STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

FINANCIAL STATEMENTS
As of and for the Years Ended
June 30, 2011 and 2010,
and Report of Independent Auditors

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

Financial Statements
and Other Supplementary Information
June 30, 2011 and 2010

(With Report of Independent Auditors Thereon)

Prepared By Board Staff

AUDITED BY:
MOSS ADAMS LLP

INTRODUCTORY SECTION

TABLE OF CONTENTS

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

INTRODUCTORY SECTION

FINANCIAL SECTION

REQUIRED SUPPLEMENTARY INFORMATION

OTHER SUPPLEMENTAL INFORMATION

TABLE OF CONTENTS

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

ADDITIONAL INFORMATION

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

Official Roster
As of June 30, 2011

BOARD OF DIRECTORS

NAME	TITLE
Ms. Mary Lou Cameron	Chairwoman
Mr. H. Russell Goff	Vice-Chairman
Dr. Beulah Woodfin	Secretary
Dr. Gautam Vora	Member
Mr. Bradley Day	Member
Ms. Hanna Skandera	Ex-officio Member
Mr. James B. Lewis	Ex-officio Member

ADMINISTRATIVE STAFF

Ms. Jan Goodwin	Executive Director
Mr. Rick Scroggins	Deputy Director
Mr. Chris Schatzman	General Counsel
Mr. Bob Jacksha	Chief Investment Officer
Mr. Robert Westervelt	Chief Financial Officer
Ms. Clara Mares	Administrative Services Manager
Mr. Greg Trujillo	Information Technology Manager
Mr. Vince Lujan	Member Services Manager

FINANCIAL SECTION

Report of Independent Auditors

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

We have audited the accompanying Statements of Plan Net Assets and Statements of Changes in Plan Net Assets of the State of New Mexico Educational Retirement Board (the "ERB"), as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. We have also audited the Schedule of Revenues and Expenses – Budget and Actual (Non-GAAP Basis) shown as supplemental information for the year ended June 30, 2011, as listed in the table of contents. These financial statements and schedule are the responsibility of ERB's management. Our responsibility is to express opinions on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ERB's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2, the financial statements of ERB are intended to present the net assets and changes in net assets of only that portion of the State of New Mexico which are attributable to the transactions of the Fund administered by ERB. They do not purport to, and do not present fairly, the financial position of the State of New Mexico as of June 30, 2011 and 2010, and the changes in its financial position, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the plan net assets of ERB as of June 30, 2011 and 2010, and the respective changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Schedule of Revenues and Expenses - Budget and Actual, (Non-GAAP Basis) presents fairly the revenues and expenses on the basis of accounting as described in Note 1, for the year ended June 30, 2011.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2011, on our consideration of the ERB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 9 to 16 and Required Supplementary Schedules of Funding Progress and of Employer Contributions on pages 60 to 62 are not a required part of the financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. The Schedule of Accountability in Government Act – Performance Measures on page 66 is also presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information and the supplemental information. However, we did not audit the information and express no opinion on it.

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

Our audit was conducted for the purpose of forming opinions on the financial statements of ERB taken as a whole. The Schedule of Cash Accounts, as listed in the table of contents, is presented for purposes of additional analysis and is 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.

Moss Adams LLP

Albuquerque, New Mexico
December 8, 2011

Agency management prepared this Management's Discussion and Analysis ("MD&A") of the financial position of the State of New Mexico Educational Retirement Board ("Board") for the fiscal years ended June 30, 2011 ("FY11"), 2010 ("FY10") and 2009 ("FY09"). For more detailed information of the Board's FY11 and FY10 financial activities, the reader should review the financial statements, including the notes and required supplementary information.

FINANCIAL REPORTING REQUIREMENTS

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

FINANCIAL HIGHLIGHTS

- Net assets held in trust for pension benefits increased $1.4 billion, or 16.5% in FY11 compared to an increase of $1.1 billion, or 15.7%, in FY10 and a decrease of $1.7 billion, or 18.9%, in FY09. A significant downward trend in financial markets in FY08 and the early part of FY09 reversed toward the end of FY09 and the Board experienced strong returns on its investment portfolio in FY10 and continuing through FY11.

- Investment advisor and custodial fees increased $3.4 million, or 10.8% in FY11 compared to an increase of $15.0 million, or 89.6%, in FY10 and a decrease of $3.6 million, or 17.8% in FY09. These fees are based on investment returns and portfolio balance, so strong returns and an increasing portfolio balance lead to increasing advisor and custody fees. The magnitude of the increase is less in FY11 for several reasons. One is a significant portion of the management fees are based on a manager's performance exceeding a benchmark. Thus, while a manager may have a strong positive performance, it may not result in a performance fee if the benchmark also exhibits positive performance. The fee is based on performance relative to the benchmark. There were also more favorable fee schedules negotiated with several of the fund managers. Finally, several contracts were renegotiated to allow fees to be deducted from assets under management instead of paid directly by the Board, thus are not reflected in the expense categories in the financial statements. As an offset, this change results in a lower reported investment return for these investment categories. These arrangements are common industry practice for the investment categories where they were utilized.

- Total cash and cash equivalents increased $202.0 million as of June 30, 2011, compared to an increase of $49.5 million in FY10 and a $44 million decrease in FY09. It is normal for the cash balance as of a specific date to fluctuate somewhat as the Board adjusts holdings. On June 30, 2011, the Board held cash of approximately $559 million, or 6.0% of total investments. This was slightly in excess of the target allocation ranges established by the Board. The cash was raised in anticipation of funding newly approved managers. It was anticipated that these managers would draw down the cash prior to June 30, but various circumstances delayed the funding. The Board held $357 million in cash and cash equivalents, or 4.4% of investments, at the end of FY10, and $307 million, or 4.1% of investments, at the end of FY09. These prior two years were within the Board's investment policy that targets cash holdings of 5% or less.

- Investment holdings increased $1.2 billion, or 14.8% in FY11, compared to an increase of $602 million, or 8.0%, in FY10 and a decrease of $2.05 billion, or 21.4%, in FY09, primarily due to the weak performance of domestic and foreign equity markets continuing into FY09, then turning around and strengthening through FY10 and FY11.

- Total receivables decreased by $2.1 million in FY11 compared to a decrease of just over $30 million in FY10 and a decrease of $161 million in FY09, with the majority of the changes showing in investment broker sales proceeds. A decrease indicates a smaller volume of investments were sold at or near fiscal year end, and remained outstanding on June 30. Securities sales and purchases are usually based on "trade date + 3 days," meaning that the transaction will settle three business days after it is initiated. There was an increase of $1.3 million in "other receivables" in 2011, which is a 273% increase over the prior year. This reflects the refunds receivable which is discussed in Note 3 to the financial statements. Other receivables in FY10 totaled $475 thousand and in FY09 totaled $68 thousand; both amounts are considered insignificant to the financial statements taken as a whole.

- Capital assets decreased $2.0 million, or 32.4% in FY11, compared to a decrease of $2.0 million, or 24.4%, in FY10 and a decrease of $1.9 million, or 18.7%, in FY09. These decreases in net value reflect the large depreciation costs, mostly on the pension administration system capitalized in FY08 with a relatively short depreciation period, combined with minimal new asset additions during each of these years. See Notes 2 and 8 for additional information on capital asset activity and depreciable life expectancies. The Board does not have any debt activity.

- Accounts payable decreased $7.5 million, or 79.25% in FY11 compared to an increase of $5.3 million, or 127%, in FY10 and a decrease of $1.3 million, or 24.1%, in FY09, primarily due to changes in the amount of investment advisor fees due at each respective year-end.

- Investment purchases payable-brokers increased by $41.1 million in FY11 compared to a decrease of $27.9 million in FY10 and a decrease of $143 million in FY09. An increase indicates that a larger volume of investments were purchased at or near fiscal year end and remained outstanding on June 30. Securities sales and purchases are usually based on "trade date + 3 days," meaning that the transaction will settle three business days after it is initiated.

- Employer and member contributions decreased $8.2 million, or 1.5% in FY11 compared to an increase of $28.2 million, or 5.3%, in FY10 and an increase of $42.9 million, or 8.7%, in FY09. Prior year increases were attributed to an increase in active member contribution rates and salary increases. The current year decrease is statistically insignificant and may be attributable to limited hiring or limited salary increases by the employers. There was no change in total employer plus employee contribution rates in FY11. Benefit payments to retirees increased in FY11 by $45.2 million, or 7.0%; increased by $38.5 million, or 6.2%, in FY10, and increased by $38.9 million, or 6.7%, in FY09. These increases are due to the increase in the number of retirees each year, as well as the compounding cost of living adjustments paid to retirees. Refunds and interest to terminated members increased by $6.3 million, or 21.9% in FY11 compared to a decrease of $907 thousand, or 3.1%, in FY10 and an increase of $211 thousand or 0.7%, in FY09. These FY11 refund figures include the receivable for the overpayments discussed in Note 3 to the financial statements.

- The Plan's total membership increased by 1,258, or 1.0% to 130,141 members as of June 30, 2011 compared to an increase in FY 10 of 1,988, or 1.6%, to 128,883 members, and an increase of 2,023, or 1.6%, to 126,895 members in FY09.

ACTUARIAL PLAN STATUS

The funding objective of the Board is to meet long term benefit promises to current and future members through member and employer contributions and investment earnings. Information relating to progress in meeting this objective is presented on page 60. The unfunded actuarial accrued liability (UAAL) is a measure of the currently unfunded part of future benefit obligations. The UAAL increased from $4,922,187,834 in FY2010 to $5,650,842,751 in FY 2011. This is primarily caused by the significant investment losses incurred in FY 2008 and FY 2009. To smooth the effects of short term investment results investment earnings or losses are figured into the UAAL calculation on a rolling five year basis. As such the investment losses recorded during FY 2008 and 2009 continue to have a negative impact on the change from year to year.

