4 An actuarial report detailing our current position and projections for the future.
- 5 An investment section that presents an overview of our investing program and the results achieved.

The responsibility for both the accuracy of the data and the completeness and fairness of the report, rests with the staff of the Board. To the best of our knowledge and judgement, this report represents an accurate presentation, in all material aspects, of the financial and actuarial status of the program.

The report shows that the Educational Retirement Fund suffered a second year of disappointing investment returns during 2002, however, the long-term funding picture of the plan continues to be stable. The unfunded liability is \$1,153 million, compared to the fiscal year 2001 figure of \$652 million, and the funding period in years went from 12.5 to 27.2. The financial and actuarial statistics comply with all national standards for public pension funds.

The past two years have been difficult ones for our country. We have been beset by a recession complicated by corporate misconduct and dishonesty that, by some estimates, has wiped out \$8 trillion of paper wealth in this country. At times like this, it helps to keep things in perspective. We have seen this country come through many difficult political, social and economic times. During this recent period of unrest, the Educational Retirement Board and staff have made decisions, not only with a review of the present, but also with an eye to the future. ERB has never failed to send its pension checks out on the first of the month, every month, to its retirees. This will not change..

The financial soundness of the ERA's retirement plan is very important as over 100,000 New Mesicans count on us for management of one of their largest assets. The Board and Staff take this responsibility very seriously. Our goals continue to be to insure the long-term stability of the plan and provide the highest level of service.

Sincerely,

Danny Joe Lyle  
Director

**The Educational Retirement  
Board of Trustees  
as Constituted on June 30, 2002**

**Delman Shirley**, Chairperson

Current term expires December 31, 2004

Elected by New Mexico Association of Educational Retirees

**Dr. Pauline Turner**, Vice-Chairperson

Current term expires June 30, 2004

Elected by American Association of  
University Professors

**Mary Lou Cameron**, Member

Current term expires December 31, 2005

Elected by New Mexico National  
Education Association

**Julie P. Neerken**, Secretary

Current term expires June 10, 2002

Appointed by the Governor

**Michael Davis**, Member

Superintendent of Public Instruction

Ex-Officio Member

**Bruce Malott**, Member

Current term expires June 10, 2003

Appointed by the Governor

**Michael Montoya**, Member

New Mexico State Treasurer

Ex-Officio Member



*(left to right: Michael Montoya, Pauline Turner, Bruce Malott, Julie Neerken, Delman Shirley, Mary Lou Cameron, Michael Davis)*



### Educational Retirement Board

**Board of Trustees:** The management of the Educational Retirement Board (ERB) is vested in a board of seven members. The Board stands in a fiduciary relationship to the members covered under the Educational Retirement Act (ERA). Administrative management of the fund is vested in a Director who is appointed by the Board of Trustees. The Board contracts with an actuary and uses legal counsel provided by the Attorney General's Office, contract counsel and in-house counsel. Benefits are financed by employee and employer contributions and investment earnings. Board meetings are held bimonthly.

**Investment Committee:** The role of the Investment Committee is to establish and recommend policy to the Board in matters relating to the investments of the system. The Investment Committee is composed of the Director and three members of the Board appointed by the chairperson. The Investment Committee holds bimonthly meetings.

**Executive Office:** The executive office is responsible for the overall management of the retirement system to achieve the primary objectives as established by the Board of Trustees.

**The Director** is responsible for administering the Educational Retirement Act. Additionally, the Director certifies expenditures of the fund.

**The Deputy Director** provides administrative and managerial assistance in the overall management of the ERB.

**The Investment Division** is responsible for the investment activities of the retirement fund. The ERB portfolio is managed partially in-house and partially by contract managers.

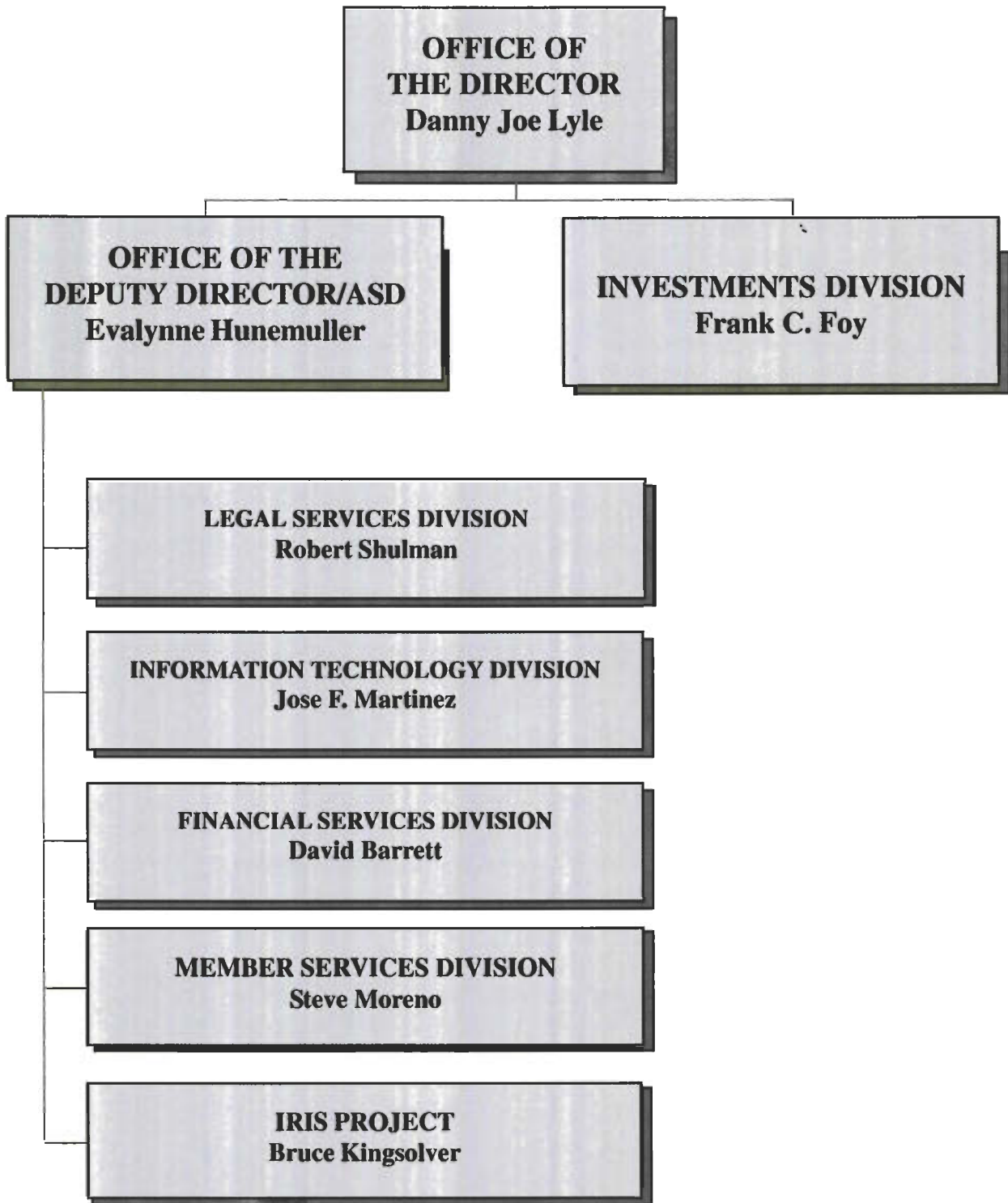
**The Legal Division** is responsible for advising the Board in all litigation matters and providing counsel on a wide variety of issues including the interpretation of the ERA.

**The Benefits Division** provides professional retirement counseling to members from the time of enrollment through the process of retirement. This division also administers the annuitant payroll and refund of contributions.

**The Accounting Division** has the responsibility for planning, organizing, and directing a complete accounting and financial reporting system and ensuring appropriate accounting controls.

**The Information Technology Division** is responsible for planning and controlling all information systems' activities within the ERB. Additionally, the division formulates short-term and long-term technology plans.

**Administrative Organization**



## Introduction

### Consulting and Professional Services

To assist the Board and administration in carrying out its fiduciary duty regarding the prudent investment of the fund's assets, the Board has hired an actuarial firm and investment consultant.

The actuarial firm chosen by the Board is responsible for:

- Certifying the adequacy of the contribution rate used by the System;
- Measuring and reporting the assets and liability of the System; and
- Reviewing and analyzing trends in the System's contributions.

The investment consultant chosen by the Board is responsible for advising the Board regarding:

- Returns earned by the Fund and by each of its managers relative to both its benchmark and a peer group of public pension funds.
- Analysis of investment style, risk and return of the Fund's investment managers.
- Asset allocation strategies.
- Selection of external managers.

To assist the Board in carrying out its duty regarding disability benefits, the Board has engaged the services of three physicians as the Medical Review Board.

The Medical Review Board is responsible for:

- Reviewing all disability examination reports; and
- Advising the ERB of the nature and extent of the disability.

The Office of the Attorney General provides legal counsel to the ERB.

The Groom Law Group of Washington, D.C. provides legal tax counsel.

An independent Certified Public Accountant conducts the financial audit of the ERB.

## PLAN SUMMARY

Membership	12
Participating Employers	13
Growth of Retired Participants	14
History of Contribution Rates	14
Summary of Plan Provisions	15
Membership Data	18

**Nina Otero-Warren** (1881-1965): Appointed school superintendent of Santa Fe and State Republican Party Chief. While Party Chief, she paved the road for female participation in politics. Although New Mexico was the last of the western states to obtain suffrage, much of the credit is due to Nina Otero-Warren.



## Plan Summary

### Membership

The State of New Mexico Educational Retirement Board (Board) was created by the Educational Retirement Act, Section 22-11-1 through 22-11-52, NMSA 1978, as amended, to administer and have the responsibility for operating the Educational Employees' Retirement Plan. The Plan is a cost-sharing, multiple-employer plan established and administered by the Board to provide retirement, disability, and death benefits for all certified teachers and other employees of the State of New Mexico (the State) educational institutions, junior colleges, and technical-vocational institutions.

The Board is an agency of the State of New Mexico. The Plan administered by the Board is considered part of the State of New Mexico financial reporting entity and is a pension trust fund of the State of New Mexico.

The Board has developed criteria to determine whether other state agencies, boards or commissions, which benefit the members of the Board, should be included within its financial reporting entity. The criteria include, but are not limited to, whether the Board exercises oversight responsibility on 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 no such other entities should be included in its financial reporting entity.

Membership in the Plan is a condition of employment. Employees of public schools, universities, junior colleges, technical vocational institutions, state special schools, and state agencies providing an educational program who are employed more than twenty-five percent of the time are required to be members of the Plan.

Faculty and professionals initially employed after July 1, 1991, with one of the six four-year institutions of higher education may elect to participate in the Plan or an Alternate Retirement Plan (ARP) administered by ERB. The election must be made within ninety (90) days of employment and is irrevocable.

At June 30, 2002, there were 61,091 members covered under the ERA by 129 actively contributing employers.

**Participating Employers**  
**June 30, 2002**

**PUBLIC SCHOOLS:**

Alamogordo  
 Albuquerque  
 Animas  
 Artesia  
 Aztec  
 Belen  
 Bernalillo  
 Bloomfield  
 Capitan  
 Carlsbad  
 Carrizozo  
 Central Consolidated  
 Chama Valley  
 Cimarron  
 Clayton  
 Cloudcroft  
 Clovis  
 Cobre Consolidated  
 Corona  
 Cuba  
 Deming  
 Des Moines  
 Dexter  
 Dora  
 Dulce  
 Elida  
 Espanola  
 Estancia  
 Eunice  
 Farmington  
 Floyd  
 Fort Sumner  
 Gadsen Independent  
 Gallup McKinley County  
 Grady  
 Grants-Cibola  
 Hagerman  
 Hatch Valley  
 Hobbs  
 Hondo Valley  
 House  
 Jal  
 Jemez Mountain  
 Jemez Valley  
 Lake Arthur

Las Cruces  
 Las Vegas City  
 Logan  
 Lordsburg  
 Los Alamos  
 Los Lunas  
 Loving  
 Lovington  
 Magdalena  
 Maxwell  
 Melrose  
 Mesa Vista Consolidated  
 Mora Independent  
 Moriarty  
 Mosquero  
 Mountainair  
 Pecos Independent  
 Penasco Independent  
 Pojoaque Valley  
 Portales  
 Quemado  
 Questa Independent  
 Raton  
 Reserve Independent  
 Rio Rancho  
 Roswell Independent  
 Roy  
 Ruidoso  
 San Jon  
 Santa Fe  
 Santa Rosa Consolidated  
 Silver Consolidated  
 Socorro Consolidated  
 Springer  
 Taos  
 Tatum  
 Texico  
 Truth or Consequences  
 Tucumcari  
 Tularosa  
 Vaughn  
 Wagon Mound  
 West Las Vegas  
 Zuni

**COLLEGES & UNIVERSITIES:**

Albuquerque TVI  
 Clovis Community College  
 Eastern New Mexico University  
 Eastern New Mexico Univ. at Roswell  
 Luna Area Vocational School  
 Mesa Technical College  
 New Mexico Highlands University  
 New Mexico Institute Mining & Tech.  
 New Mexico Junior College  
 New Mexico State University  
 Northern NM Community College  
 San Juan College  
 Santa Fe Community College  
 University of New Mexico  
 Western New Mexico University

**SPECIAL SCHOOLS:**

New Mexico Boys School  
 New Mexico Military Institute  
 New Mexico School for the Deaf  
 NM School for Visually Handicapped  
 Youth Diagnostic Center

**STATE AGENCIES:**

Children, Youth & Families  
 NM Educational Retirement Board  
 NM Dept. of Corrections  
 NM Dept. of Health & Environment  
 NM Dept. of Education  
 NM Activities Association  
 NM Dept. of Vocational Rehabilitation  
 High Plains Regional Cooperative  
 Region IX-RD Cooperative  
 Central Regional Cooperative

**CHARTER SCHOOLS:**

Academy for Technology & Classics  
 Amistad Elementary Charter School  
 Amy Biehl Charter High School  
 East Mountain High School  
 Monte del Sol Charter School  
 San Diego Riverside Charter School  
 South Valley Charter High School  
 Southwest Secondary Learning  
 Taos Municipal Charter School  
 Twenty-First Century Charter School

## Plan Summary

### Growth of Retired Participants

Year Ending <u>June 30</u>	<u>Number</u>	All Retirees <u>Average Monthly Benefit</u>
(1)	(2)	(3)
1982	7,567	\$ 393
1984	8,462	430
1986	10,004	512
1988	11,375	663
1990	12,741	767
1992	14,107	846
1993	15,001	890
1994	15,814	933
1995	16,593	973
1996	17,381	1,011
1997	18,317	1,055
1998	19,244	1,104
1999	20,109	1,139
2000	21,186	1,228
2001	22,191	1,274
2002	23,052	1,315