The Board has been working to address the funding status for several years. In 2005 the State Legislature passed Senate Bill 181, which gradually increased both employer and employee contribution rates over a period of time. Originally scheduled for full implementation in 2012, the scheduled FY 2011 increase in employer contributions was postponed by the legislature. When fully implemented the total combined contribution rate will be 21.8% of payroll. In the 2009 Legislative session, several changes to plan design were adopted that have significantly reduced the Normal Cost Percentage. These included changing retirement eligibility from either 25 years of service or age plus years of service equaling 75 (rule of 75), to 30 years of service or age plus years of service equaling 80 (rule of 80). A lower Normal Cost Percentage means less of the contributions received will be needed to fund current Normal Costs and more will work toward reducing the UAAL. A change affecting funding was also implemented, requiring employers of ERB retirees working under the Return to Work program to contribute to the fund an amount equal to the employer share, and the employee share. In the 2011 Legislative session, the responsibility for paying the employee share of the contribution was transferred to the Return to Work retiree although no additional retirement benefits will accrue to that member for the additional contributions. Furthermore, those employee contributions are nonrefundable. In addition, the Board has approved and is submitting to the Legislature's Investment and Pension Oversight Committee in December 2011 recommendations for consideration by the 2012 Legislature with the objective of achieving 80% (+-2%) funding by 2030 and 95% funding (+-5%) by 2040.

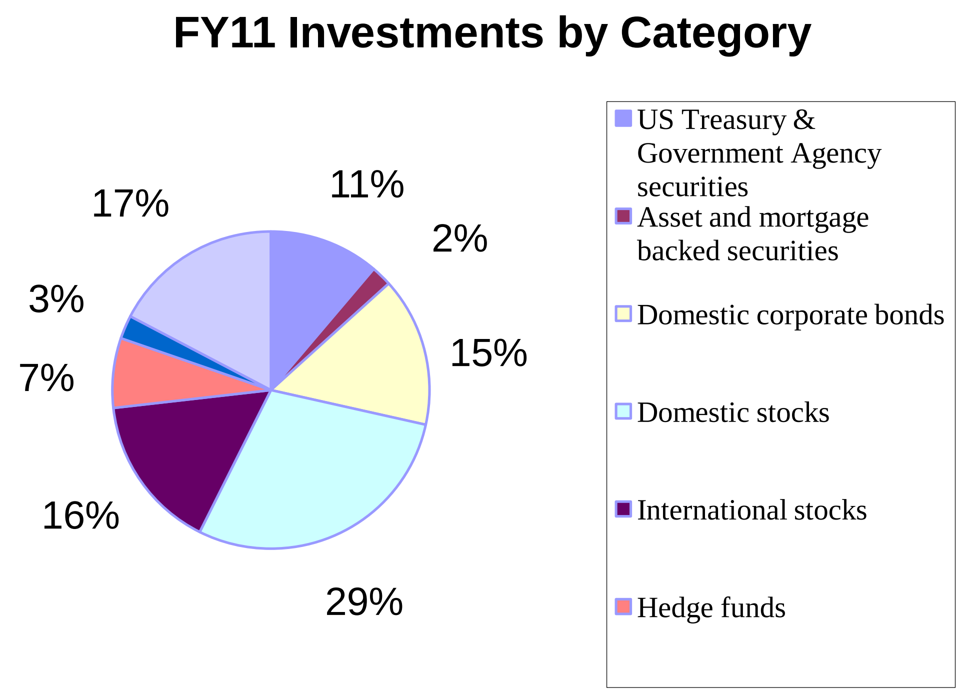
CONDENSED FINANCIAL INFORMATION

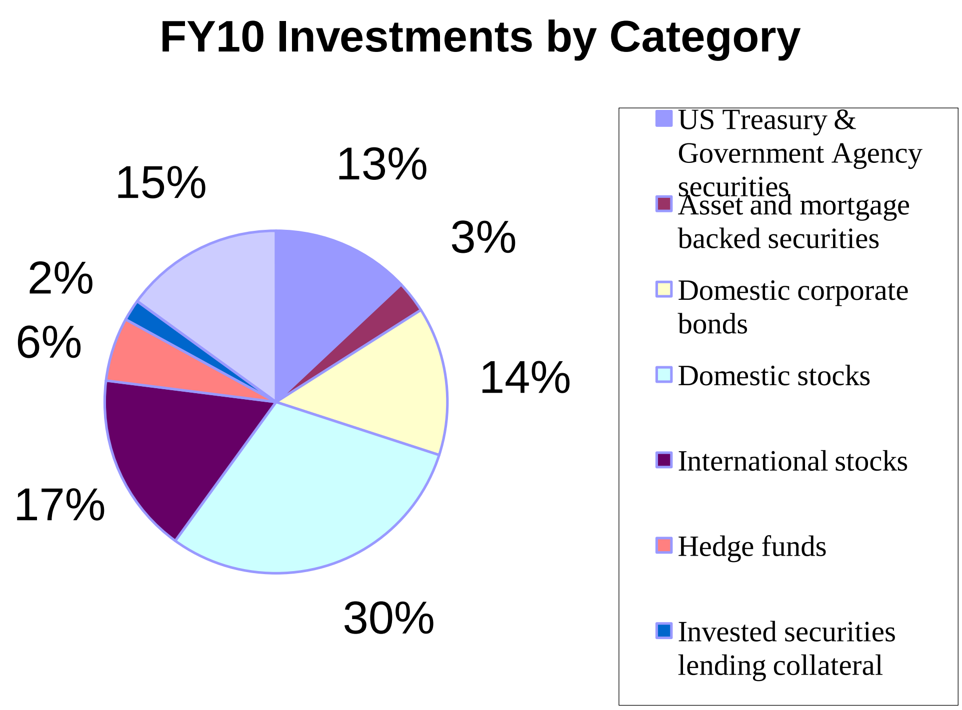
Statements of Plan Net Assets

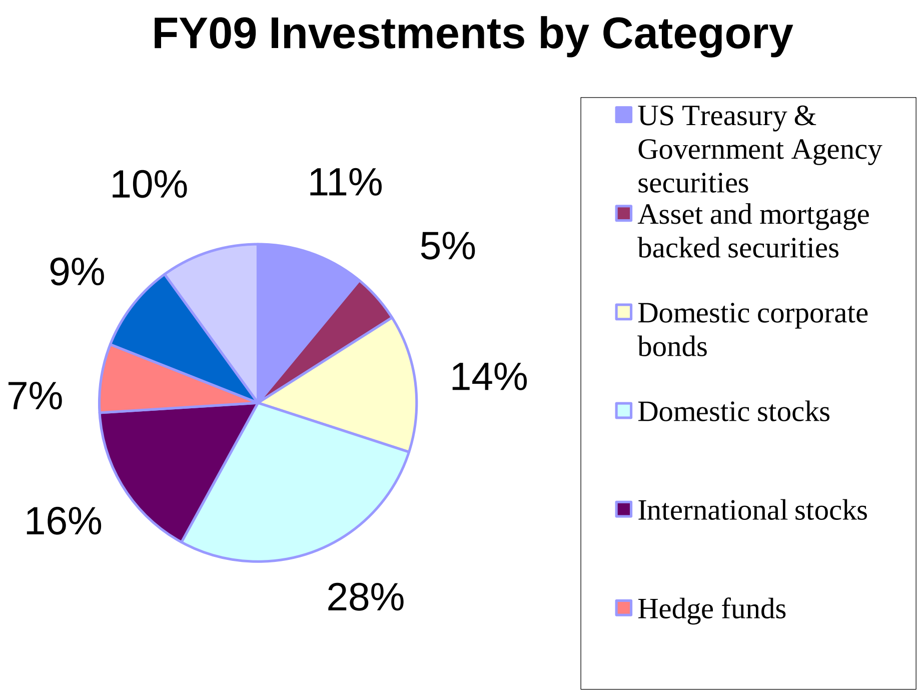
	FY11	FY10	FY09
Cash and short-term investments	$ 552,278,318	$ 344,561,297	$ 289,479,681
Receivables	191,498,873	193,577,375	223,723,966
Investment in State General Fund Investment Pool	6,346,596	12,081,842	17,627,763
Investments—at fair value	9,328,773,209	8,125,244,790	7,523,202,286
Capital assets (net of accumulated depreciation)	4,201,681	6,217,017	8,226,741
Total assets	10,083,098,677	8,681,682,321	8,062,260,437
Current liabilities	494,307,120	448,957,805	948,409,876
Long-term liabilities (compensated absences)	228,616	201,082	198,861
Total liabilities	494,535,736	449,158,887	948,608,737
Net assets held in trust for pension benefits	$ 9,588,562,941	$ 8,232,523,434	$ 7,113,651,700

Statements of Changes in Plan Net Assets

	FY11	FY10	FY09
Contributions	$ 555,775,940	$ 563,942,946	$ 535,699,520
Investment income less investment expenses	148,016,532	153,062,596	185,177,492
Net appreciation (depreciation) in the fair value of investments	1,396,479,035	1,095,257,890	(1,724,901,896)
Other income	4,033,431	3,108,550	3,696,085
Total additions (deductions)	2,104,304,938	1,815,371,982	(1,000,328,799)
Benefit payments	701,771,592	656,232,670	617,705,038
Refunds	35,086,806	28,779,655	29,686,510
Administrative expenses	11,407,033	11,487,923	8,671,992
Total deductions	748,265,431	696,500,248	656,063,540
Increase (Decrease) in net assets	1,356,039,507	1,118,871,734	(1,656,392,339)
Net assets held in trust for pension benefits:			
Beginning of year	8,232,523,434	7,113,651,700	8,770,044,039
End of year	$ 9,588,562,941	$ 8,232,523,434	$ 7,113,651,700


FY11 Investments by Category
11%
2%
15%
29%
16%
7%
3%
17%
US Treasury & Government Agency securities
Asset and mortgage backed securities
Domestic corporate bonds
Domestic stocks
International stocks
Hedge funds


FY10 Investments by Category
13%
3%
14%
30%
17%
6%
2%
15%
US Treasury & Government Agency securities
Asset and mortgage backed securities
Domestic corporate bonds
Domestic stocks
International stocks
Hedge funds
Invested securities lending collateral



BUDGETARY HIGHLIGHTS

A major portion of the Board's contractual services fees are based on market performance, and the budget is established to absorb all expenses that may be incurred during the period. These initial budget estimates may be adjusted throughout the year, based on market performance, to arrive at a final budget. In FY11, the Board's initial budget was increased by $10.5 million from $26.9 million to $37.2 million. In FY10, the budget was increased by $20.5 million from $28.6 million to $49.1 million. In FY09, the Board's budget was increased by $530 thousand from $32.4 million to $32.9 million. Changes in the corpus of the fund generally drive changes in income and expenses. The Board had savings over budgeted amounts in the three expense categories totaling $7.5 million during the 2011 fiscal year compared with savings of $7.9 million in fiscal year 2010 and savings of $9.6 million in fiscal year 2009.