### History of Contribution Rates

Fiscal Year <u>Beginning July 1</u>	<u>Employee Rate</u>	<u>Employer Rate</u>	<u>Total Rate</u>
(1)	(2)	(3)	(4)
1982	6.80%	6.80%	13.60%
1984	7.60	7.60	15.20
1986	7.60	7.60	15.20
1988	7.60	7.60	15.20
1990	7.60	7.60	15.20
1992	7.60	7.60	15.20
1993	7.60	8.65	16.25
1994	7.60	8.65	16.25
1995	7.60	8.65	16.25
1996	7.60	8.65	16.25
1997	7.60	8.65	16.25
1998	7.60	8.65	16.25
1999	7.60	8.65	16.25
2000	7.60	8.65	16.25
2001	7.60	8.65	16.25
2002	7.60	8.65	16.25

## Summary of Plan Provisions

1. **Effective Date:** July 1, 1967.
2. **Plan Year:** Twelve-month period ending June 30th.
3. **Administration:** The Educational Retirement Board is responsible for administration of the System and investment of System assets.
4. **Type of Plan:** The System is a qualified, defined benefit, governmental retirement plan. For government accounting purposes, it is a cost-sharing multiple-employer Public Employee Retirement System.
5. **Eligibility:** All teachers, nurses and administrators employed by public schools in New Mexico, including public colleges and universities, participate in the System. These are the "regular members", and their participation is a condition of employment. However, see the section on the Alternative Retirement Plan below for an exception. Generally, other employees of these schools are also required to participate, although such employees employed continuously since June 30, 1971 may exempt themselves. Certain other employees of various state schools and agencies also participate.
6. **Member Contributions:** All active members contribute 7.6% of their earnings. Substantially all earnings are included for this purpose. Employee contributions are "picked up" by the local employer for federal income tax treatment.
7. **Employer Contributions:** The school district or other local administrative unit which employs a member contributes 8.65% of the member's earnings. In addition, state universities, colleges and junior colleges contribute 3% of the earnings of non-members who are participating in the Alternative Retirement Plan.
8. **Service:** Employees receive credit for each calendar quarter in which they are contributing members. Credit is also granted for service prior to the System's effective date, and certain military service. Credit may also be purchased for some out-of-state service under certain circumstances.
9. **Final Average Compensation (FAC):** The average of the member's earnings for the last five consecutive years, or such other five consecutive year period that gives the largest average. Monthly benefits are based on one-twelfth of this amount.
10. **Normal Retirement**
  - a. **Eligibility:** A member may retire upon Normal Retirement on the earliest of (i) the date he/she attains age 65 with credit for 5 years of service, or (ii) the date the member completes 25 years of service, or (iii) the date that the sum of the member's age and service is at least 75, provided the member is at least age 60.
  - b. **Monthly Benefit:** 2.35% of FAC (monthly) times years of service.
  - c. **Payment Form:** Benefits are paid as a monthly life annuity, with a guarantee that if the payments made do not exceed the member's accumulated contributions with interest, determined as of the date of retirement, the balance will be paid in a lump-sum to the member's beneficiary. Optional forms of payment are available; see following.



## Plan Summary

### 11. Early Retirement

- a. **Eligibility:** A member may take early retirement once the sum of his/her age and service equals or exceeds 75.
- b. **Monthly Benefit:** 2.35% of FAC (monthly) times years of service, multiplied by the early retirement factor below.

- c. **Early Retirement Factor:**

Age at Retirement	Factor
60 or later	1.000
59	.976
58	.952
57	.928
56	.904
55	.880
54	.808
53	.736
52	.664
51	.592
50	.520
49	.448
48	.376
47	.304
46	.232
45	.160

- d. **Payment Form:** Same as for Normal Retirement above.

### 12. Disability Retirement

- a. **Eligibility:** A member is eligible provided (i) he/she has credit for at least 10 years of service, and (ii) the disability is approved by the Board.
- b. **Monthly Benefit:** 2% of FAC (monthly) times years of service, but not less than the smaller of (i) one-third of

FAC, or (ii) 2% of FAC times years of service projected to age 60.

- c. **Payment Form:** 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 sum of the member's accumulated contributions with interest as of the date of retirement, the balance will be paid in a lump-sum to the member's beneficiary. If the disabled member survives to age 60, the regular optional forms of payment are available.

### 13. Vested Termination Benefit

- a. **Eligibility:** A member with at least 5 years of service who does not withdraw his/her contributions from the fund is eligible for a vested termination benefit.
- b. **Monthly Benefit:** 2.35% of FAC (monthly) times years of service. Both FAC and service are determined at the time the member leaves active employment.

- c. **Payment Form:** Benefits commence when the participant attains his/her normal retirement age. Optionally benefits may commence at the early retirement age, applying the same reduction factors as are used for regular early retirement. The form of payment is the same as for Normal Retirement above.

### 14. Withdrawal (Refund) Benefit

- a. **Eligibility:** All members leaving covered employment with less than 5 years of service for a reason other than

the member's death. Optionally, members eligible for other benefits may withdraw their contributions in lieu of the regular benefits due.

- b. **Benefit:** The member who elects to withdraw receives a lump-sum payment of his/her employee contributions, plus interest computed at a rate equal to 75% of the five-year average return for the trust fund.

### 15. Death in Service

**Benefit:** Upon the death of an active member, the beneficiary may receive a refund of the member's contributions, plus interest based upon the yield for the trust fund during the preceding year.

Alternatively, if the member has five or more years of service, the beneficiary may elect to receive an annuity determined as though the member had retired, elected option B below, and then died. If the member is not eligible for early or normal retirement, this benefit may still be elected, with payments deferred until the member would have been eligible for retirement.

- 16. **Optional Forms of Payment:** There are optional forms of payment available on an actuarially equivalent basis, as follows:

- a. **Option B - A Joint and 100% Survivor annuity with a "pop-up" feature.** The regular life annuity amount is reduced to provide a Joint and 100% Survivor benefit, i.e., a benefit payable as long as either the member or his joint annuitant shall live. However, if the joint annuitant predeceases the member, then the member's benefit amount reverts back to the regular life annuity amount. The "pop-up" feature is subsidized by the System.

- b. **Option C - A Joint and 50% Survivor annuity with a pop-up feature.** The benefit is reduced to provide a Joint and 50% Survivor benefit, i.e., a benefit payable as long as both the member and the joint annuitant are alive, reducing to 50% of this amount upon the member's death, if the joint annuitant is still living. If the joint annuitant predeceases the member, the benefit reverts to the regular life annuity amount. The pop-up feature is subsidized by the System.

- 17. **Cost-of-living Increase:** All retired members and beneficiaries receiving benefits receive an automatic adjustment in their benefit each July, beginning in the year they attain age 65. The adjustment is equal to one-half the change in the cost of living, except that the adjustment shall not exceed four percent, nor be less than two percent. Members retired prior to July 1, 1984 are also entitled to an increase of the lesser of 2% or the increase in the cost of living for years prior to the attainment of 65. Members on disability are entitled to an adjustment commencing on July 1 of the third full year following disability retirement.

- 18. **Alternative Retirement Plan (ARP):** Beginning July 1, 1991, new faculty members employed by state universities may elect participation in the ARP rather than in this System. If this election is not made, the employee remains a member of this System permanently. No benefits are paid to ARP members from ERB. Also see the section on Employer Contributions above.

## Plan Summary

### Membership Data

	June 30, 2002 (1)	June 30, 2001 (2)
<b>1. Active members</b>		
a. Number	61,091	60,155
b. Total payroll supplied by System (annualized)	\$ 1,978,528,267	\$ 1,819,553,855
c. Average salary	\$ 32,387	\$ 30,248
d. Average age	45.2	44.9
e. Average service	9.3	9.2
<b>2. Vested inactive members (excluding pending refunds)</b>		
a. Number	5,217	4,800
b. Total annual deferred benefits	\$ 29,601,294	\$ 26,345,464
c. Average annual deferred benefit	5,674	5,489
<b>3. Nonvested inactive members and vested pending refunds</b>		
a. Number	14,714	13,401
b. Employee assessments with interest due	\$ 40,586,228	\$ 36,138,814
c. Average refund due	2,758	2,697
<b>4. Service retirees</b>		
a. Number	20,699	19,930
b. Total annual benefits	\$ 340,775,737	\$ 317,670,322
c. Average annual benefit	16,463	15,939
<b>5. Disabled retirees</b>		
a. Number	589	580
b. Total annual benefits	\$ 4,405,617	\$ 4,235,904
c. Average annual benefit	7,480	7,303
<b>6. Beneficiaries</b>		
a. Number	1,764	1,681
b. Total annual benefits	\$ 18,707,056	\$ 17,251,985
c. Average annual benefit	10,605	10,263

Note: Retirement benefits include impact of July 1 cost-of-living increases.

## FINANCIAL STATUS:

Independent Auditor's Report	20
Statement of Plan Assets	21
Statement of Changes in Plan Net Assets	22
Notes to Financial Statements	23

Myrtle Attaway Farquhar (1900-1972): Teacher in the Hobbs public school system who was an inspiration to many of her students and peers. Inducted into the Southeastern New Mexico Education Association Hall of Fame in 1969 on the recommendation of the Hobbs Teacher Association. Helped establish the Washington Heights Nursery School which grew into a community project. A street in Hobbs is named in honor of her and her husband.



# INDEPENDENT AUDITORS' REPORT

Members of the State of New Mexico Educational Retirement Board and  
Mr. Domingo Martinez, New Mexico State Auditor  
Santa Fe, New Mexico

We have audited the accompanying statement of plan net assets and statement of changes in plan net assets of the State of New Mexico Educational Retirement Board (the "ERB") as of and for the year ended June 30, 2002, as listed in the foregoing table of contents. These financial statements are the responsibility of ERB's management. Our responsibility is to express an opinion on these financial statements based on our audit. The statement of plan net assets and changes in plan net assets of the ERB as of and for the year ended June 30, 2001, were audit by other auditors, whose report dated December 12, 2001, expressed an unqualified opinion on those financial statements.

We conducted our audit 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements of the ERB are intended to present the net assets and changes in net assets of only that portion of the funds of the State of New Mexico (the "State") which are attributable to the transactions of the ERB. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of ERB, as of June 30, 2002, and changes in its financial status for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the statement 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 2.

Management's Discussion and Analysis and the Required Supplementary Information of Funding Progress and of Employer Contributions are not a required part of the financial statements, but are supplementary information required by the GASB. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming an opinion on the financial statements of ERB taken as a whole. The accompanying financial information listed in the table of contents, including Statement 3 and Schedules 1 through 5, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole. We were not engaged to audit the non-financial information included in Schedule 6 and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2002, on our consideration of ERB's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit

Deloitte & Touche, LLP  
December 6, 2002

## Statements of Plan Net Assets June 30, 2002 and 2001

<b>Assets</b>	<b>2002</b>	<b>2001</b>
Cash and short-term investments (Note 3)	\$ 189,327,483	104,653,543
Receivables (Note 4)		
Contributions	42,979,199	43,866,087
Investment sales proceeds-brokers	44,555,672	47,907,015
Interest and dividends	27,183,401	27,886,454
Other	1,526	13,357
Total receivables	114,719,798	119,672,913
Investments, at fair value (Note 5)		
U. S. Treasury securities	455,999,937	580,929,000
U. S. Government agency securities	801,770,798	820,044,813
Domestic corporate bonds	601,700,740	681,938,490
Domestic stocks	2,898,146,632	3,005,398,454
Commingled mid-cap stocks	-	346,876,264
Commingled international stocks	992,565,074	1,072,736,336
Invested securities lending collateral	849,455,775	458,223,989
Total investments	6,599,638,956	6,966,147,346
Capital assets, at cost, net of accumulated depreciation of \$1,406,318 and \$1,193,558 respectively (Note 6)	1,425,410	1,139,216
Capital assets in progress (Note 6)	2,205,176	-
Total capital assets	3,630,586	1,139,216
Total assets	\$ 6,907,316,823	7,191,613,018
<b>Liabilities</b>		
Accounts payable	\$ 1,715,936	1,217,349
Accrued payroll and employee benefits	52,225	42,758
Accrued compensated absences (Note 8)	142,134	128,943
Due to other state agencies (Note 7)	156,094	143,566
Refunds payable (Note 9)	2,522,051	3,091,297
Investment purchases payable-brokers	39,860,759	61,695,792
Funds held for others (Note 2.E.)	55,921	67,383
Securities lending collateral	849,455,775	458,223,989
Total liabilities	<u>\$ 893,960,895</u>	<u>524,611,077</u>

### Net assets held in trust for pension benefits

**The accompanying notes are an integral part of these financial statements**

## Financial

### Statement of Changes in Plan Net Assets For the Years Ended June 30, 2002 and 2001

	2002	2001
<b>ADDITIONS</b>		
<b>Contributions</b>		
Employer	\$ 173,863,363	161,524,340
Member	<u>151,378,455</u>	<u>150,068,398</u>
Total contributions	<u>325,241,818</u>	<u>311,592,738</u>
<b>Investment income</b>		
<i>From investing activities</i>		
Net depreciation in fair value of investments (Note 5)	(746,928,008)	(978,572,992)
Interest income	128,989,938	142,566,952
Dividend income	<u>36,924,516</u>	<u>31,142,922</u>
Total investing activity loss	<u>(581,013,554)</u>	<u>(804,863,118)</u>
Investing activity expenses:		
Investment advisor fees	(3,807,364)	(4,487,976)
Custody fees	<u>(484,309)</u>	<u>(302,201)</u>
Total investing activity expenses	<u>(4,291,673)</u>	<u>(4,790,177)</u>
Net loss from investing activities	<u>(585,305,227)</u>	<u>(809,653,295)</u>
<i>From securities lending activities</i>		
Securities lending income	22,250,077	39,773,012
Securities lending expenses:		
Borrower rebates	(19,246,939)	(37,183,529)
Agent fees	<u>(410,539)</u>	<u>(642,939)</u>
Total securities lending expenses	<u>(19,657,478)</u>	<u>(37,826,468)</u>
Net income from securities lending activities	<u>2,592,599</u>	<u>1,946,544</u>
Total net investment loss	<u>(582,712,628)</u>	<u>(807,706,751)</u>
<b>Miscellaneous Income</b>		
Penalties	5,412	18,608
Interest on restoration of service	3,351,634	3,651,403
Other	<u>93,018</u>	<u>19,419</u>
Total additions	<u>(254,020,746)</u>	<u>(492,424,583)</u>
<b>DEDUCTIONS</b>		
Refunds to terminated members	20,103,972	23,684,106
Interest on refunds	8,404,063	12,949,806
Administrative expenses	3,622,362	3,517,803
Age and service benefit payments	362,446,592	335,155,233
Disability benefit payments	<u>5,048,278</u>	<u>5,440,446</u>
Total deductions	<u>399,625,267</u>	<u>380,747,394</u>
Net decrease	(653,646,013)	(873,171,977)
Net assets held in trust for pension benefits		
Beginning of the year	<u>6,667,001,941</u>	<u>7,540,173,918</u>
End of the year	\$ <u>6,013,355,928</u>	<u>6,667,001,941</u>

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Board have been prepared in conformity with generally accepted accounting principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standards-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Plan's accounting policies are described below:

### A. Fund Accounting

All operations of the Board are accounted for as a Pension Trust Fund, which is used to account for assets held by the Board in a trustee capacity for individuals, other governments, and/or other funds. The following Pension Trust Fund is administered by the Board:

Educational Employees' Retirement Fund – A pension trust fund established to account for transactions for the benefit of educational employees who are members of the Plan. The Educational Retirement Act (ERA) does not specifically require segregation of assets in order to maintain separate accounting. The Board uses one pension trust fund in the interest of efficient and economical financial administration consistent with legal specifications (i.e., separate accounting controls) and operational requirements.

### B. Basis of Accounting

- (1) The Board's financial statements are prepared using the accrual basis of accounting. 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.
- (2) Contributions – As a condition of participation in the Fund, both employees and employers are required

to contribute 7.60 percent and 8.65 percent of salaries and wages respectively. These obligations to contribute are established in State Statute. Per the Educational Retirement Act, Section 22-11-1 to 22-11-53, et. al, NMSA 1978, annotated, contribution requirements of the Plan members and participating employers are established and may be amended by the Board.

- (3) Administrative costs of the Board are financed through investment earnings.

### C. GASB Statement No. 34

The Governmental Accounting Standards Board (GASB) issued Statement No. 34 entitled, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" (GASB 34) in June 1999. GASB 34 was the most comprehensive change to governmental financial reporting since GASB was created in 1984.

This new Standard was implemented in phases based on the annual amount of revenues earned by the primary government, which is the State of New Mexico. State of New Mexico House Joint Memorial 24 of the 45<sup>th</sup> Legislature – First Session 2001 requires all state agencies, state oversight agencies, school districts, colleges and universities and any other agencies that receive governmental funds to implement GASB 34 for the fiscal year ended June 30, 2002, with early implementation allowed, but not required.

GASB 34 minimally affects the Board because it is a qualified governmental defined benefit pension plan. GASB Statement No. 25 "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" issued in 1995 governs the Board's financial reporting. The main impact of GASB Statement No. 34 on the Board is the inclusion of the mandatory Management's Discussion & Analysis (MD&A) as part of the financial statements of the Board. Other



## Financial

minor changes related to GASB 34 include changes in terminology and certain note disclosures.

### D Budgets and Budgetary Accounting

Formal budgetary integration is used as a management control device by the Board in administering the Educational Employees' Retirement Fund.

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, which recognizes encumbrances and capital expenses as current expenses, excludes depreciation expense, and recognizes revenue when cash is received. Budgetary comparisons for the Educational Employees' Retirement Fund are presented in Exhibit 3 on this 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 FY02. The Board developed performance measures, which were approved by the State Budget Division. Schedule 6 shows those performance measure targets compared to actual performance for FY02.

Appropriations from the Fund lapse at fiscal year end except for those amounts that represent encumbrances.

The original budget was amended during the fiscal year. All budget adjustments were approved by SBD and LFC in accordance with State laws and regulations.

The Board follows these procedures in establishing the annual budget:

- (1) By August 30<sup>th</sup>, the Board prepares a Budget Appropriation Request to be

presented to the next Legislature. The Request includes proposed expenses and the means of financing them.

- (2) On September 1<sup>st</sup>, the Budget Appropriation Request is submitted to the Department of Finance and Administration (DFA) and the Legislative Finance Committee (LFC).
- (3) 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. Recommendations and adjustments are made prior to presenting the Budget Appropriation Request to the Legislature.
- (5) Both DFA's and LFC's recommended appropriation proposals are presented to the Legislature for approval of the final budget.
- (6) On May 1<sup>st</sup>, the Board submits its Annual Operating Budget to DFA and LFC based on the final appropriation from the Legislature.
- (7) Budgetary control is exercised at the appropriation unit level (revenue source and expenditure category) and all changes between budget categories are approved by DFA and LFC.

### E. Investments

Investments are reported at fair market value. Short-term investments are reported at cost, which approximates fair market value. Overnight investments with the Office of the State Treasurer and the Short-term Investment Funds (STIF) at Deutsche Bank (formerly Banker's Trust) have been reported as cash equivalents on the accompanying Statement of Plan Net Assets. Deutsche

Bank determines the fair market value of investments through their pricing sources, primarily Interactive Data Corporation, then secondarily Bloomberg, and finally to the broker for those securities not priced in the two other sources.

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

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.

**F. Capital Assets**

Capital assets represent the cost of assets, net of accumulated depreciation, used for the administration of the Pension Trust Fund. Capital assets include the Board's Administration Building located in Santa Fe, New Mexico. The Board's capitalization policy, based on the requirements from the Department of Finance and Administration, is to include all assets costing \$1,000 and greater. 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.

Estimated useful lives are as follows:

- \* Building and Building Improvements 25 years
- \* Depreciable Land Improvements 10 years
- \* Furniture and Equipment 10 years

- \* Integrated Retirement Information System software 10 years
- \* Data Processing Equipment 5 years

**G. 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, the Funds Held for Others are transferred to the member's individual contribution account (appropriate contribution reserves) and income accounts.

**CASH DEPOSITS**

The Board is required by Statute to remit any money received for or on the behalf of the Plan into its own account at the State Treasury. Excess money at the end of the day in the Board's account at the State Treasury is pooled and invested by the Office of the State Treasurer in overnight repurchase agreements. All repurchase agreements are collateralized by the U. S. Treasury Securities held by the New Mexico State Treasurer's Custodian bank.

In addition to the overnight investment at the State Treasury, in June 2000, the Board began investing in Short-term Investment Funds (STIF) at Banker's Trust (now Deutsche Bank) called the "Deutsche Bank Trust Pyramid Government Securities Cash Fund." Each internal and external investment manager has a component in the STIF Fund through Deutsche Bank. The investment objective of the STIF Fund is to seek a high level of current income consistent with liquidity and the preservation of capital through investment in a diversified portfolio of short-term obligations issued or guaranteed by the U.S. Government, its agencies or instrumentalities, and repurchase agreements of the same. The STIF Fund is used to facilitate more efficient trade procedures with the Board's external money managers. Net cash balances in

## Financial

each internal and external investment manager's portfolios are swept into the STIF Fund at the end of each day. Overnight investments of \$189,248,570 and \$101,759,259 for 2002 and 2001 respectively, are considered cash equivalents and are reported as part of the cash balance in the Statement of Plan Net Assets.

### RECEIVABLES

The receivables presented in the Statement of Plan Net Assets are current and considered to be 100% collectible. Therefore, no allowance for doubtful accounts is considered necessary.

### INVESTMENTS

The Board is authorized by Statute to invest the assets of the Plan in the following instruments:

- A. Bills, bonds or notes of the United States government-sponsored enterprises or federal agency securities;
- B. Obligations, including but not limited to bills, bonds and notes of governments other than the United States or their political subdivisions, agencies or instrumentalities, and these may be denominated in foreign currencies;
- C. Bonds, notes or obligations of a municipality or political subdivision of the State which were issued pursuant to law; provided the issuer has not within ten years prior to making the investment, been in default for more than three months in payment of any part of the principal or interest on any debt evidenced by its bonds, notes or obligations; and provided that the bonds are city or county utility or utility-district revenue bonds with the revenues of such utility, other than for payment of operation and maintenance expenses, pledged wholly to payment of the interest on and the principal on such indebtedness, and the utility project has been completely self-supporting for a period of five years preceding the date of the investment;
- D. Contracts for the present purchase and resale at a specified time in the future, not to exceed one year, of specific securities at specified prices at a price differential representing the interest income to be earned by the Board. No such contract shall be entered into unless the contract is fully secured by obligations of the United States, or other securities backed by the United States, having a market value of at least one hundred two percent (102%) of the amount of the contract. The collateral required in this section shall be delivered to the State Fiscal Agent or his designee contemporaneously with the transfer of funds or delivery of the securities, at the earliest time industry practice permits, but in all cases settlement shall be on a same-day basis. No such contract shall be entered into unless the contracting bank, brokerage firm or recognized institutional investor has a net worth in excess of five hundred million dollars (\$500,000,000);
- E. Obligations, including but not limited to bonds, notes or commercial paper of any corporation organized within the United States; preferred stock or common stock of any corporation organized within the United States whose securities are listed on at least one national stock exchange or on the N.A.S.D. national market or American depositary receipts of any corporation organized outside the United States whose securities are listed on at least one national stock exchange or on the N.A.S.D. national market; provided that the corporation shall have a minimum net worth of twenty-five million dollars (\$25,000,000); and provided that the Fund shall not at any one time own more than ten percent of the voting stock of a company;
- F. Prime bankers' acceptances issued by money center banks;
- G. Obligations, including but not limited to bonds, notes or commercial paper of any corporation organized outside the United States, and these may be denominated in foreign currencies; preferred stock or

- common stock of any corporation organized outside the United States whose securities are listed on at least one national or foreign stock exchange, and these may be denominated in foreign currencies; provided that the corporation shall have a minimum net worth of twenty-five million dollars (\$25,000,000); and provided that the Fund shall not at any one time own more than ten percent of the voting stock of a company;
- H. Currency transactions, including spot or cash basis currency transactions; forward currency contracts and buying or selling options or futures on foreign currencies, but only for purposes of hedging foreign currency risk and not for speculation;
- I. Stocks or shares of a diversified investment company registered under the Investment Company Act of 1940, as amended, which invests primarily in United States or non-United States fixed income securities, equity securities or short-term debt instruments pursuant to Paragraphs A., B., D., E. and G. above; provided that the investment company has total assets under management of at least one hundred million dollars (\$100,000,000); individual, common or collective trust funds of banks or trust companies, which invest primarily in United States or non-United States fixed income securities, equity securities or short-term debt instruments pursuant to Paragraphs A., B., D., E. and G. above; provided that the investment manager has total assets under management of at least one hundred million dollars (\$100,000,000); the Board may allow reasonable administrative and investment expenses to be paid directly from the income or assets of these investments; or
- J. Industrial revenue bonds issued pursuant to the Industrial Revenue Bond Act [Sections 3-32-1 through 3-32-16, NMSA 1978, annotated], where both the principal and interest of the bonds are fully and unconditionally guaranteed within the United States and which has net assets of at least twenty-five million dollars (\$25,000,000) and has issued securities traded on one or more national stock exchanges and where the senior securities of the guaranteeing corporation would have the equivalent of a BAA rating.
- K. 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. 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 one hundred two percent (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. 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 Fund 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 is further disclosed below.
- L. The Board's investments are categorized to give indication of the level of risk assumed by the entity at fiscal year end as follows:
- (1) Category 1 – includes investments that are insured or registered for which the securities are held by the Board or its agent in the Board's name.
  - (2) Category 2 – includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Board's name.

## Financial

<u>Securities Lent</u>	<u>Underlying Securities</u>	<u>Cash Collateral Received/ Securities Collateral Value*</u>	<u>Cash Collateral Investment Value*</u>
<b>2002</b>			
<u>Lent for cash collateral:</u>			
U. S. Government & Agency Securities	\$619,758,122	635,350,000	—
U. S. Equities	199,725,227	205,095,300	—
U. S. Corporates	9,718,574	10,002,480	—
U. S. Corporate Obligations with variable rates	—	—	334,745,670
Asset-backed Securities with variable rates	—	—	160,185,536
Commercial Paper	—	—	<u>354,524,569</u>
	<u>\$829,201,923</u>	<u>850,447,780</u>	<u>849,455,775</u>

<u>Securities Lent</u>	<u>Underlying Securities</u>	<u>Cash Collateral Received/ Securities Collateral Value*</u>	<u>Cash Collateral Investment Value*</u>
<b>2001</b>			
<u>Lent for cash collateral:</u>			
U. S. Government & Agency Securities	\$417,418,707	431,585,238	—
Domestic Stock	26,072,571	26,853,000	—
Domestic Corporate Fixed Income Securities	—	—	408,747,850
Master Notes	—	—	49,476,139
Commercial Paper	—	—	—
	<u>\$443,491,278</u>	<u>458,438,238</u>	<u>458,223,989</u>

\* Reported at fair value

- (3) Category 3 – includes uninsured and unregistered investments for which the securities are held by the counter party or its trust department or agent, but not in the Board's name.

Except for the commingled funds, all of the Board's investments are classified as Category 1. The commingled funds are not categorized because they are not evidenced by securities that exist in physical stock or book entry form, but rather as shares of a total fund.

**Securities Lending:** chart represents the balances relating to the securities lending transactions at the financial statement date:

The cash collateral amount at fiscal year end was greater than the one hundred two percent (102%) of market value requirement.

There were no significant violations of the provisions of the statutes or the contract during the period covered by this audit.

The Board, through its agents, Wall Street Portfolio Advisors for the month of July 2001 and HSBC for the other eleven months

of the fiscal year, generally loaned portions of its U.S. Treasury Securities, equity securities, and domestic corporate bonds to approved broker-dealers in return for one hundred two percent (102%) of the market or fair value of the securities loaned. The collateral for these securities was generally cash, which was reinvested in short-term money market instruments having fixed coupons or floating rate instruments. The Board does not have the ability to pledge or sell the collateral without borrower default. HSBC has provided the Board one hundred percent (100%) loss indemnification in the event of borrower default.

The Board generally invests, through its lending agent, the cash collateral that matches the maturities of the securities loans. The maturities of both securities loans and collateral reinvestments are closely matched to avoid interest rate exposure. The weighted-average maturities for the loans and invested

collateral outstanding at fiscal year end were as follows:

	<u>2002</u>	<u>2001</u>
Loans outstanding	3 days	5 days
Collateral reinvestment	16 days	34 days

In the event of any security reinvestment that exceeds the maturity of the securities loan, the rate of interest is either a floating rate or a variable rate instrument.

Pursuant to the one hundred two percent (102%) of cash collateral requirement and the one hundred percent (100%) loss indemnification by the securities lending agent, the Board has determined that it has minimal credit risk with the securities lending program.

The Board experienced no losses in its securities lending program during FY02 nor were there any accumulated losses from prior periods.