LONG-TERM DEBT

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

INFRASTRUCTURE

ERB has no infrastructure assets to report.

CAPITAL ASSETS

The net investment in Capital Assets at June 30, 2011, 2010 and 2009, is as follows:

Description	Cost	Accumulated Depreciation	Book Value
2011			
Land	$ 248,172	$ -	$ 248,172
Depreciable land improvements	19,361	(4,322)	15,039
Integrated Retirement Information System	9,156,963	(7,448,865)	1,708,098
Building and building improvements	3,365,714	(1,401,117)	1,964,597
Furniture and equipment	1,122,920	(857,145)	265,775
Total	$ 13,913,130	$ (9,711,449)	$ 4,201,681
2010			
Land	$ 248,172	$ -	$ 248,172
Depreciable land improvements	19,361	(3,623)	15,738
Integrated Retirement Information System	9,156,963	(5,617,473)	3,539,490
Building and building improvements	3,365,714	(1,264,065)	2,101,649
Furniture and equipment	1,134,761	(822,793)	311,968
Total	$ 13,924,971	$ (7,707,954)	$ 6,217,017
2009			
Land	$ 248,172	$ -	$ 248,172
Depreciable land improvements	19,361	(3,111)	16,250
Integrated Retirement Information System	9,156,963	(3,786,081)	5,370,882
Building and building improvements	3,365,714	(1,126,826)	2,238,888
Furniture and equipment	1,139,019	(786,470)	352,549
Total	$ 13,929,229	$ (5,702,488)	$ 8,226,741

FINANCIAL CONTACT

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

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENTS OF PLAN NET ASSETS
June 30, 2011 and 2010

		2011		2010
Assets				
Cash	**$**	**11,915**	$	6,092
Short term Investments		**552,266,403**		344,555,205
Receivables				
Contributions		**71,938,279**		68,233,170
Investment sales proceeds-brokers		**86,433,723**		94,497,269
Interest and dividends		**31,350,765**		30,371,094
Other		**1,776,106**		475,842
Total receivables		**191,498,873**		193,577,375
Interest in State General Fund Investment Pool		**6,346,596**		12,081,842
Investments, at fair value				
U.S. Treasury securities		**597,060,723**		554,294,917
Government agency securities		**451,764,467**		510,939,793
Asset and mortgage backed securities		**200,365,752**		242,937,602
Domestic corporate bonds		**1,419,705,812**		1,099,340,868
Domestic stocks		**2,698,482,870**		2,423,224,608
International stocks		**1,473,098,558**		1,367,105,988
Private equity		**398,411,954**		241,336,795
Hedge Funds		**663,541,830**		499,102,188
Private real estate		**119,497,509**		80,872,114
Other investments		**1,093,388,583**		914,462,725
Invested securities lending collateral		**213,455,151**		191,627,192
Total investments		**9,328,773,209**		8,125,244,790
Capital assets, at cost, net of accumulated depreciation of $9,711,449 and $7,707,954, respectively		**4,201,681**		6,217,017
Total assets	**$**	**10,083,098,677**	$	8,681,682,321
Liabilities				
Accounts payable	**$**	**1,964,740**	$	9,470,796
Accounts payable school contributions		**327,151**		14,463
Accrued payroll and employee benefits		**123,474**		179,210
Accrued compensated absences		**228,616**		201,082
Refunds payable		**672,751**		1,213,339
Investment purchases payable		**277,238,076**		236,142,568
Funds held for others		**190,801**		848,955
Securities lending collateral		**213,790,127**		201,088,474
Total liabilities		**494,535,736**		449,158,887
Net assets held in trust for pension benefits	**$**	**9,588,562,941**	$	8,232,523,434

See Accompanying Notes to Financial Statements.

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENTS OF CHANGES IN PLAN NET ASSETS
Years Ended June 30, 2011 and 2010

	2011	2010
Additions		
Contributions		
Employer	$ 308,367,952	$ 313,276,296
Member	247,407,988	250,666,650
Total contributions	555,775,940	563,942,946
Investment income from investing activities		
Net change in fair value of investments	1,396,479,035	1,095,257,890
Interest income	84,798,251	109,220,628
Dividend income	97,206,639	73,935,003
Total investing activity gain	1,578,483,925	1,278,413,521
Investing activity expenses:		
Investment advisor fees	(34,192,522)	(30,555,537)
Custody fees	(1,055,194)	(1,246,558)
Total investing activity expenses	(35,247,716)	(31,802,095)
Net gain from investing activities	1,543,236,209	1,246,611,426
From securities lending activities		
Securities lending income	1,071,109	1,798,532
Securities lending expenses:		
Borrower rebates	(377,434)	(154,676)
Agent fees	189,185	244,148
Total securities lending (income) expenses	(188,249)	89,472
Net income from securities lending activities	1,259,358	1,709,060
Total net investment gain	1,544,495,567	1,248,320,486
Miscellaneous income		
Penalties	3,093	5,673
Interest on restoration of service	3,273,298	2,900,360
Other	757,040	202,517
Total miscellaneous income	4,033,431	3,108,550
Total additions	2,104,304,938	1,815,371,982
Deductions		
Refunds to terminated members	29,286,820	24,573,831
Interest on refunds	5,799,986	4,205,824
Administrative expenses	11,407,033	11,487,923
Age and service benefit payments	694,153,334	648,962,031
Disability benefit payments	7,618,258	7,270,639
Total deductions	748,265,431	696,500,248
Net increase	1,356,039,507	1,118,871,734
Net assets held in trust for pension benefits		
Beginning of the year	8,232,523,434	7,113,651,700
End of the year	$ 9,588,562,941	$ 8,232,523,434

See Accompanying Notes to Financial Statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The original budget was amended during the fiscal year. One Budget Adjustment Request (BAR) was approved for the addition of $8.65 million to contractual services expense and addition of $1.35 million in other administrative expenses. A second BAR was approved for an additional $500 thousand in contractual services. The additional expenses were approved to be funded from earnings on invested fund balance, as are all of the fund's expenses.

The Board follows these procedures in establishing the annual budget:

(1) By August 31, the Board's staff prepares a Budget Appropriation Request for the Board's approval to be presented to the next legislature. The Request includes proposed expenses and the means of financing them.

(2) On September 1, the Budget Appropriation Request is submitted to the DFA and the LFC.

(3) The DFA makes recommendations and adjustments to the Board's Budget Appropriation Request, which becomes the Governor's proposal to the Legislature.

(4) The LFC holds hearings on the Budget Appropriation Request during the Legislature's interim period. Recommendations and adjustments are made prior to presenting the Budget Appropriation Request to the Legislature.

(5) Both the DFA's and the LFC's recommended appropriation proposals are presented to the Legislature for approval of the final budget. The final budget approved by the Legislature is then sent to the Governor's office for final approval.

(6) On May 1, the Board submits its Annual Operating Budget to the DFA and the LFC based on the final appropriation from the Legislature.

(7) Per Section 9 of the General Appropriation Act of 2010, all agencies, including legislative agencies, may request category transfers among personal services and employee benefits, contractual services and other. Therefore, the legal level of budgetary control would be the appropriation program level (A-Code, P-Code, R-Code, and Z-Code). The A-Code pertains to capital outlay appropriations (general obligation/severance tax or state general fund). The P-Code pertains to operating funds. The R-Code pertains to American Recovery & Reinvestment Act (ARRA) funds. The Z-Code pertains to special appropriations.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

***Investments*—**Investments are recorded at fair value. The estimated fair value of investments is based on quoted market prices, except for certain alternative investments for which quoted market prices are not available. The estimated fair value of these alternative investments is based on the most recent valuations provided by the external investment managers, adjusted for cash receipts, cash disbursements, and securities distributions through June 30, 2011.

The Board believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed.

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

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

The Board's investments in limited partnerships are valued at estimated fair value based on their proportionate share of the partnership's fair value as recorded in the partnership's financial statements. The limited partnerships allocate gains, losses and expenses to the partners based on the ownership percentage as described in the partnership agreements. At June 30, 2011, the Board had commitments for additional future contributions to the limited partnerships totaling $801.8 million.

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

Other investments, as presented in the Statements of Plan Net Assets, include investments in swap agreements, distressed debt, option agreements, real estate investment trusts, and timber partnerships.

***Capital Assets*—**Capital assets represent the cost of assets, net of accumulated depreciation, used for the administration of the Plan. Capital assets include the Board's administration building located in Santa Fe, New Mexico. The Board's capitalization policy, based on the requirements from Section 12-6-10 NMSA 1978, is to include all assets with a useful life of more than one year and costing $5,000 and greater. Assets with original cost

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

less than $5,000 but categorized as sensitive, primarily IT equipment, are also capitalized for tracking and control purposes. All additions are capitalized at historical cost as of the date of acquisition, and depreciation is calculated on a straight-line basis over the asset's estimated useful life with no salvage value.

Estimated useful lives are as follows:

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

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

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

Funding Policy—Funding of the retirement plan is accomplished through member and employer contributions and the investment earnings on these contributions. The contribution rate is set by statute for both members and for the employers. The funding period is determined, as described below, using the Entry Age Normal actuarial cost method.