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

<u>Investment Description</u>	<u>2002</u>	<u>2001</u>
Investments – Category 1: (Held by Board's agent in Board's name)		
U.S. Government and Agency Securities (not on securities loan)	\$ 638,012,613	\$ 983,555,106
Domestic Corporate Bonds (not on securities loan)	591,982,166	681,938,490
Domestic Stocks (not on securities loan)	<u>2,698,421,404</u>	<u>2,979,325,883</u>
Subtotal	3,928,416,183	4,644,819,479
Investments – Not Categorized:		
Commingled Mid-cap Stocks	—	346,876,264
Commingled International Stocks	992,565,074	1,072,736,336
Investments Held by Broker-Dealers under Securities Loans with Cash Collateral:		
U.S. Government and Agencies Securities	619,758,122	417,418,707
Domestic Corporate Bonds	9,718,574	—
Domestic Stocks	199,725,228	26,072,571
Securities Lending Cash Collateral Investments	<u>849,455,775</u>	<u>458,223,989</u>
Total	<u>\$6,599,638,956</u>	<u>\$6,966,147,346</u>

## Financial

### *Derivatives:*

**Government Agency Mortgage-backed Securities** – The Plan’s investment portfolio, excluding securities lending collateral investments, included mortgage-backed securities issued by agencies of the United States government of approximately \$246.7 million at fair value. The overall return or yield on mortgage-backed securities depends on the amount of interest collected over the life of the security and the change in market value. Although the Plan will receive the full amount of the principal if prepaid, the interest income that would have been collected during the remaining period to maturity, net of any market adjustment is lost. Accordingly, the yields and maturities of mortgage-backed securities generally depend on when the underlying mortgage loan principal and interest are repaid. If market rates fall below a mortgage loan’s contractual rate, it’s generally to the borrowers advantage to prepay the existing loan and obtain new lower financing. In addition to changes in interest rates, mortgage loan prepayments depend on other factors such as loan types and geographic location of the related properties.

**Collateralized Mortgage Obligations** – In accordance with investment policy and fiduciary principles, the Plan invests in mortgage-backed securities, including certain agency collateralized mortgage obligations (CMO). CMO selections are chosen from a conservative segment which offers low volatility. CMO securities are included in aggregate with other U. S. Government and Agency securities in the disclosure of custodial risk above. The Plan had \$338.5 million in CMO securities at June 30, 2002.

### 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. The Capital Assets in Progress represent costs associated with the Integrated Retirement Information System (IRIS) Project. Although these costs have been capitalized, depreciation expense will not be calculated until the project is completed during late FY03 or early FY04.

The Net Investment in Capital Assets at June 30 is as follows:

Description	Cost	Accumulated Depreciation	Book Value
<b>2002:</b>			
Land	\$ 248,172	—	248,172
Capital assets in progress	2,205,176	—	2,205,176
Depreciable Land Improvements	1,875	( 937)	938
Building & Building Improvements	1,136,225	(600,074)	536,151
Furniture & Equipment	<u>1,445,456</u>	<u>(805,307)</u>	<u>640,149</u>
Total	<u>\$5,036,904</u>	<u>(1,406,318)</u>	<u>3,630,586</u>
<b>2001:</b>			
Land & Land Improvements	\$ 250,047	—	250,047
Building & Building Improvements	1,123,344	(555,538)	567,806
Furniture & Equipment	<u>959,383</u>	<u>(638,020)</u>	<u>321,363</u>
Total	<u>\$2,332,774</u>	<u>(1,193,558)</u>	<u>1,139,216</u>

Depreciation expense for 2002 was \$269,632 and for 2001 was \$214,027.

**DUE TO OTHER STATE AGENCIES**

This account represents the amount due to various participating public employers for over remittances of employer contributions during the fiscal years ended June 30, 2002 and 2001. Over remittances can be applied to future reporting periods or refunded, at the option of the administrative unit. Over remittances outstanding for more than three months are refunded to the administrative unit.

**ACCRUED COMPENSATED ABSENCES:**

Qualified employees are entitled to accumulate vacation leave according to a graduated leave schedule of 80-160 hours per year, depending upon the length of service and employee's hire date. A maximum of thirty (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 of New Mexico, 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, 2002 and 2001.

Qualified employees are entitled to accumulate sick leave at the rate of one (1) day for each calendar month of service. There is no limit to the amount of sick leave that 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 six hundred (600) hours, up to seven hundred twenty (720) hours, not to exceed one hundred twenty (120) hours at fifty percent (50%) of their current hourly rate.

In the case of retiring employees, they may be paid for accrued sick leave in excess of six hundred (600) hours, up to one thousand (1,000) hours, not to exceed four hundred (400) hours at fifty percent (50%) of their current hourly rate. All sick leave balances in excess of six hundred (600) hours, up to seven hundred twenty (720) hours for each employee have been recorded at fifty percent (50%) of their current hourly rate.

The following table provides a summary of the change in accrued compensated absences for the fiscal years ended June 30, 2002 and 2001:

	2002	2001
Balances Payable at Beginning of Fiscal Year	\$ 128,943	\$ 98,734
Changes in Balances During Fiscal Year	13,191	30,209
Balances Payable End of Fiscal Year	\$ 142,134	\$128,943

**REFUNDS PAYABLE**

Refunds Payable represents amounts due to terminated members who have submitted a claim for refund, but who have not been paid on or before the end of the fiscal year, which is June 30, 2002 and 2001.

**LEASES**

The Board leases mailing equipment and office space under operating leases. Operating leases do not give rise to property rights or leases obligations; therefore, the amounts of the Board's lease agreements are not reflected on the Statement of Plan Net Assets.

The lease for the Board's mailing equipment was \$143 per month until December 31, 2000 and \$200 per month thereafter until the lease expires on December 31, 2004. The Board rented a storage unit on a one-year lease agreement in July 2001 for \$150 per month. This lease agreement expires June 30, 2002.

The lease for office space in Albuquerque is for the Board's satellite office. The office relocated in November 2001. The new lease payment is \$2,333 per month and is effective through October 30, 2002. Monthly rental rates increase every year beginning November 1<sup>st</sup>. The lease contract expires October 30, 2005. The office space for the Las Cruces and Farmington satellite offices is donated by an educational institution in each city.

Leases are subject to future appropriations and are cancelable by the Board at the end of each



## Financial

fiscal year with thirty (30) days written notice to the lessor. The following table summarizes the Board's future minimum lease payments:

### Fiscal Year Ended June 30 2002

2003	33,447
2004	35,718
2005	35,440
2006	<u>11,604</u>
Total	<u>\$ 116,209</u>

Lease expense was \$26,433 for the fiscal year ended June 30, 2002 and \$11,960 for the fiscal year ended June 30, 2001.

### 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 through the Educational Retirement Act (ERA) while others have elected to participate in the Public Employees' Retirement Plan through the Public Employees Retirement Act (PERA) of the State of New Mexico.

*Plan Description – ERA:* This Plan is a cost-sharing, multiple-employer defined benefit plan established and administered by the Board to provide retirement, disability benefits, survivor benefits and cost-of-living adjustments for all

*Plan Description – PERA:* This Plan is a cost-sharing, multiple-employer defined benefit plan administered by the Public Employees Retirement Association (PERA). The Plan provides for retirement, 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. That report may be obtained by writing to PERA, P. O. Box 2123, Santa Fe, NM 87504-2123.

*Funding Policy – ERA:* Educational Retirement Board Plan members are required to contribute

7.60% of their gross salary. The Board is required to contribute 8.65% of the gross covered salary. The contribution requirements of the Plan members and the Board are established in State statute at Chapter 22, Section 11, NMSA 1978, annotated. The requirements may be amended by acts of the Legislature. The Board's contributions to ERA for the fiscal years ending June 30, 2002, 2001, and 2000 were \$53,970, \$50,620, and \$46,560, respectively, equal to the amount of the required contributions for each fiscal year.

*Funding Policy – PERA:* PERA Plan members are required to contribute 7.42% of their gross salary. The Board is required to contribute 16.59% of the gross covered salary. The contribution requirements of the Plan members and the Board are established in State statute at Chapter 10, Section 11, NMSA 1978, annotated. The requirements may be amended by acts of the Legislature. The Board's contributions to PERA for the fiscal years ending June 30, 2002, 2001, and 2000 were \$346,424, \$291,513, and \$259,881, respectively, equal to the amount of the required contributions for each fiscal year.

### POST-EMPLOYMENT BENEFITS

The Retiree Health Care Act (Section 10-7C-1 to 10-7C-16, NMSA 1978) provides comprehensive core group health insurance for persons who have retired from certain public service in the State of New Mexico. The purpose is to provide eligible retirees, their spouses, dependents, and surviving spouses with health insurance consisting of a plan or optional plans of benefits that can be purchased by funds flowing into the Retiree Health Care Fund and by co-payments and out-of-pocket payments of eligible retirees.

Monies flow to the Retiree Health Care Fund on a pay-as-you-go basis from eligible employees, employers and retirees. Eligible employers are institutions of higher education, school districts, or other entities participating in the Public School Insurance Authority, and state agencies, state courts, magistrate courts, municipalities or counties, which are affiliated under or covered by the Educational Retirement Act, the Public Employees Retirement Act, or the Magistrate

## RETIREMENT ACT

Eligible retirees are as follows: (1) retirees who make contributions to the Fund for at least five years prior to retirement and whose eligible employer made contributions as a participant in the Retiree Health Care Act during that period of time on the person's behalf unless that person retired on or before July 1, 1995, in which event, the time period required for employee and employer contributions shall become the period of time between July 1, 1990 and the date of retirement; or (2) retirees defined by the Act who retired prior to July 1, 1990.

Each participating employer makes contributions to the Fund in the amount of one percent (1%) of each participating employee's annual salary. Each participating employee contributes one-half of one percent (0.5%) of his or her annual salary to the Fund. The contribution rates increased to one and three-tenths percent (1.3%) for employers and sixty-five hundredths of one percent (0.65%) for employees effective July 1, 2002.

Each participating retiree pays a variable monthly premium based on coverage desired and years' of service. The basic rate is eighty-six dollars and thirty-one cents (\$86.31) for the least expensive Plan and increasing from there for FY02. An additional premium of five dollars (\$5.00) per month is charged if the eligible participant retired prior to July 1, 1990 and made no contributions to the Plan.

Contributions from participating employers and employees become the property of the Retiree Health Care Fund and are not refundable under any circumstances, including termination of employment or termination of the participating employers' operation or participation in the Retiree Health Care Act. The employer, employee, and retiree contributions are required to be remitted to the Retiree Health Care Authority on a monthly basis.

The Retiree Health Care Authority issues a separate, publicly available audited financial report that includes post-employment benefit expenditures of premiums and claims paid, participant contributions (employer, employee,

and retiree), and net expenditures for the fiscal year. The report also includes the approximate number of retirees participating in the Plan. That report may be obtained by writing to the Retiree Health Care Authority, 810 West San Mateo Road, Santa Fe, NM 87505.

For the fiscal year ended June 30, 2002, the Board remitted \$17,904 in employer contributions and \$8,828 in employee contributions to the Retiree Health Care Authority.

For the fiscal year ended June 30, 2001, \$15,296 in employer contributions and \$7,648 in employee contributions were remitted to the Retiree Health Care Authority by the Board.

## CONTINGENCIES

Rule III Section B (10) of the "Rules and Procedures of the Educational Retirement Board" requires that the Board contact members who have been terminated for a period of two years and maintain a balance of \$500 or less in his or her contribution account for the purpose of refunding any balances as required by the Rule.

For 2002, 8,477 terminated members were eligible to receive refunds in the aggregate amount of \$1,348,316. For 2001, 6,718 terminated members with an aggregate balance of \$1,052,740 were eligible to receive refunds. The aggregate balances are exclusive of interest. There have been no adjustments made in the accompanying Statement of Plan Net Assets to reflect this contingent liability.

## 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 only for a small deductible payment in amounts that vary according to the type of claim.

## Financial

### STATUTORY DISCLOSURES

Section 2.2.2.12A(2) of the Audit Rule 2002, 2.2.2 NMAC entitled, "Requirements for Contracting and Conducting Audits of Agencies" requires that all State Agencies disclose all special, deficiency and specific appropriations. The Board received the following specific appropriations as follows: (see charts below).

Any unspent amounts of the above specific appropriations revert to the Educational Employees' Retirement Fund, the source of the funding, and not to the State of New Mexico General Fund.

### SUBSEQUENT EVENTS

The Board transitioned \$1.074 billion of its equity portfolio during August 2002 in an effort to maximize the long-term earnings of the Fund. The Board contracted with four additional money managers and terminated or did not renew contracts with two previous money managers. The new money managers were hired to manage the small cap value and growth, large cap value, and an enhanced index fund portions of the Board's portfolio.

### PREPARATION OF FINANCIAL STATEMENTS, EXHIBIT, SCHEDULES AND NOTES

Board staff prepared the financial statements, exhibits, schedules and notes for the fiscal year ended June 30, 2002 and 2001.

#### Building Remodel/Addition:

Laws of 2000-Second Session 2000/Section 29 (FY00-FY04)	\$ 750,000
Expended in FY01	(8,389)
Encumbered in FY01	<u>(63,999)</u>
Rebudgeted in FY02	\$ 677,612
Expended in FY02	-
Encumbered in FY02	-
Unencumbered Balance at 6/30/02	\$ <u>677,612</u>

Laws of 2002-Special Session 2002/Section 55 (FY02-FY07) (\$500,000 appropriated, but allotment not requested until FY03)	—
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#### Pension Information Management System (IRIS):

Laws of 2000-Second Special Session/Chapter 5, Section 8 (FY00-FY02)	\$3,000,000
Expended in FY01	(38,007)
Encumbered in FY01	<u>(41,514)</u>
Rebudgeted in FY02	\$2,920,479

Laws of 2001-Second Session/Chapter 64, Section B(FY01-FY02)	<u>\$3,000,000</u>
Subtotal FY02 Budget with carryover from FY01	\$5,920,479
Expended in FY02	(2,157,222)
Encumbered in FY02	<u>(2,060,087)</u>
Unencumbered Balance at 6/30/02	<u>\$1,703,170</u>



**Combining Statement of Additions,  
Components of Plan Net Assets for**

	Member Contribution Accounts	Age & Service	Disability
Additions:			
Interest income			
Interest on resoration of service credit			
Dividend income			
Securities lending income			
Membership contributions	151,378,455		
Employer contributions			
Penalties			
Other		<u>51,309</u>	
Total additions	<u>151,378,455</u>	<u>51,309</u>	
Deductions:			
Administrative expenses			
Depreciation expenses			
Net depreciation in assets			
Benefit payments		362,446,592	5,048,278
Refunds to terminated members with interest	<u>20,103,972</u>		
Total deductions	<u>20,103,972</u>	<u>362,446,592</u>	<u>5,048,278</u>
Net increase (decrease) in plan net assets	<u>131,274,483</u>	<u>(362,395,283)</u>	<u>(5,048,278)</u>
Net assets transfers in (out):			
Net transfers	<u>(190,479,727)</u>	<u>861,026,672</u>	<u>10,077,350</u>
Total net transfers in (out)	<u>(190,479,727)</u>	<u>861,026,672</u>	<u>10,077,350</u>
Plan Net Assets July 1, 2001	1,128,423,156	2,375,306,215	22,161,759
Plan Net Assets June 30, 2002	<u>1,069,217,912</u>	<u>2,873,937,604</u>	<u>27,190,831</u>

**Deductions, and Changes in  
The Year Ended June 20, 2002**

Employer Contributions	Unreserved (Excess Earnings)	Income Accounts	Totals
		128,989,938	\$ 128,989,938
		3,351,634	3,351,634
		36,924,516	36,924,516
		2,592,599	2,592,599
			151,378,455
173,863,363			173,863,363
		5,412	5,412
		<u>41,709</u>	<u>93,018</u>
<u>173,863,363</u>		<u>171,905,808</u>	<u>497,198,935</u>
		9,849,579	9,849,579
		269,632	269,632
		746,928,008	746,928,008
			367,494,870
		<u>8,404,063</u>	<u>28,508,035</u>
		<u>765,451,282</u>	<u>1,153,050,124</u>
<u>173,863,363</u>		<u>(593,545,474)</u>	<u>(655,851,189)</u>
<u>(426,523,146)</u>	<u>(847,646,623)</u>	<u>593,545,474</u>	
<u>(426,523,146)</u>	<u>(847,646,623)</u>	<u>593,545,474</u>	
987,888,763	2,153,222,048		6,667,001,941
<u>735,228,980</u>	<u>1,305,575,425</u>		<u>6,011,150,752</u>



## Actuarial:

Letter of Transmittal	40
Executive Summary	42
Introduction and Narrative	43
Actuarial Exhibits	47

**Florence Hawley Ellis** (1917-1991): World-renowned anthropologist and University of New Mexico professor. Dr. Ellis was first to do extensive excavations for Spanish remains at the Southwest's first capital in 1958. She was one of the first anthropologists to date Southwest pottery through study of tree rings, first applied extensively at Chaco Canyon. She established the Department of Dendrochronology at both the University of New Mexico and the University of Chicago. In 1980, the Ghost Ranch Anthropology Museum was dedicated in her name.