The Entry Age Normal actuarial cost method assigns the plan's total unfunded liabilities (the actuarial present value of future benefits less the actuarial value of assets) to various periods. The unfunded actuarial accrued liability is assigned to years prior to the valuation, and the normal cost is assigned to the year following the valuation. The remaining costs are the normal costs for future years. Each year's contribution is composed of (i) that year's normal cost, plus (ii) a payment used to reduce the unfunded actuarial accrued liability.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The normal cost is the level (as a percentage of pay) contribution required to fund the benefits for a new member. Under the entry age method, a calculation is made to determine the average uniform and constant percentage rate of employer contribution which, if applied to the compensation of each new participant during the entire period of his or her anticipated covered service, would be required in addition to the contributions of the participant to meet the cost of all benefits payable on their behalf. Part of the normal cost is paid from the employees' own contributions. The local employers pay the balance from their contributions. In the calculation of the normal cost, the benefit provisions applicable to future new members were used.

The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability is the excess of the actuarial accrued liability over the actuarial value of the assets.

The balance of the employers' contribution - the remainder after paying their share of the normal cost - is used to reduce the unfunded actuarial accrued liability. The funding period is the length of time required for the unfunded actuarial accrued liability to be completely amortized, assuming that the portion used to reduce the unfunded remains level as a percentage of total payroll, which is assumed to grow 3.75% per year. The 3.00% contribution made by employers to ERB on behalf of employees who elected to participate in the Alternative Retirement Plan is also used to amortize the unfunded actuarial accrued liability.

It is assumed that all contributions are made monthly at the end of the month.

Active member payroll was projected to increase 3.75% a year for the purpose of determining the funding period. This estimate is consistent with the base rate of increase in salaries used to calculate actuarial present values.

The actuarial valuation of assets used for funding purposes is derived as follows: The actuarial value of assets is based on the market value of assets with a five-year phase-in of actual investment return in excess of or (less than) expected investment income. Expected investment income is determined using the assumed investment return rate and the market value of assets (adjusted for receipts and disbursements during the year). Returns are measured net of all investment and administrative expenses.

As required under GASB Statement Number 50, *Pension Disclosures (an amendment of GASB 25 and 27)*, the following is a Schedule of Funding Progress using the entry age normal funding method to illustrate the funding status of the retirement plan.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The funded status of the ERB plan at June 30, 2011 is as follows (dollar amounts in millions):

Actuarial Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
(a)	(b)	(b) - (a)	(a)/(b)	(c)	((b-a)/c)
$9,642.2	$15,293.1	$5,650.8	63.0%	$2,523.8	223.9%

The required Schedule of Funding Progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

NOTE 2. EDUCATIONAL RETIREMENT BOARD

Plan Description**—**The State of New Mexico Educational Retirement Board ("Board") ("ERB") 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"). 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.

Contributing employers to the Plan include the following:

Public schools	89
Universities and colleges	15
Charter schools	82
Special schools	4
State agencies	11
	201

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

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

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

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

The Board serves 201 employers in the State and has an active and inactive membership of 130,141 and 128,883 at June 30, 2011 and 2010, respectively. The status and number of all participants at June 30, 2011 and 2010 consisted of the following:

	2011	**2010**
(1) Retirees and beneficiaries of deceased retirees currently receiving benefits	35,457	33,749
(2) Inactive members	33,011	31,837
(3) Current active members	61,673	63,297
	130,141	128,883

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

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

A brief summary of Plan coverage provisions follows:

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

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

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

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

(1) A further requirement to be eligible to retire is that a member must have at least one year of employment after July 1, 1957, and at least five years of contributory employment. Eligible members who have one year of employment after July 1, 1957, but less than the required five years of contributory employment, may contribute to the fund for each year needed. The cost of such contributions is a sum equal to the prevailing combined contributions of the member and the local administrative unit in effect at the time the contributory employment is acquired, which was 20.3% as of June 30, 2010, times the average annual salary of the last five years, for each year of contributory employment needed, plus 3% compounded interest from July 1, 1957, to the date of payment.

(2) *Forms of Payment* - The benefit is paid as a monthly life annuity with a guarantee that, if the payments made do not exceed the member's accumulated contributions plus accumulated interest, determined as of the date of retirement, the balance will be paid in a lump sum to the member's surviving beneficiary.

(3) *Benefit Options* - There are three benefit options available.

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

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Option B - The single life annuity monthly benefit is reduced to provide for a 100% survivor's benefit. The reduced benefit is payable during the life of the member, with the provision that, upon death, the same benefit is paid to the beneficiary for his or her lifetime. The named beneficiary may not be changed after the effective date of retirement. If the beneficiary predeceases the member, the member's benefit is adjusted by adding back the amount by which the benefit was reduced at retirement due to the election of Option B retroactively to the time of retirement.

Option C - The single life annuity monthly benefit is reduced to provide for a 50% survivor's benefit. The reduced benefit is payable during the life of the member, with the provision that, upon death, the reduced 50% benefit is paid to the beneficiary for his or her lifetime. The named beneficiary may not be changed after the effective date of retirement. If the beneficiary predeceases the member, the member's benefit is adjusted by adding the amount by which the benefit was reduced at retirement due to the election of Option C retroactively to the time of retirement.

(4) *Cost of Living Adjustment* - Retired members and surviving beneficiaries receiving benefits receive an automatic cost of living adjustment ("COLA") to their benefit each July 1, beginning in the year the member attains or would have attained age 65 or on July 1 of the year following the member's retirement date, whichever is later. The adjustment is equal to one-half the change in the Consumer Price Index ("CPI"), except that the COLA shall not exceed 4% nor be less than 2%, unless the change in CPI is less than 2%, in which case, the COLA would equal the change in CPI, but never less than zero. Members retired prior to July 1, 1984, are also entitled to an increase of the lesser of 3% or the increase in CPI for years prior to the attainment of age 65.

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

(5) *Disability Benefit*:

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

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

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

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

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

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

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

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

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

contributions made and earnings on those contributions. Retirement, death, and other benefits, including disability benefits, cannot be paid from the Educational Retirement Fund and the ERB does not calculate or determine what benefits can be paid from an ARP account.

For the year ended June 30, 2011, employees participating in the ARP contributed 9.4% of their gross annual salaries. The colleges and universities are required to contribute 7.9% of participating employees' gross annual salary to the ARP vendor on behalf of the participant and 3% of gross annual salary to the Educational Retirement Fund to help offset the impact of the ARP on the defined benefit plan. Employees participating in the ARP do not accrue any right to benefits in the defined benefit plan as a result of that contribution being made to the Fund. The 3% fee remitted to ERB for the years ended June 30, 2011 and 2010 were $4,042,339 and $4,252,523, respectively. The colleges and universities are responsible for submitting the employers' and the employees' contributions directly to the ARP vendors annuity carriers. ARP participants are completely vested in all contributions made to their accounts.

Prior to August 31, 2011, the two vendors approved to offer ARP plans to the participants were Teachers Insurance and Annuity Association/College Retirement Equities Fund ("TIAA-CREF"), and Variable Annuity Life Insurance Company ("VALIC" or "AIG VALIC," now known as "AIG Retirement"). The ERB began a process to select new ARP vendors in the fall of 2010 and on April 29, 2011 selected TIAA-CREF and Fidelity Investments as the ARP vendors. New contracts with those vendors became effective September 1, 2011. Employees are normally allowed to transfer between vendors once each year; however, after the award of new APR contracts employees were allowed an additional period in the fall of 2011 to transfer vendors.

In 2009, the New Mexico legislature created the Retirement Systems Solvency Task Force to study New Mexico public retirement plans and prepare solvency plans and recommendations. The Task Force asked the ERB to develop recommendations for changes to the defined benefit retirement plan to achieve an eighty percent (80%) funding level within thirty (30) years as recommended by the Governmental Accounting Standards Board. The ERB submitted recommendation changes to that plan to the New Mexico Legislature for consideration during its regular 2011 session. Because the changes might have had a material effect on the decisions of those ARP participants who elected to switch to the defined benefit plan pursuant to Section 22-11-47 (D), on December 12, 2010, the ERB adopted a resolution allowing those ARP participants that had elected to switch to the defined benefit plan pursuant to Section 22-11-47 (D) the option of electing to either return to the ARP during a 120 day period from May 1, 2011 to August 29, 2011 or to remain in the defined benefit plan. The 120 day period began on the first day of the month

NOTE 2. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

following the last day in April on which the Governor could take action on any legislation passed in the 2011 regular legislative session. In that same resolution the ERB also extended the 120 period that ARP participants who were then or would become eligible to elect to become members of the defined benefit plan under Section 22-11-47 (D) on or before April 30, 2010 to run from May 1, 2011 to August 29, 2011 so that those ARP participants would be informed as to any changes to the defined benefit plan that might become law when there were considering whether to switch to the defined benefit plan.

NOTE 3. REFUND OVERPAYMENTS

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

NOTE 4. INTEREST IN STATE GENERAL FUND INVESTMENT POOL AND CASH DEPOSITS

Investment in State General Fund Investment Pool

The Board is required by statute to remit any money received for or on behalf of the Plan into its own account at the New Mexico State Treasury. Excess money at the end of the day in the Board's account at the New Mexico State Treasury is pooled and invested by the Office of the New Mexico State Treasurer in overnight repurchase agreements. Accordingly, the investments of the Department consist of an interest in the investment pools managed by the New Mexico State Treasurer's Office.

NOTE 4. INTEREST IN STATE GENERAL FUND INVESTMENT POOL AND CASH DEPOSITS (CONTINUED)

All repurchase agreements are collateralized by the U.S. Treasury securities held by the New Mexico State Treasurer's custodian bank. The amount deposited as of June 30, 2011 and 2010 with the New Mexico State Treasurer's Office was $6,346,596 and $12,081,842, respectively.

Interest Rate Risk - The State Investment Pool does not have an investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk - The New Mexico State Treasurer pools are not rated. For additional GASB 40 disclosure information regarding cash held by the State Treasurer, the reader should see the separate audit report for the State Treasurer's Office for the fiscal year ended June 30, 2011.

Cash Deposits

In addition to the overnight investment at the New Mexico State Treasury, the Board invests in the Short-Term Investment Fund ("STIF"), held by J.P. Morgan. The STIF is used to facilitate more efficient trade procedures with the Board's external money managers. Net cash balances in each internal and external investment manager's portfolio are swept into the STIF at the end of each day. STIF investments and cash of $552,278,318 and $344,561,297 as of June 30, 2011 and 2010, respectively, are considered cash equivalents and are reported as cash and short term investments balances in the statements of plan net assets.

Custodial Credit Risk - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Board will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Board does not have a deposit policy for custodial credit risk. As of June 30, 2011 and 2010, there were no cash balances exposed to custodial credit risk. All cash is invested in a mutual fund consisting of 100% U.S. Treasury securities.

NOTE 5. INVESTMENTS

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

The Uniform Prudent Investor Act does the following:

A. Sets a higher standard of care and prudence for investments, above and beyond the previous standard and guiding principles of law

B. Applies to the trust as a whole, rather than individual investments

C. Requires investment strategy to be based on suitable risk and reward strategies

D. Requires diversification unless the trustees reasonably determine it is not in the best interest of the fund.

NOTE 5. INVESTMENTS (CONTINUED)

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

Investment Description	**2011**	**2010**
Investments:		
(held by the Board's agent in the Board's name)		
U.S. government and agency securities	$ 909,257,503	$ 1,055,613,784
Asset- and mortgage-backed securities	200,365,752	242,937,602
Domestic corporate bonds	1,417,079,705	1,098,504,281
Domestic stocks	2,634,642,147	2,241,803,445
International stocks	1,470,790,233	1,365,737,297
Hedge fund of funds	663,541,830	499,102,188
Private equity	398,411,954	241,336,795
Private real estate	119,497,509	80,872,114
Infrastructure	89,490,761	49,560,584
Timber	22,146,962	11,793,471
Distressed senior credit	454,829,219	412,386,606
Other investments	526,921,641	440,722,064
Total	8,906,975,216	7,740,370,231
Investments held by broker/dealers under securities loans with cash collateral:		
U.S. government and agencies securities	139,567,687	9,620,926
Domestic corporate bonds	2,626,107	836,587
Domestic stocks	63,840,723	181,421,163
International equities	2,308,325	1,368,691
Securities lending collateral investments	213,455,151	191,627,192
Total	421,797,993	384,874,559
Total Investments	$ 9,328,773,209	$ 8,125,244,790

NOTE 5. INVESTMENTS (CONTINUED)

***Foreign Currency Risk*—**Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. Foreign currency risk is present in the Board's investment in foreign equity securities. Managers of these assets are given discretion to hedge this risk. The Board's exposure to foreign currency risk as of June 30, 2011 was $1,347,083,133. The Board's exposure to foreign currency risk as June 30, 2010 was $1,431,175,890.

Exposure to foreign currency risk as of June 30, 2011 is as follows:

Currency	Equity Securities	Cash (overdraft)
Australian Dollar	$ 28,437,326	$ 25,365
Brazilian Real	80,675,847	2,312,715
British Pound Sterling	135,287,105	708,947
Canadian Dollar	7,896,804	99,410
Czech Koruna	3,874,872	178,326
Danish Krone	5,838,569	12,288
Egyptian Pound	1,700,681	27,649
Euro	240,973,759	7,344,875
Hong Kong Dollar	167,794,244	355,526
Indian Rupee	69,036,169	851,255
Indonesian Rupiah	23,000,058	(26,096)
Israeli Shekel	3,347,138	14,209
Japanese Yen	99,529,425	263,605
Malaysian Ringgit	9,634,878	-
Mexican Peso	9,501,106	41,425
New Taiwan Dollar	98,308,214	2,141,187
NewTurkish Lira	33,665,458	31,901
Norwegian Krone	5,946,471	250,246
Philippine Peso	30,938	-
Polish Zloty	13,836,958	68,111
Singapore Dollar	13,357,750	74,282
South African Rand	52,150,809	189,359
South Korean Won	184,212,855	45,982
Swedish Krona	5,023,172	85,903
Swiss Franc	31,414,578	39,448
Thai Baht	7,472,217	(186)
Total foreign exposure	1,331,947,401	15,135,732
Investments not subject to foreign currency risk	7,996,825,808	537,130,671
Total Investments	$ 9,328,773,209	$ 552,266,403

NOTE 5. INVESTMENTS (CONTINUED)

Exposure to foreign currency risk as of June 30, 2010 is as follows:

Currency	Equity Securities	Cash (overdraft)
Australian Dollar	$ 27,034,136	$ 20,149
Brazilian Real	82,138,510	(188,975)
British Pound Sterling	119,497,770	242,078
Canadian Dollar	7,753,122	30,785
Czech Koruna	-	96,832
Denmark Krone	6,623,703	148,131
Egyptian Pound	6,796,161	(299,458)
Euro	133,563,733	(381,224)
Hong Kong Dollar	187,888,163	(440,499)
Hungarian Forint	1,076,936	25,815
Indian Rupee	38,606,488	226,385
Indonesian Rupiah	25,143,767	(280,740)
Japanese Yen	102,454,646	78,643
Malaysian Ringgit	12,399,003	-
Mexican Peso	8,486,046	892,061
New Israeli Shekel	4,628,130	124,488
New Taiwan Dollar	52,138,107	52,049
Norwegian Krone	5,239,514	19,968
Polish Zloty	6,424,761	113,618
Singapore Dollar	12,849,717	95,458
South African Rand	55,575,920	(630,135)
South Korean Won	147,140,198	475,714
Swedish Krona	3,807,732	23,164
Swiss Franc	27,866,177	45,328
Thai Baht	10,655,188	7
Turkish Lira USD	26,937,749	960,586
Total foreign exposure	1,112,725,377	1,450,228
Investments not subject to foreign currency risk	7,012,519,413	343,104,977
Total Investments	$ 8,125,244,790	$ 344,555,205

NOTE 5. INVESTMENTS (CONTINUED)

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

In the event of the failure of the counterparty to deliver back the borrowed securities, the Board will sell the collateral securities and offset any gains or losses with the counterparty.

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

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

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

Investment Type	Amount 2011	Amount 2010	Duration (In Years) 2011	2010
U.S. Treasury Securities	$ 394,315,801	$ 457,392,402	6.08	6.91
U.S. Government & Agency Obligations	65,124,227	402,735,873	5.07	3.58
Corporate Obligations	1,082,050,140	823,419,995	4.68	4.07
Asset & Mortgage-Backed Securities	640,922,004	224,248,227	3.05	3.01
Guaranteed Fixed Income	-	5,823,295	N/A	1.96
Short-Term Investments	185,380,241	344,561,296	0.00	0.45
Overall	$ 2,367,792,413	$ 2,258,181,088	5.06	4.53

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

***Credit Risk*—**Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policies of the Board require that noncash, interest-paying securities in the high-yield bond portfolios may not exceed 5% of the market value of the portfolio and that investments in cash may represent no more than 5% of each individual fund. Credit risk is managed through diversification and by operating within defined parameters versus a benchmark index. Excluding those investments issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk, the Board's credit quality distribution for investments with credit risk exposure at of June 30, 2011 and 2010, is summarized below. The investments were rated and categorized according to Standard & Poor's rating standards.

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/11

Investment Type	Rating	Fair Market Value
Asset Backed Securities	A	$ 1,263,637
	A-	3,362,571
	A+	662,156
	AA	367,925
	AA+	975,635
	AAA	10,015,854
	B	667,338
	B-	1,762,797
	B+	707,674
	BB	1,160,703
	BB-	1,065,699
	BB+	4,200,423
	BBB	1,477,731
	BBB-	2,603,956
	BBB+	10,578,881
	CCC	4,129,686
	CCC-	109,628
	D	6,181
	N/R	251,281
Commercial Mortgage-Backed	A	6,729,812
	A-	2,614,333
	A+	15,544,392
	AA	2,214,857
	AA-	2,679,999
	AA+	258,113
	AAA	76,599,015
	B+	332,201
	BB-	734,891
	BBB	2,105,803
	BBB-	751,520
	BBB+	9,140,942
	CCC+	624,290
	D	1,817,406
Mortgage-Backed Securities	AAA	372,924,234
Total Asset & Mortgage Backed Securities		540,441,564

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/11 (continued)

Investment Type	Rating	Fair Market Value
Collateralized Debt/Loan Obligations	A	2,647,168
	A+	453,160
	AA	299,530
	AA	714,401
	AA+	83,579
	AAA	4,473,439
	B	1,676,197
	B-	1,425,929
	BB	723,482
	BBB-	2,333,384
	BBB+	2,617,381
	C	134,162
	CC	625,238
	CC	700,941
	CCC	7,090,766
	CCC+	416,774
	D	1,035,204
	N/R	8,991,152
Collateralized Bonds	AAA	7,030,338
Total Collateralized Debt Obligations		43,472,225
Corporate Bonds	A	77,888,713
	A-	74,439,159
	A+	22,627,472
	AA	12,333,850
	AA-	23,866,005
	AA+	18,763,646
	AAA	224,547
	B	68,048,963
	B-	82,557,719
	B+	60,696,486
	BB	14,857,058
	BB-	18,375,020
	BB+	18,605,874
	BBB	99,380,248
	BBB-	62,610,875
	BBB+	58,205,888
	C	6,365,532
	CC	1,693,481
	CCC	14,313,990
	CCC-	4,007,579
	CCC+	16,911,595
	N/R	74,094,140
Corporate Convertible Bonds	BB-	2,424,889
	CC	4,851,484
	CCC+	1,154,991
Common Stock	N/R	36,571,152
Preferred Stock	N/R	228,446
Total Domestic Corporate Securities		876,098,802