# Actuarial Report

December 13, 2002

Board of Trustees  
Educational Retirement Board of New Mexico  
P.O. Box 26129  
Santa Fe, NM 87502-0129

Dear Members of the Board:

## **Subject: Actuarial Valuation as of June 30, 2002**

We certify that the information contained in this report is accurate and fairly presents the actuarial position of the Educational Retirement Board of New Mexico (ERB) as of June 30, 2002.

All calculations have been made in conformity with generally accepted actuarial principles and practices, and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion the results presented also comply with the relevant statutes, and, where applicable, the Internal Revenue Code, ERISA, and the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries. Both are Enrolled Actuaries and Members of the American Academy of Actuaries, and both are experienced in performing valuations for large public retirement systems.

To the best of our knowledge, this report is based on benefit provisions in effect as of June 30, 2002, audited financial information prepared as of that date, member data gathered as of that date, and actuarial assumptions and methods previously adopted by the Board.

### **Actuarial Valuation**

The primary purposes of the valuation report are to determine the adequacy of the current employer contribution rate, to describe the current financial condition of ERB, and to analyze changes in ERB's condition. In addition, the report provides information required by ERB in connection with Governmental Accounting Standards Board Statement No. 25 (GASB 25), and it provides various summaries of the data.

Valuations are prepared annually, as of June 30 of each year, the last day of ERB's plan and fiscal year.

### **Financing Objectives**

The member and employer contribution rates are established by statute. The current employer contribution rate is 8.65% and the current member contribution rate is 7.60%. In addition, certain higher education employers make an additional contribution equal to 3.00% of the total pay for their employees who elected to join the Alternative Retirement Program rather than ERB. These rates are intended to be sufficient to pay ERB's normal cost and to amortize ERB's unfunded actuarial accrued liability (UAAL) in payments which are level as a percentage of payroll. Except for short-term fluctuations, the amortization period should not exceed the 30-year period allowed under GASB No. 25. (The amortization period, also referred to as the funding period, is the number of years expected to be required to completely amortize the UAAL, assuming that ERB's experience exactly follows the actuarial assumptions.) This funding policy is set by the Board of Trustees, and is considered reasonable by the actuary. The Board has a goal of maintaining a funding period of no more than 25 years.

### **Progress Toward Realization of Financing Objectives**

As of June 30, 2002, the funding period is 27.2 years. This is an increase from last year's funding period of 12.5 years. Therefore, the current statutory rate is adequate. The contribution that would be required in order to amortize the UAAL over 25 years, the Board's target period, is 8.81%. (Last year the 25-year funding rate was 7.35%.)

The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) decreased from last year. The funded ratio at June 30, 2001 was 91.9%, while it is now 86.8%. Five years ago the ratio stood at 77.1%. However, if the ratio had been calculated using the market value rather than the actuarial value of assets, it would have been 68.7%. During the last fiscal year, the UAAL increased from \$652.0 million to \$1,152.8 million.

The increase in the funding period is due primarily to a combination of higher salary increases last year than anticipated by our assumed rates, and the lower than assumed investment rate of return.

### **Future Expected Changes**

The fact that the current calculated funding period is still less than 30 years, the maximum allowable period under GASB 25, may be misleading. All of the standard actuarial measurements, including the funded ratio and the funding period, are functions of the actuarial value of assets. The actuarial value of assets recognizes investment gains and losses – the positive or negative differences between the actual net investment return on market value and the expected 8.00% investment return – over a period of five years, at the rate of 20% per year. Therefore, 60% of the losses from FY 2001 and 80% of the losses in FY 2002 are not yet reflected in the actuarial measurements. As these losses are recognized over the next four valuations, we expect the funding period to continue increasing, in the absence of any changes in the benefit – and – contribution structure of ERB, and in the absence of offsetting experience gains.

### **Benefit Provisions**

The actuarial valuation reflects the benefit and contribution provisions set forth in the relevant New Mexico statutes. There were no material changes made to these provisions since the previous actuarial valuation. There are no ancillary benefits (such as cost-of-living increases to retirees) funded by a source independent of ERB.

### **Assumptions and Methods**

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan's actuary. The last review of these assumptions occurred following the 2000 actuarial valuation, and the Board adopted all of our recommendations. We believe the recommended assumptions are internally consistent and are reasonably based on the actual experience of ERB.

### **Member and Financial Data**

Member data for retired, active, and inactive participants was supplied as of June 30, 2002, by the ERB staff. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior year's data. Asset information was also supplied by the ERB staff and by the plan's auditors.

We would like to thank the ERB staff and the auditors for their assistance with this project.

Sincerely,

Gabriel, Roeder, Smith & Company

J. Christian Conradi, ASA, MAAA, EA  
Senior Consultant

W. Michael Carter, FSA, MAAA, EA  
Senior Consultant

# Actuarial Report

## Executive Summary

<u>Item</u>	<u>2002</u>	<u>2001</u>
<b>Membership</b>		
• Number of		
- Active members	61,091	60,155
- Retirees and beneficiaries	23,052	22,191
- Inactive, vested	5,217	4,800
- Inactive, nonvested	<u>14,714</u>	<u>13,401</u>
- Total	104,074	100,547
• Payroll	\$1,978.5 million	\$1,819.6 million
<b>Statutory contribution rates</b>		
• Employer	8.65%	8.65%
• Member	7.60%	7.60%
<b>Assets</b>		
• Market value	\$6,013.4 million	\$6,667.0 million
• Actuarial value	7,595.6 million	7,418.3 million
• Return on market value	-8.8%	-11.1%
• Return on actuarial value	3.3%	9.5%
• Employer contributions	\$173.9 million	\$161.5 million
• External cash flow %	(1.2%)	(1.0%)
<b>Actuarial Information</b>		
• Normal cost %	12.72%	12.72%
• Unfunded actuarial accrued liability (UAAL)	\$1,152.4 million	\$652.0 million
• Funded ratio	86.8%	91.9%
• Funding period (years)	27.2	12.5
<b>Gains/(losses)</b>		
• Asset experience	\$ (346.1) million	\$ 100.1 million
• Liability experience	(189.6) million	(208.0) million
• Benefit changes	N/A	N/A
• Assumption/method changes	N/A	31.9 million
• Total	\$ (535.7) million	\$ (76.1) million

## Introduction

Table 1 shows the most significant actuarial results. Table 2 analyzes changes in the UAAL. Tables 3 and 4 show more detailed actuarial information. Tables 5a and 5b develop the GASB 25 Annual Required Contribution for the last fiscal year, and Tables 6a-6c show required GASB 25 disclosure information. Tables 7a, 7b, 15 and 16 show statistical information about the membership, and Tables 8a-11b, and Table 13 show information about plan assets. Tables 12a and 12b show the calculation of the actuarial gains and losses, and Table 14 shows the solvency test, used by some funds in their annual report. Finally, Appendix 1 is a summary of the benefit and contribution provisions of ERB, and Appendix 2 is a summary of the actuarial methods and assumptions.

## Actuarial Information

The determination of the unfunded actuarial accrued liability (UAAL) and the funding period involves the following steps:

- The actuarial present value of future benefits is determined for the present members, including retired members, beneficiaries, inactive members and active members. This amounts to \$10,545.6 million, as shown on Table 3.
- The entry age normal funding method is used to allocate the actuarial present value of future benefits between the portion due for the current year (the normal cost), prior years (the actuarial accrued liability) and future years. The actuarial accrued liability is \$8,748.0 million, as shown in line 6d on Table 1.
- Under the entry age normal cost method the current and future normal costs are determined as a level percentage of payroll. Table 4 shows an analysis of the normal cost rate. The amount needed to fund the current and future normal costs is 12.72% of payroll inclusive of member contributions. This is the total (member plus employer) contribution rate needed to pay for the average new member.
- A part of the normal cost is paid by the employee contributions of 7.60%, leaving 5.12% to be funded by the employers. I.e., the current year's employer normal cost is 5.12% of payroll. This is shown in Line 3 of Table 1.
- The unfunded actuarial accrued liability (UAAL) is determined by subtracting the actuarial value of assets from the actuarial accrued liability. (The actuarial value of assets is a smoothed market value, as discussed in more detail below.) The UAAL is \$1,152.8 million, as shown in line 8 on Table 1.
- Since the statutory employer contribution rate is 8.65%, and the employer normal cost rate is 5.12%, the difference of 3.53% is used to amortize the UAAL. The 3% contribution made on behalf of ARP members is also used to amortize the UAAL.
- Finally, the funding period is the anticipated period needed to reduce the UAAL to zero, assuming that plan experience exactly follows the assumptions, that no benefit changes are made, that payroll grows at 3.0% per year, and that the contributions are made as required. The funding period this year is 27.2 years.

## Actuarial Report

### Analysis of Changes

Table 2 shows an analysis of the changes in the UAAL. Since the UAAL is an actuarial present value, with future anticipated benefits discounted using an 8.00% interest rate, the UAAL increases each year by the imputed interest rate, less employer contributions made to amortize the UAAL. (Keep in mind that part of the employer contribution is used to pay the normal cost, so only part of each year's contribution is available to amortize the UAAL.)

As shown on Table 2, the UAAL increased by \$52.2 million for imputed interest and decreased by \$87.5 million because of payments made. This means that the UAAL was expected to decrease \$35.3 million before recognizing plan experience. The UAAL as of June 30, 2001 was \$652.0 million, and the expected UAAL at June 30, 2002, recognizing actual contributions made, was \$616.7 million.

The plan experienced a liability loss of \$189.6 million. This loss represents 2.2% of the total actuarial accrued liability. The main cause for this loss is the large salary increases granted for the 2001-02 school year. For members with more than three years of service, the average increase in pay between last year's valuation and this year's is 9.5%.

Moreover, recognizing past investment losses produced a loss of \$346.5 million. The investment loss resulted from the fact that the return on the actuarial value of assets, which was 3.3%, was less than the 8.00% assumed investment return rate. (The actuarial assets are beginning to absorb the two major investment losses in fiscal years 2001 and 2002. The market rate of return was -8.8%.)

There were no material benefit changes adopted since last actuarial valuation, and no changes made to the actuarial assumptions and methods.

As a result of all the experience, the UAAL increased from \$652.0 million to \$1,152.8 million, and the funding period increased from 12.5 years to 27.2 years.

### GASB 25 Disclosure

Governmental Accounting Standards Board Statement No. 25 (GASB 25) is the relevant accounting standard for governmental retirement systems like ERB.

Tables 5a and 5b show the calculation of the Annual Required Contribution (ARC) as computed under GASB 25, and they show what percent of this amount was actually received. For ERB, the ARC is defined to be the actual contributions required by statute, as long as this is not less than the minimum allowed under GASB 25. The GASB 25 minimum is equal to the normal cost, plus a 30-year amortization of the UAAL.

Tables 6a, 6b, and 6c show information required to be reported under GASB 25. Table 6a shows a history of funding progress—a comparison of the actuarial value of assets with the actuarial accrued liability and a comparison of the UAAL with covered payroll. This table shows steady progress over the last five years, with the best funded ratio in 2001, 91.9%, then it decreased to 86.8% as of 2002.

Table 6b shows a six-year comparison of the employer contributions actually received with the GASB 25 ARC.

Table 6c shows other information which must be included in the notes section of the financial report. The auditor's notes should also disclose the following items that may affect the comparability of the trend information shown in Tables 6a and 6b:

- Actuarial assumptions were changed as June 30, 1998 and June 30, 2001.

### Benefit Provisions

Appendix 1 summarizes the provisions of ERB. These have not been materially changed since the previous valuation.

This valuation reflects benefits promised to members by statute. There are no ancillary benefits - retirement type benefits not required by statutes but which might be deemed an ERB liability if continued beyond the availability of funding by the current funding source.

### Actuarial Assumptions and Methods

In determining costs and liabilities, actuaries use assumptions about the future, such as rates of salary increase, probabilities of retirement, termination, death and disability, and an investment return assumption. ERB's Board adopts the assumptions used, taking into account the actuary's recommendations, as summarized in Appendix 2.

The most significant assumptions are (i) the assumed investment return, currently set at 8.00%, and (ii) the assumption regarding future salary increases, which is based on a table that varies by service and averages about 5.6%.

In addition to the actuarial assumptions, the actuary also makes use of an actuarial funding method to allocate costs to particular years. In common with most public-sector plans, ERB uses the entry age normal method. This method produces a relatively level pattern of funding over time, and thereby provides equity between various generations of taxpayers. We continue to believe this method is appropriate for ERB.

### Assets

ERB assets are held in trust. The ERB staff and the ERB auditors have provided the asset information used in this valuation.

Table 8a presents a summary of the market value of assets held by the fund, and Table 8b shows the allocation of assets held for investment. About 66% of the assets are now held in equities, kept stable from 67% last year and 67% the year before. Table 9 shows a reconciliation of the assets from the beginning of the prior year to the valuation date.

Tables 10a and 10b show the development of the actuarial value of assets (AVA). The AVA is a smoothed market value. A smoothed value is used in order to dampen some of the year-to-year fluctuations that would occur if the market value were used instead. The method used phases in differences between the actual and expected market returns over five year. The expected return is determined using the 8.00% assumption and the plan's market value, adjusted for contributions received and benefits and refunds paid. Both the actual and expected returns are computed net of administrative expenses.

Note that the actuarial value is 126% of the market value. Over time, we would expect the actuarial value to trend back towards the market value, so this disparity should shrink in the future.

Table 11a shows the investment return rate for the year on both market value (-8.8%) and actuarial value (3.3%). Table 11b shows historical return rates since the current actuarial asset method was adopted.

Finally, Table 13 shows a history of cash flows to the trust, and the net cash flow measured as a

## Actuarial Report

percentage of the assets. The cash flow is slightly negative, 1.2% of market value, but this is not a sign of concern in a mature plan such as ERB.