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/11 (continued)

Investment Type	Rating	Fair Market Value
Bank Loans	B	32,086,816
	B-	6,092,637
	B+	31,465,800
	BB	6,373,861
	BB-	10,641,131
	CCC	28,926,584
	CCC+	3,353,260
	N/R	23,807,545
Total Bank Loans		142,747,634
Agency Bonds	AA-	1,114,190
	AAA	38,023,942
Municipal/Provincial Bonds	A	247,610
	A-	2,588,977
	A+	3,168,198
	AA	251,723
	AA-	392,343
	AA+	128,553
	AAA	505,782
	N/R	4,061,784
Total Government Agencies		50,483,102
Government Bonds	AAA	797,815
Government Bonds Sovereign Debt	BBB	4,366,065
International Authority	AAA	4,955,548
Total US Government Securities		10,119,428
Other Investments Not Rated	N/R	1,261,544
Other Investments Not Subject To Credit Risk		7,664,148,910
TOTAL		$ 9,328,773,209

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/10

Investment Type	Rating	Fair Market Value
Short Term Investment Funds	A	$ 4,752,608
	N/R	156,471,219
Total Short Term Investment Funds		161,223,827
Asset Backed Securities	A	238,643
	A-	68,599
	AA-	1,162,339
	AAA	2,683,142
	AAA	10,310,584
	B-	662,931
	B+	415,144
	BB	991,120
	BB-	884,985
	BBB	85,524
	BBB-	594,472
	BBB+	2,814,367
	CC	13,515
	CCC	217,500
	CCC	3,779,800
	CCC+	117,141
Commercial Mortgage-Backed	A	1,713,996
	A	4,740,384
	A-	8,303,594
	A+	7,943,475
	AA	1,083,706
	AA-	6,592,879
	AA+	257,057
	AAA	16,500,382
	AAA	74,086,802
	B-	452,653
	B+	143,227
	BB-	1,062,411
	BBB	861,236
	BBB-	2,634,898
	BBB+	4,165,049
	D	1,537,890
Non-Government Backed C.M.O.s	A	2,899,910
	A-	339,455
	A+	433,147
	AA	781,700
	AA	631,401
	AA+	97,718
	AAA	6,082,775
	B	349,438
	B-	1,667,298
	BB	437,723
	BBB	98,608
	BBB+	3,672,363
	CC	935,408
	CC	5,658,433
	CCC	136,049
	CCC	14,407,957
	D	537,588
	N/R	1,463,564
Total Asset & Mortgage Backed Securities		197,749,980

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/10 (continued)

Investment Type	Rating	Fair Market Value
Collateralized Debt/Loan Obligations	A	2,093,091
	A-	5,055,773
	A+	3,106,389
	AA	2,143,820
	AA-	3,437,454
	B-	577,013
	B+	612,915
	BB	1,505,500
	BB-	227,030
	BB+	9,814,855
	BBB	82,681
	BBB-	62,384
	BBB	792,515
	BBB-	6,771,020
	BBB+	8,434,429
	CCC-	225,000
	D	245,757
Collateralized Bonds	BBB+	790,629
Total Collateralized Debt Obligations		45,978,255
Bank Loans	B	18,045,783
	B-	3,325,000
	B	40,581,842
	B-	18,250,438
	B+	13,203,418
	B+	24,624,461
	BB	307,485
	BB+	638,675
	BB+	275,115
	BBB-	2,947,457
	BBB-	2,928,251
	C	5,526,418
	CCC+	1,095,875
	CCC+	18,656,366
	D	1,411,850
	D	10,057,393
	N/R	20,628,380
Total Bank Loans		182,504,207
Government Agencies	A	748,046
	AA	2,549,142
	AAA	7,370,673
	AAA	42,134,032
	BBB	4,114,228
Government Mortgage Backed Securities	AAA	351,063,282
Municipal/Provincial Bonds	A-	3,012,945
	A+	1,009,758
	AAA	3,272,188
	AAA	1,808,550
Total Government Agencies		417,082,844

NOTE 5. INVESTMENTS (CONTINUED)

Summary of Investment by Rating - Credit Risk as of 06/30/10 (continued)

Investment Type	Rating	Fair Market Value
Corporate Bonds	A	95,935,953
	A-	53,249,505
	A+	23,750,793
	AA	12,365,267
	AA-	18,884,797
	AA+	18,437,957
	AAA	2,074,647
	B	73,301,298
	B-	30,897,572
	B+	55,727,679
	Ba3	1,659,561
	BB	22,308,134
	BB-	28,309,654
	BB+	10,244,369
	BBB	1,264,360
	BBB	82,362,403
	BBB-	68,065,982
	BBB+	77,092,551
	C	880,884
	C	5,590,700
	C2	64,839
	Caa1	580,500
	CC	185,625
	CCC	8,203,175
	CCC	9,490,425
	CCC+	2,801,750
	CCC+	29,456,196
	D	2,911,078
	D	8,264,518
	N/R	22,813,126
Corporate Convertible Bonds	N/R	4,168,688
Guaranteed Fixed Income	AAA	5,823,295
Common Stock	B+	3,305,281
Preferred Stock	BB-	798,431
	C	39,890
Other Fixed Income	Not Rated	59,610
Total Domestic Corporate Securities		781,370,493
Government Bonds	AAA	430,307,061
	BBB	3,885,907
Index Linked Government Bonds	AAA	23,199,434
Total US Government Securities		457,392,402
Other Investments Not Rated		183,042,568
Other Investments Not Subject to Credit Risk		5,698,900,214
TOTAL		$ 8,125,244,790

NOTE 5. INVESTMENTS (CONTINUED)

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

***Concentration Risk*—**Concentration risk is identified by the amount of investment in any one issuer that represents 2% or more of plan net assets. As of June 30 2011 and 2010, with the exception of U.S. Government and Agency securities, the Board was not exposed to any concentration risk greater than 2%.

NOTE 6. DERIVATIVE INSTRUMENTS

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

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

The Board's investment policies do allow for certain portfolio managers to trade in certain derivatives for hedging purposes. Golden Tree Asset Management and Beach Point Capital did so in fiscal year 2011. The amounts held in hedging derivatives were not material during the year and at year end.

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

NOTE 6. DERIVATIVE INSTRUMENTS (CONTINUED)

The following table summarizes the aggregate notional or contractual amounts for the Board's derivative financial instruments as of June 30, 2011 and 2010.

	(Dollar Amounts in Thousands)	
	2011	2010
Futures contracts - long:	13,200	32,039
Futures contracts-short:	(56,900)	(44,287)
Foreign exchange forward contracts, net	4,920	(17,738)
Options - call purchased	-	187
Options - calls sold	-	(169)
Options - puts sold	-	(3)
Swaps - credit default swap	16,927	8,514
Swaps - interst rate swap	13,415	19,285
Swaps - zero coupon	5,870	-

The fair values of derivative instruments outstanding as of June 30, 2011 and 2010 are classified by type and by the changes in fair value of the derivative instrument in the following table.

Dollar Amounts in Millions

	Unrealized Gain/(Loss) as of June 30, 2011		Fair Value at June 30, 2011	
Derivative Type	Classification	Gain/(Loss)	Classification	Amount
Futures	Investment Income	$ (106)	Investment	$ (106)
Total return type swaps	Investment Income	51	Investment	(120)
Swaps - credit default swap index	Investment Income	6	Investment	16
Swaps - interest rate swaps	Investment Income	(1,541)	Investment	(1,541)
Swaps - zero coupon	Investment Income	379	Investment	379
Swaps - index	Investment Income	(18)	Investment	162
Foreign exchange contracts	Investment Income	(363)	Investment	(355)

	Unrealized Gain/(Loss) as of June 30, 2010		Fair Value at June 30, 2010	
Derivative Type	Classification	Gain/(Loss)	Classification	Amount
Futures	Investment Income	$ 1,513	Investment	$ 1,513
Total return type swaps	Investment Income	(576)	Investment	(576)
Swaps - credit default swap index	Investment Income	(58)	Investment	(58)
Swaps - loan default swap index	Investment Income	10	Investment	10
Options	Investment Income	(67)	Investment	(67)
Foreign exchange contracts	Investment Income	215	Investment	215

NOTE 6. DERIVATIVE INSTRUMENTS (CONTINUED)

Risks—There are certain risks inherent in investments in derivatives. The Board is exposed to credit risk in the event of non-performance by counterparties to financial instruments. The fund managers that are authorized to invest in derivatives are given specific parameters as to the types of derivatives invested in and ratings of the counterparties they are allowed to enter into contracts with to ensure transactions are entered into with only high quality institutions. The board is exposed to market risk; the risk that changes in market conditions may make an investment less valuable. Exposure to market risk is managed within risk limits set by management through buying and selling of specific instruments or by entering into offsetting positions. As discussed in Note 5, foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. Managers of these assets are given discretion to hedge this risk.

The Plan invests in the following types of Derivative Instruments.

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

	2011	2010
Asset backed securities	**$ 33,221,315**	$ 25,039,803
Collateralized mortgage obligations	**32,848,421**	46,900,978
Commercial mortgage backed securities	**122,147,575**	132,079,638
Collateralized debt/loan obligations	**13,990,725**	45,978,255

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

NOTE 6. DERIVATIVE INSTRUMENTS (CONTINUED)

The following tables summarize the System's foreign exchange contracts by currency as of June 30, 2011 and 2010:

(Dollar Amounts in Thousands)

Fiscal Year Ending 6/30/2011

Currency	Buys	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
Brazilian real	382	2	-	-
British pound sterling	96	-	(1,328)	15
Canadian dollar	369	5	(6,624)	(67)
Egyptian pound	-	-	(79)	-
Euro	-	-	(9,605)	(311)
US dollar	22,483	-	(773)	-
Total	23,330	7	(18,409)	(363)

Fiscal Year Ending 6/30/2010

Currency	Buys	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
British pound sterling	2,923	1	(4,355)	(31)
Euro	32,854	(18)	(49,159)	(166)
Total	35,777	(17)	(53,514)	(197)

NOTE 6. DERIVATIVE INSTRUMENTS (CONTINUED)

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

During 2011 and 2010, the Board was a party to futures contracts held for trading purposes for U.S. Treasury bonds and 90 day Euro dollar fixed income futures. Upon entering into a futures contract, the Board is required to deposit either in cash or securities an amount ("initial margin") equal to a certain percentage of the nominal value of the contract. Subsequent payments are then made or received by the Board, depending on the daily fluctuation in the value of the underlying contracts. Cash Collateral in the amount of $1,800,000 as of June 30, 2011 was held in a Money Market fund by the custodial bank. U.S. Treasury Securities owned and included in the investments of the Board with a value of approximately $564,000, as of June 30, 2010, were held by the Plan's broker as performance security on futures contracts.