### Member Data

Membership data was provided on electronic files by the ERB staff. Data for active members included sex, birthdate, service, salary paid in the prior year, and accumulated contributions. Data for inactive, nonretired members was similar, but included the member's accrued benefit as well. For retired members, data included status (service retiree, disabled retiree or beneficiary), sex, birthdate, pension amount, form of payment, beneficiary sex and birthdate if applicable, and date of retirement.

While not verifying the correctness of the data at the source, we performed various tests to ensure the internal consistency of the data and its overall reasonableness.

Table 7a summarizes data on all members. Table 7b is a history of key statistical information about active members, and Table 15 is a history of statistical information about retirees. Table 16 is an age/service distribution of active members and their average pay.

The number of active members increased 1.6% since last year, from 60,155 to 61,091. Note that the actual number of active members during the year will be somewhat higher, since the June 30 count excludes May and June retirees, but does not include new teachers who will join the system for the 2002-2003 school year.

Total payroll increased 8.7% since last year. For all comparative purposes, payroll is the amount supplied by the ERB staff (i.e., the 2001-02 member pay). However, this figure is increased by one year's pay increase to determine the member's rate of pay at July 1, 2002.

Pay is assumed to change only at the beginning of a school/fiscal year.

Average pay increased 7.1% since last year. Average pay for members active in both this valuation and the last year's valuation increased 10.7%. The difference between these two figures is due to the effect of retirements and terminations, and their replacement by new members who generally earn less.

# Actuarial Report

## Actuarial Information

	<u>July 1, 2002</u> (1)	<u>July 1, 2001</u> (2)
1. Payroll		
a. Supplied by System (annualized)	\$ 1,978,528,267	\$ 1,819,553,855
b. Adjusted for one-year's pay increase	2,088,571,200	1,921,943,600
2. Actuarial present value of future pay	\$ 14,132,519,737	\$ 13,136,602,632
3. Normal cost rate (payable monthly)		
a. Total normal cost rate	12.72%	12.72%
b. Less: member contribution rate	<u>(7.60%)</u>	<u>(7.60%)</u>
c. Employer normal cost rate	5.12%	5.12%
4. Employer normal cost (Item 3c * Item 1b)	\$ 106,934,845	\$ 98,403,512
5. Actuarial accrued liability for active members		
a. Actuarial present value of future benefits	\$ 6,497,787,700	\$ 5,968,823,600
b. Less: actuarial present value of future normal costs (Item 3a * Item 2)	<u>(1,797,656,511)</u>	<u>(1,670,975,855)</u>
c. Actuarial accrued liability	\$ 4,700,131,189	\$ 4,297,847,745
6. Total actuarial accrued liability for:		
a. Retirees and beneficiaries	\$ 3,860,531,900	\$ 3,604,455,400
b. Inactive members	187,308,311	168,032,149
c. Active members (Item 5c)	<u>4,700,131,189</u>	<u>4,297,847,745</u>
d. Total	\$ 8,747,971,400	\$ 8,070,335,294
7. Actuarial value of assets	\$ 7,595,590,780	\$ 7,418,311,093
8. Unfunded actuarial accrued liability (UAAL) (Item 6d - Item 7)	\$ 1,152,380,620	\$ 652,024,201
9. Amortization payment		
a. Employer contribution rate	8.65%	8.65%
b. Less: Employer normal cost rate (Item 3c)	(5.12%)	(5.12%)
c. Amortization rate	3.53%	3.53%
d. Amortization contribution (Item 9c * Item 1b)	\$ 73,726,563	\$ 67,844,609
e. Expected ARP contribution	<u>3,007,898</u>	<u>2,533,279</u>
d. Total	\$ 76,734,461	\$ 70,377,888
10. Funding period based on current 8.65% employer contribution requirement, with payments increasing at assumed payroll growth rate	27.2 years	12.5 years

**Table 1**



## Actuarial Report

### Analysis of Change in Unfunded Actuarial Accrued Liability (UAAL)

<u>Basis</u> (1)	<u>June 30, 2002</u> (2)	<u>June 30, 2001</u> (3)
1. UAAL at prior valuation	\$ 652.0	\$ 624.8
2. Increases/(decreases) due to:		
a. Interest on UAAL	52.2	50.0
b. Amortization payments <sup>1</sup>	(87.5)	(98.8)
c. Liability experience	189.6	208.0
d. Asset experience	346.1	(100.1)
e. Changes in actuarial assumptions and methods	N/A	(31.9)
f. Benefit change	N/A	N/A
g. Total	500.4	27.2
3. Current UAAL (1-2g)	1,152.4	652.0

Note : Dollar amounts in millions

Actual contributions reduced by normal cost, and adjusted for timing.

**Table 2**

## Actuarial Report

### Actuarial Present Value of Future Benefits

	<u>June 30, 2002</u> (1)	<u>June 30, 2001</u> (2)
<b>1. Active members</b>		
a. Service retirement benefits	\$ 5,863,072,600	\$ 5,379,912,000
b. Refunds and deferred termination benefits	519,150,600	481,532,400
c. Survivor benefits	44,452,900	40,826,900
d. Disability retirement benefits	<u>71,111,600</u>	<u>66,552,300</u>
e. Total	\$ 6,497,787,700	\$ 5,968,823,600
<b>2. Retired members</b>		
a. Service retirement	\$ 3,653,839,200	\$ 3,410,037,700
b. Disability retirement	42,614,300	40,939,900
c. Beneficiaries	<u>164,078,400</u>	<u>153,477,800</u>
d. Total	\$ 3,860,531,900	\$ 3,604,455,400
<b>3. Inactive members</b>		
a. Vested terminations	\$ 146,722,083	\$ 131,893,335
b. Nonvested terminations	<u>40,586,228</u>	<u>36,138,814</u>
c. Total	\$ 187,308,311	\$ 168,032,149
<b>4. Total actuarial present value of future benefits</b>	\$ 10,545,627,911	\$ 9,741,311,149

**Table 3**

## Actuarial Report

### Analysis of Normal Cost

	<u>June 30, 2002</u> (1)	<u>June 30, 2001</u> (2)
1. Gross normal cost rate (payable monthly)		
a. Service retirement benefits	8.92%	8.92%
b. Refunds and deferred termination benefits	3.57%	3.57%
c. Disability retirement benefits	0.16%	0.16%
d. Survivor benefits	0.07%	0.07%
e. Total	12.72%	12.72%
2. Less: member contribution rate	<u>(7.60%)</u>	<u>(7.60%)</u>
3. Employer normal cost rate	5.12%	5.12%

**Table 4**

**Calculation of GASB 25 ARC as Percent of Payroll  
(For Following Fiscal Year)**

	June 30, 2002 (1)	June 30, 2001 (2)
1. Long term GASB 25 funding period (years)	30	30
2. Amortization contribution percentage		
a. Amortization payment	\$ 73,308,849	\$ 41,513,982
b. Less: expected payment for ARP members	<u>3,007,898</u>	<u>2,533,279</u>
c. Net (a-b)	\$ 70,300,951	\$ 38,980,703
d. Expected payroll	2,088,571,200	1,921,943,600
e. Amortization contribution percentage (c/d)	3.37%	2.03%
3. GASB 25 Annual Required Contribution		
a. Employer normal cost rate	5.12%	5.12%
b. Amortization percentage	<u>3.37%</u>	<u>2.03%</u>
c. Total	8.49%	7.15%
d. Statutory rate	8.65%	8.65%
e. ARC ( max of (c,d) )	8.65%	8.65%

**Table 5a**

## Actuarial Report

### Actual Contributions as Percentage of GASB 25 ARC for Year Ending 06/30/2002

1. Actual contributions		
a. On behalf of ERB members	\$	170,943,074
b. On behalf of ARP members		2,920,289
c. Total	\$	173,863,363
2. Statutory employer contribution rate		8.65%
3. Imputed fiscal year payroll for ERB members (Item 1a / Item 2)	\$	1,976,220,509
4. GASB 25 Annual Required Contribution		
a. Required GASB 25 employer contribution for ERB members as percent of payroll		8.65%
b. Required GASB 25 employer contribution for ERB members (Item 4a * Item 3)	\$	170,943,074
c. GASB 25 ARC (Item 4b + Item 1b)	\$	173,863,363
5. Percentage of ARC contributed (Item 1c / Item 4c)		100.0%

**Table 5b**

**Schedule of Funding Progress**  
**(As required by GASB #25)**

Valuation Date	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial		Funded Ratio (2)/(3)	Annual Covered Payroll (6)	UAAAL as % of Payroll (4)/(6)
			Accrued Liability (UAAAL) (3) - (2)	(4)			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	
June 30, 1997	\$4,516.4	\$5,854.4	\$1,338.0	77.1%	\$1,448.7	92.4%	
June 30, 1998	\$5,169.5	\$6,398.8	\$1,229.3	80.8%	\$1,542.8	79.7%	
June 30, 1999	\$5,988.5	\$6,971.7	\$983.1	85.9%	\$1,637.5	60.0%	
June 30, 2000	\$6,835.8	\$7,460.6	\$624.8	91.6%	\$1,795.7	34.8%	
June 30, 2001	\$7,418.3	\$8,070.3	\$652.0	91.9%	\$1,819.6	35.8%	
June 30, 2002	\$7,595.6	\$8,748.0	\$1,152.4	86.8%	\$1,978.5	58.2%	

Note: Dollar amounts in millions

Table 6a

## Actuarial Report

### Schedule of Employer Contributions (As required by GASB #25)

<u>Fiscal Year</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1997	\$131,535,477	98.9%
1998	\$136,190,862	100.0%
1999	\$145,521,527	100.0%
2000	\$153,260,317	100.0%
2001	\$161,524,340	100.0%
2002	\$173,863,363	100.0%

**Table 6b**

**Notes to Required Supplementary Information  
(as required by GASB #25)**

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2002
Actuarial cost method	Entry Age Normal
Amortization method	Level payment, open
Remaining amortization period (years)	27.2
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	8.00%
Projected salary increases*	4.50% to 13.00%
*Includes inflation at	3.00%
Cost-of-living adjustments	2.00%

**Table 6c**



# Actuarial Report

## Membership Data

	June 30, 2002 (1)	June 30, 2001 (2)
1. Active members		
a. Number	61,091	60,155
b. Total payroll supplied by System (annualized)	\$ 1,978,528,267	\$ 1,819,553,855
c. Average salary	\$ 32,387	\$ 30,248
d. Average age	45.2	44.9
e. Average service	9.3	9.2
2. Vested inactive members (excluding pending refunds)		
a. Number	5,217	4,800
b. Total annual deferred benefits	\$ 29,601,294	\$ 26,345,464
c. Average annual deferred benefit	5,674	5,489
3. Nonvested inactive members and vested pending refunds		
a. Number	14,714	13,401
b. Employee assessments with interest due	\$ 40,586,228	\$ 36,138,814
c. Average refund due	2,758	2,697
4. Service retirees		
a. Number	20,699	19,930
b. Total annual benefits	\$ 340,775,737	\$ 317,670,322
c. Average annual benefit	16,463	15,939
5. Disabled retirees		
a. Number	589	580
b. Total annual benefits	\$ 4,405,617	\$ 4,235,904
c. Average annual benefit	7,480	7,303
6. Beneficiaries		
a. Number	1,764	1,681
b. Total annual benefits	\$ 18,707,056	\$ 17,251,985
c. Average annual benefit	10,605	10,263

Note: Retirement benefits include impact of July 1 cost-of-living increases.

**Table 7a**

### Historical Summary of Active Member Data

Year Ending June 30,	Active Members		Covered Payroll		Average Salary		Average Average	
	Number	Percent Increase	Amount in Percent	Percent Increase	\$ Amount	Percent Increase	Age	Service
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1982	42,015	—	\$622	—	\$14,810	—	40.9	10.7
1984	40,385	-3.9%	670	7.7%	16,600	12.1%	42.0	9.9
1986	45,311	12.2%	786	17.3%	17,353	4.5%	41.7	9.7
1988	45,492	0.4%	863	9.8%	18,968	9.3%	43.9	10.1
1990	48,858	7.4%	1,033	19.7%	21,146	11.5%	42.6	8.5
1992	51,161	4.7%	1,150	11.3%	22,486	6.3%	43.0	8.9
1993	52,296	2.2%	1,191	3.6%	22,774	1.3%	43.2	8.9
1994	53,744	2.8%	1,259	5.7%	23,420	2.8%	43.3	9.0
1995	54,840	2.0%	1,356	7.7%	24,735	5.6%	43.2	9.0
1996	55,782	1.7%	1,414	4.3%	25,341	2.4%	43.7	9.1
1997	56,685	1.6%	1,449	2.5%	25,556	0.8%	43.9	9.1
1998	58,097	2.5%	1,543	6.5%	26,555	3.9%	44.0	9.0
1999	58,615	0.9%	1,637	6.1%	27,936	5.2%	44.3	9.2
2000	60,090	2.5%	1,796	9.7%	29,884	7.0%	44.5	9.1
2001	60,155	0.1%	1,820	1.3%	30,248	1.2%	44.9	9.2
2002	61,091	1.6%	1,979	8.7%	32,387	7.1%	45.2	9.3

Table 7b

## Actuarial Report

### Plan Net Assets (Assets at Market or Fair Value)

Item (1)	Valuation as of	
	June 30, 2002 (2)	June 30, 2001 (3)
1. Cash and cash equivalents	\$ 189,327,483	\$ 104,653,543
2. Receivables:		
a. Contributions	\$ 42,979,199	\$ 43,866,087
b. Investment income	27,183,401	27,886,454
c. Investment sales proceeds - brokers	44,555,672	47,907,015
d. Other	1,526	13,357
e. Total receivables	\$ 114,719,798	\$ 119,672,913
3. Investments		
a. U.S. treasury securities	\$ 455,999,937	\$ 580,929,000
b. U.S. government agencies	801,770,798	820,044,813
c. Domestic corporate bonds	601,700,740	681,938,490
d. Domestic equities	2,898,146,632	3,352,274,718
e. International equities	992,565,074	1,072,736,336
f. Total investments	\$ 5,750,183,181	\$ 6,507,923,357
4. Invested securities lending collateral	\$ 849,455,775	\$ 458,223,989
5. Properties : land, building, furniture and equipment (at cost, less accumulated depreciation)	\$ 3,630,586	\$ 1,139,216
6. Total assets	\$ 6,907,316,823	\$ 7,191,613,018
7. Liabilities		
a. Accounts payable	\$ 1,715,936	\$ 1,217,349
b. Accrued expenses	194,359	171,701
c. Refunds payable	2,522,051	3,091,297
d. Investment purchases payable - brokers	39,860,759	61,695,792
e. Due to other funds	212,015	210,949
f. Securities lending collateral	849,455,775	458,223,989
g. Total liabilities	\$ 893,960,895	\$ 524,611,077
8. Total market value of assets available for benefits (Item 6 - Item 7)	\$ 6,013,355,928	\$ 6,667,001,941

**Table 8a**

**Allocation of Cash and Investments**

	June 30, 2002	June 30, 2001
1. Cash and short-term equivalents	3.2%	1.6%
2. U.S. treasury securities	7.7%	8.8%
3. U.S. government agencies	13.5%	12.4%
4. Domestic corporate bonds	10.1%	10.3%
5. Domestic equities	48.8%	50.7%
6. International equities	16.7%	16.2%
7. Total investments	100.0%	100.0%

**Table 8b**

# Actuarial Report

## Reconciliation of Plan Net Assets

	Year Ending	
	<u>June 30, 2002</u> (1)	<u>June 30, 2001</u> (2)
1. Value of assets at beginning of year	\$ 6,667,001,941	\$ 7,567,525,248
2. Revenue for the year		
a. Contributions		
i. Member contributions (including redeposits and service purchases)	\$ 154,730,089	\$ 153,719,801
ii. Employer contributions	170,943,074	159,064,846
iii. Employer contributions for ARP members	2,920,289	2,459,494
iv. Total	\$ 328,593,452	\$ 315,244,141
b. Income		
i. Interest, dividends, and other income	\$ 168,605,483	\$ 148,343,115
ii. Investment expenses	(4,291,673)	(4,790,177)
iii. Net	\$ 164,313,810	\$ 143,552,938
c. Net realized and unrealized gains	\$ (746,928,008)	\$ (978,572,992)
d. Total revenue	\$ (254,020,746)	\$ (519,775,913)
3. Expenditures for the year		
a. Refunds	\$ 28,508,035	\$ 36,633,912
b. Benefit payments	367,494,870	340,595,679
c. Administrative and miscellaneous expenses	3,622,362	3,517,803
d. Total expenditures	\$ 399,625,267	\$ 380,747,394
4. Increase in net assets (Item 2 - Item 3)	\$ (653,646,013)	\$ (900,523,307)
5. Value of assets at end of year (Item 1 + Item 4)	\$ 6,013,355,928	\$ 6,667,001,941

**Table 9**

**Determination of Excess Earnings to be Deferred**

Year ended:	June 30, 1999 (1)	June 30, 2000 (2)	June 30, 2001 (3)	June 30, 2002 (4)
1. MVA at beginning of year	\$ 6,082,051,510	\$ 6,740,382,211	\$ 7,567,525,248	\$ 6,667,001,941
2. Net new investments				
a. Contributions	\$ 278,858,412	\$ 295,885,902	\$ 315,244,141	\$ 328,593,452
b. Benefits and refunds paid	(304,790,657)	(346,966,397)	(377,229,591)	(396,002,905)
c. Subtotal	\$ (25,932,245)	\$ (51,080,495)	\$ (61,985,450)	\$ (67,409,453)
3. MVA at end of year	\$ 6,740,382,211	\$ 7,567,525,248	\$ 6,667,001,941	\$ 6,013,355,928
4. Net MVA earnings ( 3 - 1 - 2)	\$ 684,262,946	\$ 878,223,532	\$ (838,537,857)	\$ (586,236,560)
5. Assumed investment return rate	8.00%	8.00%	8.00%	8.00%
6. Expected return	\$ 485,526,831	\$ 537,187,357	\$ 602,922,602	\$ 530,663,777
7. Excess return ( 4 - 6)	\$ 198,736,115	\$ 341,036,175	\$ (1,441,460,459)	\$ (1,116,900,337)
8. Excess return deferral percent	20%	40%	60%	80%
9. Amount deferred	\$ 39,747,223	\$ 136,414,470	\$ (864,876,275)	\$ (893,520,270)

Note : MVA is market value of assets.

Table 10a

## Actuarial Report

### Development of Actuarial Value of Assets

1. Market value of assets as of valuation	\$	6,013,355,928
2. Deferred amounts for fiscal year ending June 30,		
a. 2002	\$	(893,520,270)
b. 2001	\$	(864,876,275)
c. 2000	\$	136,414,470
d. 1999	\$	39,747,223
e. Total	\$	(1,582,234,852)
3. Actuarial value of assets (1) - (2)	\$	7,595,590,780
4. Actuarial value as percent of market		126.3%

**Table 10b**

Estimation of Yields

	Year Ending	
	<u>June 30, 2002</u>	<u>June 30, 2001</u>
	(1)	(2)
A. Market value yield		
1. Beginning of year market assets	\$ 6,667,001,941	\$ 7,567,525,248
2. Investment income (including realized and unrealized gains and losses)	\$ (582,614,198)	\$ (835,020,054)
3. End of year market assets	\$ 6,013,355,928	\$ 6,667,001,941
4. Estimated dollar weighted market value yield	-8.8%	-11.1%
B. Actuarial value yield		
1. Beginning of year actuarial assets	\$ 7,418,311,093	\$ 6,835,842,591
2. Actuarial return	\$ 244,689,140	\$ 644,453,952
3. End of year actuarial assets	\$ 7,595,590,780	\$ 7,418,311,093
4. Estimated actuarial value yield	3.3%	9.5%

Table 11a



# Actuarial Report

## History of Investment Return Rates

<u>Plan Year Ending</u> <u>June 30 of</u> (1)	<u>Market</u> (2)	<u>Actuarial</u> (3)
1995	18.5%	11.5%
1996	12.2%	12.0%
1997	20.3%	13.4%
1998	19.6%	15.0%
1999	11.3%	16.4%
2000	13.1%	15.1%
2001	-11.1%	9.5%
2002	-8.8%	3.3%

**Table 11b**

**Investment Experience Gain or Loss**

Item (1)	June 30, 2002 (2)	June 30, 2001 (3)
1. Actuarial assets, beginning of year	\$ 7,418,311,093	\$ 6,835,842,591
2. Total contributions during year	\$ 328,593,452	\$ 315,244,141
3. Benefits and refunds paid	\$ (396,002,905)	\$ (377,229,591)
4. Assumed net investment income at 8%		
a. Beginning of year assets	\$ 593,464,887	\$ 546,867,407
b. Contributions	13,143,738	12,609,766
c. Benefits and refunds paid	(15,840,116)	(15,089,184)
d. Total	\$ 590,768,509	\$ 544,387,989
5. Expected actuarial assets, end of year (Sum of items 1 through 4)	\$ 7,941,670,149	\$ 7,318,245,130
6. Actual actuarial assets, end of year	\$ 7,595,590,780	\$ 7,418,311,093
7. Asset gain (loss) for year (Item 6 - Item 5)	\$ (346,079,369)	\$ 100,065,963

**Table 12a**

## Actuarial Report

### Total Experience Gain or Loss

Item (1)	June 30, 2002 (2)	June 30, 2001 (3)
A. Calculation of total actuarial gain or loss		
1. Unfunded actuarial accrued liability (UAAL), previous year	\$ 652,024,201	\$ 624,777,008
2. Normal cost for the previous year	\$ 244,471,227	\$ 220,238,258
3. Less: contributions for the year	\$ (328,593,452)	\$ (315,244,141)
4. Interest at 8 %		
a. On UAAL	\$ 52,161,936	\$ 49,982,161
b. On normal cost	9,778,849	8,809,530
c. On contributions	(13,143,738)	(12,609,766)
d. Total	\$ 48,797,047	\$ 46,181,925
5. Expected UAAL (Sum of Items 1 - 4)	\$ 616,699,023	\$ 575,953,050
6. Actual UAAL	\$ 1,152,380,620	\$ 652,024,201
7. Total gain (loss) for the year (Item 5 - Item 6)	\$ (535,681,597)	\$ (76,071,151)
B. Source of gains and losses		
8. Asset gain (loss) for the year	\$ (346,079,369)	\$ 100,065,963
9. Liability gain (loss) for the year	\$ (189,602,228)	\$ (208,007,239)
10. Assumption change	N/A	\$ 31,870,125
11. Benefit change	N/A	N/A
12. Total	\$ (535,681,597)	\$ (76,071,151)

**Table 12b**

## History of Cash Flow

Year Ending June 30, (1)	Benefit		Expenditures			Total (7)	External Cash Cash Flow for the Year <sup>3</sup> (8)	Market Value of Assets (9)	External Cash Flow as Percent of Market Value (10)
	Contributions <sup>1</sup> (2)	Payments (3)	Refunds (4)	Administrative Expenses <sup>2</sup> (5)	Other (6)				
1990	160.8	(110.2)	(19.0)	(1.3)	(3.1)	(133.6)	27.2	2,088.7	1.3%
1992	185.5	(142.6)	(18.7)	(1.5)	(3.2)	(166.0)	19.5	2,729.3	0.7%
1993	188.4	(159.1)	(18.1)	(1.6)	0.0	(178.8)	9.6	3,178.6	0.3%
1994	214.2	(175.3)	(19.8)	(1.7)	0.0	(196.8)	17.4	3,190.0	0.5%
1995	229.7	(193.1)	(22.3)	(2.0)	0.0	(217.4)	12.3	3,792.3	0.3%
1996	238.9	(210.6)	(23.9)	(2.3)	0.0	(236.8)	2.1	4,257.2	0.0%
1997	245.6	(231.6)	(24.7)	(1.9)	0.0	(258.2)	(12.6)	5,107.3	(0.2%)
1998	260.9	(254.4)	(28.2)	(2.1)	0.0	(284.7)	(23.8)	6,082.1	(0.4%)
1999	278.9	(274.8)	(30.0)	(2.7)	0.0	(307.5)	(28.6)	6,740.4	(0.4%)
2000	295.9	(311.8)	(35.2)	(2.5)	0.0	(349.5)	(53.6)	7,567.5	(0.7%)
2001	315.2	(340.6)	(36.6)	(3.5)	0.0	(380.7)	(65.5)	6,667.0	(1.0%)
2002	328.6	(367.5)	(28.5)	(3.6)	0.0	(399.6)	(71.0)	6,013.4	(1.2%)

Amounts in \$ millions

<sup>1</sup> Column (2) includes employee assessments and employer contributions, as well as employer contributions for ARP members

<sup>2</sup> Excludes investment expenses starting in 1997.

<sup>3</sup> Column (8) = Column (2) + Column (7).

Table 13

## Actuarial Report

### Solvency Test

	<u>June 30, 2002</u> (1)	<u>June 30, 2001</u> (2)
1. Actuarial accrued liability (AAL)		
a. Active member contributions	\$ 1,084,611,241	1,023,953,742
b. Retirees and beneficiaries	3,860,531,900	3,604,455,400
c. Active and inactive members (employer financed)	3,802,828,259	3,441,926,152
d. Total	\$ 8,747,971,400	8,070,335,294
2. Actuarial value of assets	\$ 7,595,590,780	7,418,311,093
3. Cumulative portion of AAL covered		
a. Active member contributions	100%	100%
b. Retirees and beneficiaries	100%	100%
c. Active and inactive members (employer financed)	70%	81%

**Table 14**

**Historical Retired Participants' Data**

<u>Year Ending June 30,</u>	<u>Number</u>	<u>Average Monthly Benefit</u>
(1)	(2)	(3)
1984	8,462	\$430
1986	10,004	512
1988	11,375	663
1990	12,741	767
1992	14,107	846
1993	15,001	890
1994	15,814	966
1995	16,593	976
1996	17,381	1,011
1997	18,317	1,055
1998	19,244	1,104
1999	20,109	1,139
2000	21,186	1,228
2001	22,191	1,274
2002	23,052	1,315

Note: Retirement benefits include impact of July 1 cost-of-living increases.

**Table 15**

# Actuarial Report

## Distribution of Active Members As of

Attained Age	Years of Credited Service					
	0	1	2	3	4	5-9
	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.
Under 25	597 \$16,191	632 \$18,815	302 \$17,501	50 \$18,900	33 \$18,340	12 \$23,090
25-29	584 \$24,126	1,043 \$24,978	1,243 \$26,576	508 \$27,150	369 \$27,399	419 \$27,374
30-34	527 \$24,612	965 \$23,851	1,171 \$26,232	589 \$26,965	539 \$27,787	1,722 \$31,105
35-39	713 \$22,778	978 \$22,978	1,118 \$23,910	599 \$25,636	562 \$27,082	1,895 \$30,037
40-44	544 \$28,336	935 \$22,749	1,148 \$24,117	675 \$25,592	625 \$26,339	2,402 \$29,170
45-49	483 \$28,976	854 \$24,580	1,066 \$25,682	586 \$27,114	592 \$28,320	2,450 \$30,607
50-54	341 \$30,449	668 \$27,826	769 \$28,164	480 \$29,318	462 \$31,219	1,938 \$32,104
55-59	195 \$26,470	383 \$28,617	467 \$29,186	290 \$29,342	268 \$32,440	1,065 \$32,169
60-64	70 \$33,615	141 \$29,782	183 \$27,348	130 \$27,113	126 \$30,188	513 \$29,770
65-69	38 \$23,557	51 \$20,642	46 \$24,237	32 \$23,611	40 \$28,602	149 \$26,911
70 & Over	12 \$11,201	33 \$14,339	33 \$16,539	12 \$17,439	13 \$16,564	67 \$24,095
Total	4,104 \$24,684	6,683 \$24,086	7,546 \$25,548	3,951 \$26,882	3,629 \$28,223	12,632 \$30,451

Table 16

## by Age and by Years of Service 06/30/2002

10-14	15-19	20-24	25-29	30-34	35-39	40 & Over	Total
Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.
0	0	0	0	0	0	0	1,626
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$17,632
7	0	0	0	0	0	0	4,173
\$22,172	\$0	\$0	\$0	\$0	\$0	\$0	\$26,049
265	7	0	0	0	0	0	5,785
\$31,257	\$22,127	\$0	\$0	\$0	\$0	\$0	\$27,582
1,145	243	11	0	0	0	0	7,264
\$34,677	\$34,365	\$28,888	\$0	\$0	\$0	\$0	\$27,714
1,630	1,100	410	20	0	0	0	9,489
\$36,220	\$40,188	\$39,072	\$32,577	\$0	\$0	\$0	\$30,360
2,072	1,303	1,373	432	2	0	0	11,213
\$36,531	\$41,531	\$46,792	\$45,007	\$55,365	\$0	\$0	\$34,211
2,054	1,458	1,415	1,035	163	0	0	10,783
\$36,403	\$42,038	\$47,075	\$51,680	\$51,530	\$0	\$0	\$37,643
1,228	1,022	880	637	277	20	0	6,732
\$36,879	\$41,529	\$44,498	\$52,920	\$60,233	\$59,058	\$0	\$38,574
579	393	356	269	135	51	6	2,952
\$33,112	\$37,350	\$42,101	\$49,991	\$67,906	\$64,051	\$45,536	\$36,975
132	102	60	57	21	18	4	750
\$31,283	\$41,670	\$40,264	\$40,486	\$73,830	\$72,528	\$62,706	\$33,576
58	30	16	22	13	10	5	324
\$23,646	\$33,949	\$37,230	\$47,853	\$46,975	\$48,716	\$66,273	\$26,728
9,170	5,658	4,521	2,472	611	99	15	61,091
\$35,726	\$40,740	\$45,201	\$50,203	\$59,776	\$63,035	\$57,027	\$32,387





## Investments:

Investment Overview	74
Performance Review	75
Asset Allocation	76
Fixed Income	77
Domestic and International Equities	77
Securities-Lending Earnings	78

Graciela Olivarez (1928-1987): A high school drop-out, Graciela was the first woman to graduate from Notre Dame Law School (1970). She was a professor at the University of New Mexico's Law School and head of the State Planning Commission under Governor Apodaca. Appointed by President Lyndon Johnson as vice-chair of the U.S. Commission on Population Growth and American Future; appointed by President Jimmy Carter to the Community Services Administration, and served on the administration of two Southwestern governors. Owner of Channels 41 and 48 television. Served on numerous advisory boards, received many awards including "Outstanding Mexican American Women in the Southwest Award". Several scholarships are named for her.