FY 11
Summary of Outstanding Futures Contracts

	No. of Contracts	Notional Amount
Futures Contracts - Long	132	$ 13,200,000
Futures Contracts - Short	541	$ 56,900,000
		Fair Value
Margin Deposit		$ 1,800,000

FY 10
Summary of Outstanding Futures Contracts

	No. of Contracts	Notional Amount
Futures Contracts - Long	129	$ 129,000,000
Futures Contracts - Short	358	$ 44,287,461
		Fair Value
Margin Deposit		$ 564,000

NOTE 6. DERIVATIVE INSTRUMENTS (CONTINUED)

***Options*—**An option contract is a contract in which the writer of the option grants the buyer of the option the right to purchase from ("call option"), or sell to ("put option"), the writer of a designated instrument at a specified price within a specified period of time. Both written and purchased options were used by the Board during 2011. When the Board purchases or writes an option, an amount equal to the premium paid or received by the plan is recorded as an asset or liability and is subsequently adjusted to the current market value of the option purchased or written. Gain or loss is recognized when the option contract expires or is closed. As of June 30, 2011, no written or purchased options remained open. As of June 30, 2010, the value of open written and purchased options was approximately $172,306 and $187,109, respectively.

***Swap Contracts*—**Swap contracts are executed on a number of different bases. The two types employed by the Board on June 30, 2011 and June 30 2010, were interest rate swap contracts and credit default swap contracts. An interest rate swap contract is an agreement between two parties to exchange periodic interest payments. One party agrees to make payments to the other based on a fixed rate of interest in exchange for payments based on a variable rate. The Board employs interest rate swap contracts to adjust fixed income portfolio durations. A credit default swap contract is similar to an insurance policy, with the credit risk of an individual issuer or a basket of issuers (the "reference asset") the insured factor. Under such a contract, two parties enter into an agreement whereby the first party pays the second party a fixed periodic payment for the specified life of the contract (analogous to an insurance premium). The other party makes no payment unless a credit event related to the reference asset occurs. If such an event takes place, the second party is obligated to make a payment to the first party. The size of the payment is linked to the decline in the reference asset's market value following determination of the occurrence of a credit event.

***Hedge Funds*—**The use of other derivatives is allowed under the Hedge Fund Investment Policy. These investments are under the management of the Hedge Fund managers and are included in the classification "Hedge Funds" on the Statements of Plan Net Assets.

NOTE 7. SECURITIES LENDING

The Board or its designated agent may enter into contracts for the temporary exchange of securities for the use by brokers/dealers, banks, and other recognized institutional investors for periods not to exceed one year, for a specified fee or consideration. Securities lent include fixed income securities and domestic equities. No such contract shall be entered into unless the contract is fully secured by a collateralized, irrevocable letter of

NOTE 7. SECURITIES LENDING (CONTINUED)

credit running to the Board; cash; or equivalent collateral of at least 102% of the market value of the securities plus accrued interest temporarily exchanged. This collateral shall be delivered to the State fiscal agent or its designee contemporaneously with the transfer of funds or delivery of the securities. Such contract may authorize the Board to invest cash collateral in instruments or securities that are authorized fund investments and may authorize payment of a fee from the Plan or from income generated by the investment of cash collateral to the borrower of securities providing cash as collateral. The Board may apportion income derived from the investment of cash collateral to pay its agent in securities lending transactions.

At year-end, the Board has no net credit risk exposure to borrowers, because the amounts the Board owes the borrowers exceed the amount the borrowers owe the Board. The contract with the Board's agent requires it to indemnify the Board fully if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Board for income distributions by the securities' issuers while the securities are on loan. The Board has not experienced any losses due to credit or market risk on securities lending activities since the implementation of this program. The Board received net securities lending income totaling $1,259,358 and $1,709,060 for the fiscal years ended June 30, 2011 and 2010, respectively. The collateral information as of June 30, 2011 and 2010 is summarized as follows:

Securities on Loan	Fair Value Lent	Collateral Held	Fair Value Collateral Held
2011:			
Lent for cash collateral:			
U.S. Government & Agency Sec.	$ 139,567,687	$ 143,441,906	$ -
U.S. Equities	63,840,723	65,182,221	-
Int'l Equities	2,308,325	2,466,000	-
U.S. Corporate Obligations with Variable Rates	2,626,107	2,700,000	213,455,151
	$ 208,342,842	$ 213,790,127	$ 213,455,151

NOTE 7. SECURITIES LENDING (CONTINUED)

Securities on Loan	Fair Value Lent	Collateral Held	Fair Value Collateral Held
2010:			
Lent for cash collateral:			
U.S. Government & Agency Sec.	$ 9,620,926	$ 9,848,835	$ -
U.S. Equities	181,421,163	188,935,639	-
Int'l Equities	1,368,691	1,440,000	-
U.S. Corporate Obligations with Variable Rates	836,587	864,000	162,703,152
Asset-Backed Sec. with Variable Rates	-	-	28,924,040
Repurchase Agreements	-	-	-
	$ 193,247,367	$ 201,088,474	$ 191,627,192

The Board is permitted to loan securities under (1) open loans, which are generally overnight loans, and (2) term loans with specified expected termination dates. Cash collateral is invested in traditional money market instruments. The policy is to match the maturities of investments made with the cash collateral to the maturities of the loan agreements. The Board cannot pledge or sell collateral securities received unless the borrower defaults and, therefore, the Board does not establish an asset and a corresponding liability in the balance sheet for the collateral value of securities received. There were no significant violations of legal or contractual provisions and no borrower or lending agent default losses.

At its June 10, 2011 meeting, the Board voted to discontinue the securities lending program upon the expiration of the existing contract with the securities lending agent, ClearLend. The contract expired September 30, 2011. All securities lending transactions were unwound prior to the expiration date.

NOTE 8. CAPITAL ASSETS

Capital assets relate to all assets of the Board that are used in operations and have useful lives extending beyond a single reporting period. Depreciation expense was $2,068,829 and $2,083,713 for the years ended 2011 and 2010, respectively. Capital asset activity for the years ended June 30, 2011 and 2010 is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
2011:				
Land	$ 248,172	$ -	$ -	$ 248,172
Depreciable land improvements	19,361	-	-	19,361
Building and building improvements	3,365,714	-	-	3,365,714
Furniture and equipment	1,104,261	57,000	68,841	1,092,420
Other assets (Art in Public Places)	30,500	-	-	30,500
Integrated Retirement Information System (IRIS)	9,156,963	-	-	9,156,963
Total	13,924,971	57,000	68,841	13,913,130
Accumulated depreciation:				
Depreciable land improvements	3,623	699	-	4,322
Building and building improvements	1,264,065	137,052	-	1,401,117
Furniture and equipment	822,793	99,686	65,334	857,145
Integrated Retirement Information System (IRIS)	5,617,473	1,831,392	-	7,448,865
Total	7,707,954	2,068,829	65,334	9,711,449
Capital assets—net	$ 6,217,017	$ (2,011,829)	$ 3,507	$ 4,201,681

	Beginning Balance	Additions	Deletions	Ending Balance
2010:				
Land	$ 248,172	$ -	$ -	$ 248,172
Depreciable land improvements	19,361	-	-	19,361
Building and building improvements	3,365,714	-	-	3,365,714
Furniture and equipment	1,108,519	75,894	80,152	1,104,261
Other assets (Art in Public Places)	30,500	-	-	30,500
Integrated Retirement Information System (IRIS)	9,156,963	-	-	9,156,963
Total	13,929,229	75,894	80,152	13,924,971
Accumulated depreciation:				
Depreciable land improvements	3,111	699	187	3,623
Building and building improvements	1,126,826	137,052	(187)	1,264,065
Furniture and equipment	786,470	114,570	78,247	822,793
Integrated Retirement Information System (IRIS)	3,786,081	1,831,392	-	5,617,473
Total	5,702,488	2,083,713	78,247	7,707,954
Capital assets—net	$ 8,226,741	$ (2,007,819)	$ 1,905	$ 6,217,017

NOTE 9. DUE TO EMPLOYERS AND 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, 2011 and 2010. Over remittances can be applied to future reporting periods or refunded, at the option of the administrative unit, in the next fiscal year. There were no amounts due to other state agencies as of June 30, 2011 or 2010.

NOTE 10. ACCRUED COMPENSATED ABSENCES

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

When employees terminate employment with the State, they are compensated for accumulated vacation leave as of the termination date, up to a maximum of 240 hours. All balances up to 240 hours for each employee have been recorded at their current pay rate as of June 30, 2011 and 2010.

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

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

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

	2011	2010
Balance payable—beginning of fiscal year	**$ 201,082**	$ 198,861
Additions	**347,422**	273,482
Deletions	**(319,888)**	(271,261)
Balance payable—end of fiscal year	**$ 228,616**	$ 201,082
Amount due within one year, estimated at 97%	**$ 221,758**	$ 195,050

Funds used to liquidate this liability will come from the ERB Retirement Plan.

NOTE 11. LEASES

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

Years Ending June 30,	
2012	$ 69,609
2013	12,480
2014	10,905
2015	725
Total	$ 93,719

Lease expense was $81,899 and $80,436 for the fiscal years ended June 30, 2011 and 2010, respectively.