### Investment Overview

#### I. Investment Overview

Recognizing the important and perpetual nature of the fund and the fiduciary responsibilities of the Board, the primary goal in investing the assets shall be to provide significant real returns adjusted for inflation with acceptable risk (volatility). The “prudent man” standard as defined in the state statutes applies. In light of these dual goals, the Investment Division continues to diversify the fund’s assets for purposes of both controlling risk and enhancing return.

The primary equity goal is to build a high quality, diversified portfolio of stocks. The primary focus is on large cap “blue chip” stocks with further diversification achieved through allocations to small cap, mid cap, and international equities.

Fixed income securities shall be managed using a rate anticipation style. The duration of the portfolio will be lengthened or shortened based on the outlook for interest rates. In addition, sector analysis, spread analysis and swaps will be used to increase the return on the portfolio.

#### II. Investment Process

While ultimately responsible, the Board relies on the Investment Committee of the Board (the Director and three Board members) to monitor the activities of the Investment Division. Within the applicable statutes and investment guidelines established by the Board, the Investment Division uses both internal and external managers for its assets. External investment management firms manage the small cap, mid cap, international, and a portion of large cap assets. Fixed income assets and a portion of the large cap equity assets are managed internally. For internally managed assets, final decisions and execution of orders are the responsibility of the Investment Officers.

In the day-to-day operation of the Investment Division, the in-house staff evaluates the investment environment to determine the relative attractiveness of both individual securities and the various asset classes. Based on their analysis, net cash flow from the portfolios is reinvested, always bearing in mind the long-term asset allocation goals set by the Board. These asset allocation decisions were made in conjunction with an analysis of the long-term liabilities of the fund. In view of the importance of asset allocation to investment performance, staff and the Investment Committee regularly monitor the position of the fund relative to its target allocation. The general guidelines relating to these asset classes are reviewed annually by the Investment Committee.

The investment activity is governed by the Educational Retirement Act of New Mexico wherein the eligible investments are defined. The “prudent man” standard, as defined in the state statutes, requires all members of the Board and investment staff to discharge their duties solely in the interest of fund participants and beneficiaries and with the care, skill, prudence and diligence which they would exercise in conducting their own affairs.

#### III. Asset Allocation

The asset mix of the investment portfolio favors a high proportion of common stocks, which are expected to produce higher returns over the long term. At year end equity exposure was 67% of the total portfolio, close to its 70% goal. The targeted allocation is 53% domestic equities, 17% international equities, with the remaining 30% in fixed income. The domestic equities are further diversified according to capitalization size and investment style, international equities are divided between established and emerging markets, and fixed income is subdivided into U.S. Treasury, mortgage, and corporate bond portfolios.

## Investment Performance Review

### I. ERB Fund Strategy

The ERB investment strategy focuses on a long-term approach, investing in high quality securities, which may be held for substantial periods of time. Diversifying the portfolio across several different asset classes mitigates risk by ensuring that the Fund is not completely exposed to one poorly performing market. The long term approach to asset allocation requires that the Fund be periodically rebalanced by taking profits from the better performing asset classes and redeploying the cash into areas which have fallen in value. This discipline enforces a buy low/sell high philosophy during periods of market volatility and uncertainty. The equity assets have been further subdivided into several distinct segments of the market. Each of these sub-portfolios is managed by a different investment firm, lessening the Fund's dependence on any one money manager. The Board will continue to diversify the Fund, particularly in regard to investment styles, in order to lessen the exposure to volatile growth stocks and to dampen the overall volatility of Fund performance.

### II. Economic Overview

The fiscal year ending June 30, 2002, was clouded by a series of events which layered fear and anxiety over an already weak economy. The tragedy of September 11, 2001 obviously devastated us all on a personal level, but it also placed a damper on an economy which was just beginning to emerge from recession. The immediate cutback in both consumer and business travel, the increased levels of security and the war on terrorism certainly slowed the expected rebound. Consumer confidence fell, and businesses hesitated to invest in the face of such uncertainty. Despite histori-

cally low interest rates, job creation and capital expenditures remain weak. Nonetheless, the economy expanded during each quarter, albeit at a slower than expected rate. The economy has officially been out of recession since September 2001.

The Federal Reserve has responded to this weakness by cutting short term interest rates aggressively. On June 30, 2001, the Fed Funds rate stood at 3.75%. By December 2001, the rate had been cut to 1.75%, the lowest level in 40 years. As mortgage rates fell throughout the year, households refinanced their debt. This provided a stimulus to consumer spending, which still remains quite strong. Inflation remains at very low levels.

International equity markets fared slightly better than the U.S. market, with the MSCI EAFE index down 9.49%. Returns in local markets were actually considerably weaker than this. However returns were improved upon translation into U.S. currency, as the dollar was weakening relative to other currencies. The only bright spot was the 1.3% positive return of the emerging markets index.

As a result of the steady and steep drop in interest rates, the fixed income market realized strong positive returns. The Salomon Brothers Large Pension Fund Index, which ERB uses as its benchmark, returned 8.8% for the year.

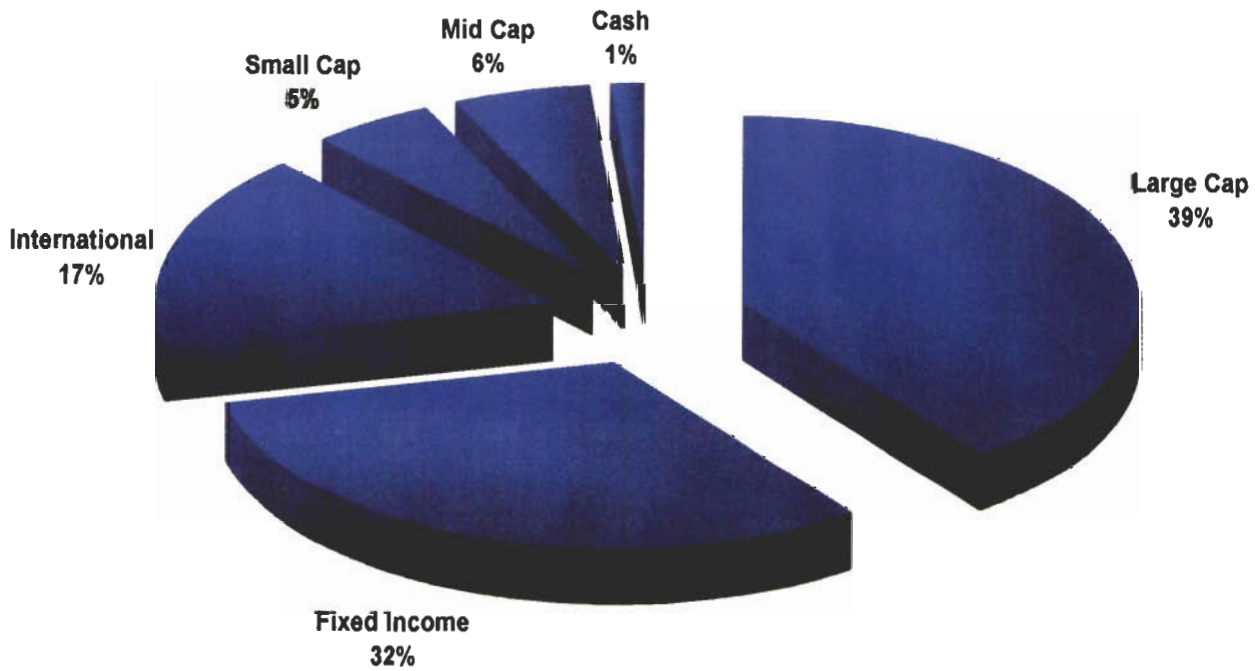
### IV. ERB Portfolio Performance

The domestic equity portfolio lost 19.1%, underperforming the S&P 500's -18% return. This was largely caused by a continued overweight in growth stocks which remained the worst performing market sector. The three international

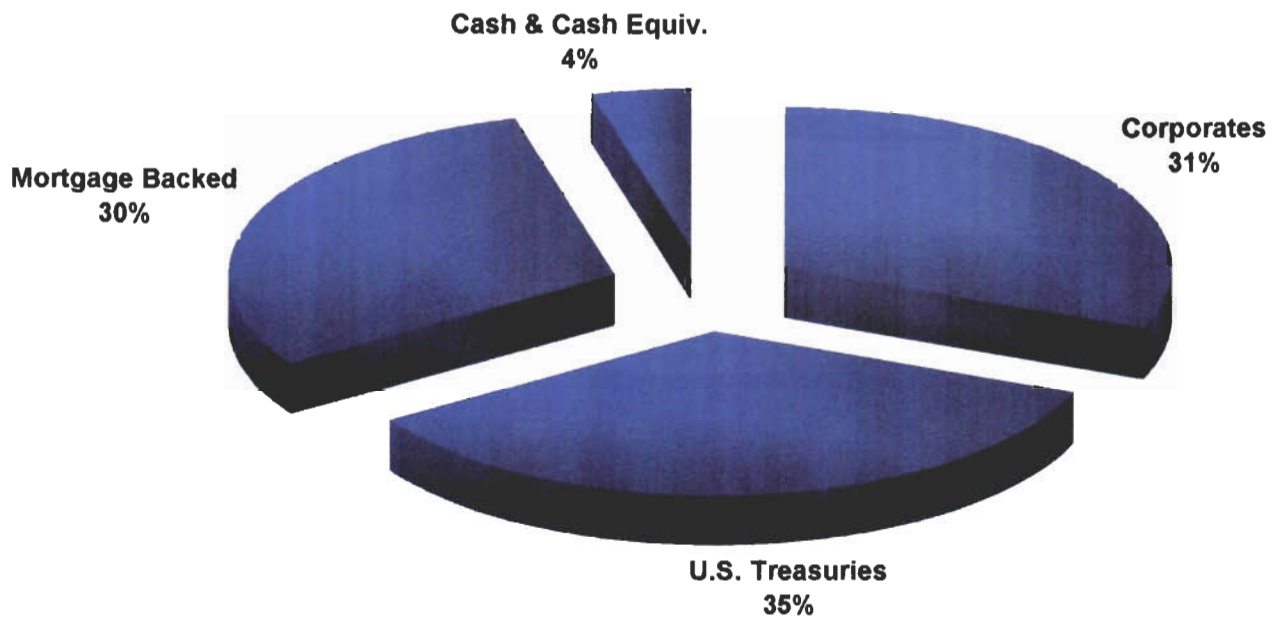
## Investments

managers returned -7.5%, slightly ahead of the benchmark of -8%. The fixed income portfolio achieved a total return of 8.25% slightly below the 8.8% return of its benchmark, the Salomon Large Pension Fund Index. The total fund returned -8.73%, compared to the -6.86% return earned by the Composite Index benchmark. This poor relative performance was almost entirely due to problems of style bias and underperformance in the domestic equity portion of the Fund. As the fiscal year ended, the Board was implementing changes to the domestic equity portfolio to alleviate this style bias and to address the poor performance of certain investment managers.

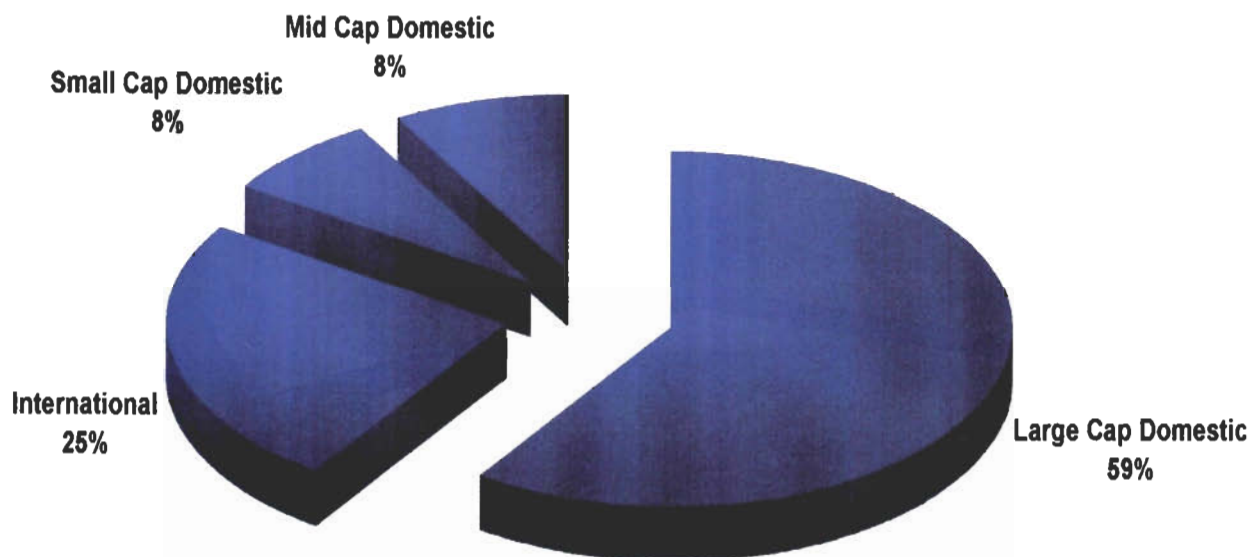
### Asset Allocation as of June 30, 2002



**Fixed Income as of June 30, 2002**



**Domestic & International Equities as of June 30, 2002**



## Investments

### Securities Lending Earnings

**Fiscal Year 2002**  
**Earned June, 2001 through May, 2002**  
**Paid July, 2001 through June, 2002**

PAY MONTH		INCOME
July	\$	165,661.46
August	\$	90,225.00
September	\$	136,067.50
October	\$	327,320.36
November	\$	372,196.55
December	\$	242,338.98
January	\$	302,183.94
February	\$	222,335.30
March	\$	186,070.28
April	\$	175,323.90
May	\$	154,297.69
June	\$	<u>177,031.19</u>
Total	\$	2,551,052.15



## **Vision of the Educational Retirement Board**

The New Mexico Educational Retirement Board will be the best retirement system in the country. We will incorporate innovative ways to protect and maximize benefits for members and will develop effective programs to support members' transition from the work place to an involved and meaningful retirement. We will increase the skills, competencies, and job satisfaction of our employees to better serve our members.