NOTE 12. RETIREMENT PLANS

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

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

NOTE 12. RETIREMENT PLANS (CONTINUED)

Funding Policy. Plan members are required to contribute 8.92% of their gross salary. The Board is required to contribute 15.09% of the gross covered salary. The contribution requirements of plan members and the Board are established in State statute under Chapter 10, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The plan members and Board's contributions to PERA for the fiscal years ending June 30, 2011, 2010, and 2009 were $648,196, $568,722, and $590,423, respectively, which equal the amount of the required contributions for each fiscal year.

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

Funding Policy. Effective July 1, 2009, plan members were required by statute to contribute 7.9% of their gross salary if they earned $20,000 or less annually on a full time equivalent basis, and plan members earning more than $20,000 annually on a full time equivalent basis were required to contribute 9.4% of their gross salary. The Board was required to contribute 12.4% of the gross covered salary for employees earning $20,000 or less on a full time equivalent basis, and 10.9% of the gross covered salary of employees earning more than $20,000 annually on a full time equivalent basis. The employer contribution was scheduled to increase by .75% each year until effective July 1, 2011, the employer contribution would be 13.9% of the gross covered salary, however these increases were postponed by 2011 House Bill 628. The contribution requirements of plan members and the Board are established in State statute under Chapter 22, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The Board's contributions to ERB for the fiscal years ending June 30, 2011, 2010, and 2009 were $11,792, $23,741, and $13,915, respectively, which equal the amount of the required contributions for each fiscal year.

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

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

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

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

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

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

The Retiree Health Care Act (Section 10-7C-15, NMSA 1978) is the statutory authority that establishes the required contributions of participating employers and their employees. During the fiscal year ended June 30, 2011, the statute required each participating employer to contribute 1.67% of each participating employee's annual salary; each participating employee was required to contribute .83% of their salary. In the fiscal years ending June 30, 2012 through June 30, 2013 the contribution rates for employees and employers will rise as follows:

Fiscal Year	Employer Contribution Rate	Employee Contribution Rate
FY12	1.834%	.917%
FY13	2.000%	1.000%

Employers joining the program after 1/1/1998 are also required to make a surplus-amount contribution to the RHCA based on one of two formulas at agreed-upon intervals.

The RHCA plan is financed on a pay-as-you-go basis. The employer, employee and retiree contributions are required to be remitted to the RHCA on a monthly basis. The statutory requirements for the contributions can be changed by the New Mexico State Legislature.

The Board's contributions to the RHCA for the years ending June 30, 2011, 2010 and 2009 were $46,063, $32,476, and $31,468 for employer contributions and $23,031, $16,238, and $15,734 in employee contributions, respectively, which equal the required contributions for each year.

NOTE 14. RISK MANAGEMENT

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

NOTE 15. STATUTORY DISCLOSURES

Section 2.2.2.10P(2) of the Audit Rule 2011, 2.2.2 NMAC entitled, "Appropriations to Agencies" requires that state agencies disclose all special, deficiency, and specific appropriations. The Board received the following specific appropriations:

ERB LAND & BUILDING PROJECT

Laws of 2009, Chapter 125, Section 41	
Appropriation	$ 2,500,000
Expended in FY2010	(17,936)
Outstanding Encumbrance at end of FY2010	(75,972)
Un-encumbered balance rebudgeted in FY2011	$ 2,406,092

Un-encumbered balance carried forward	$ 2,406,092
Outstanding encumbrance from FY2010 added back in	75,972
Expended in FY2011	(26,761)
Outstanding Encumbrance at end of FY2011	(103,305)
Un-encumbered balance rebudgeted in FY2012	$ 2,351,998

IRIS ENHANCEMENT PROJECT

Laws of 2011, Chapter 179, Section 7, Item 3	
Appropriation	$ 3,500,000
Expended in FY2011	-
Outstanding Encumbrance at end of FY2011	-
Un-encumbered balance rebudgeted in FY2012	$ 3,500,000

NOTE 16. INVESTMENT PLACEMENT AGENTS

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

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

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

REQUIRED SUPPLEMENTARY INFORMATION

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FUNDING PROGRESS

(Unaudited)

Valuation Date June 30	(1) Actuarial Value of Assets (AVA)	(2) Actuarial Accrued Liability (AAL)	(3) Unfunded Actuarial Accrued Liability (2) - (1)	(4) Funded Ratio (1)/(2)	(5) Annual Covered Payroll	(6) Unfunded Liability Actuarial as a Percentage of Covered Payroll (3)/(5)
2006	7,813.9	11,436.3	3,622.4	68.3%	2,219.4	163.2%
2007	8,591.4	12,190.1	3,598.7	70.5%	2,341.1	153.7%
2008	9,272.8	12,967.0	3,694.2	71.5%	2,491.7	148.3%
2009	9,366.3	13,883.3	4,517.0	67.5%	2,585.7	174.7%
2010	9,431.3	14,353.5	4,922.2	65.7%	2,575.8	191.1%
2011	9,642.2	15,293.1	5,650.8	63.0%	2,523.8	223.9%

Note: Dollar amounts are in millions.

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF EMPLOYER CONTRIBUTIONS

(Unaudited)

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2006	$ 299,967,996	75.5%
2007	$ 364,128,448	70.3%
2008	$ 368,196,682	79.0%
2009	$ 375,430,722	86.2%
2010	$ 357,220,043	87.7%
2011	$ 377,884,749	81.6%

ACTUARIAL METHODS AND SIGNIFICANT ASSUMPTIONS

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

	2011	2010
Valuation date	June 30, 2011	June 30, 2010
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level payment, open	Level payment, open
Amortization period for GASB 25 ARC**	30 years	30 years
Asset valuation method	5-year smoothed market	5-year smoothed market
Actuarial assumptions:		
Investment rate of return*	7.75%	8.00%
Projected salary increases*	4.75% to 13.50%	5.00% to 13.50%
* Includes inflation calculated at	3.00%	3.00%
Cost of living adjustments	2.00%	2.00%

**The Governmental Accounting Standards Board ("GASB") Annual Required Contribution ("ARC") for this Plan is defined as the larger of (a) the employer normal cost plus a 30-year amortization of the Unfunded Actuarial Accrued Liability ("UAAL"), and (b) the statutory employer contribution rate, plus the 3.00% contribution on behalf of ARP members. Under GASB 25, the maximum allowable amortization period is 30 years.

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OTHER SUPPLEMENTAL INFORMATION

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF REVENUES AND EXPENSES—BUDGET AND ACTUAL (NON-GAAP BASIS)
For the Year Ended June 30, 2011

	Original Budget	Final Budget	Actual Budgetary Basis	Variance—Final Budget Favorable (Unfavorable)
REVENUES:				
Other state funds	$ 26,908,300	37,208,300	37,208,300	-
TOTAL BUDGETED REVENUE	$ 26,908,300	37,208,300	37,208,300	-
EXPENSES:				
Personal services and employee benefits	$ 4,197,400	4,197,400	4,087,075	110,325
Contractual services	21,826,700	30,976,700	24,276,385	6,700,315
Other costs	884,200	2,034,200	1,468,538	565,662
TOTAL EXPENSES	$ 26,908,300	37,208,300	29,831,998	7,376,302

RECONCILIATION OF GAAP BASIS TO BUDGETARY BASIS:

Revenue GAAP basis	$ 2,104,304,938
Net appreciation in investment value	1,396,479,035
Investment advisor and custody fees (a)	(35,247,716)
Current-year revenue not needed for budgeted expenses	(3,428,327,957)
Revenue (non-GAAP) budgetary basis	$ 37,208,300
Expenses GAAP basis—administrative (b)	$ 11,407,033
Capital outlay	(57,000)
Depreciation expense	(2,068,829)
Investment advisor and custody fees (a)	20,550,794
Expenses (non-GAAP) budgetary basis	$ 29,831,998

(A) Certain fund managers deduct their fees directly from the earnings reported, while others are paid directly. The total is shown as a reconciling item for revenues above, but only the amount paid directly is budgeted and showing in the expense reconciliation above. The amount deducted from earnings in 2011 was $14,696,922.

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

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF CASH ACCOUNTS
As of June 30, 2011 and 2010

Educational Employees' Retirement Fund
Pension Trust Account
Funds 605 and 629

	2011	2010
Petty cash	**$ 100**	$ 100
Qualified Excess Benefit Arrangement Trust		
Checking Account at Wells Fargo Bank	**11,815**	5,992
Short-term investment accounts:		
Overnight repurchase agreement pool—State Treasurer	**6,346,596**	12,081,842
Short-Term Investment Fund—STIF	**552,266,403**	344,555,205
Balance per financial statements	**$ 558,624,914**	$ 356,643,139
Pledged collateral for Wells Fargo demand deposit account:		
Total amount on deposit at June 30	**$ 11,815**	$ 5,992
Less Federal Deposit Insurance Corporation coverage	**(11,815)**	(5,992)
Total uninsured public funds	**$ -**	$ -

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF ACCOUNTABILITY IN GOVERNMENT ACT—
PERFORMANCE MEASURES
As of June 30, 2011
(Unaudited)

Type	Description	Target	Actual
Outcome	Average number of days to process refund requests	15	15
Output	Average number of days to respond to requests for benefits estimates and purchase of service requests	18	18
Outcome	Percentage of member satisfaction with seminars and trainings	95%	98%
Outcome	Average rate of return over a cumulative five-year period	8.00%	5.30%
Output	Percent of retirement applications processed within 60 days	95%	95%
Output	Number of benefit estimates and purchase of service requests computed annually	8,000	8,587
Output	Number of member workshops conducted	35	35
Quality	Percent of accurately computed retirements	99.5%	99.5%
Outcome	Funding period of UAAL in years	≤ 30	Infinite

ADDITIONAL INFORMATION

MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the State of New Mexico Educational Retirement Board (ERB) as of and for the year ended June 30, 2011, and have issued our report thereon dated December 8, 2011. We have also audited the Statement of Revenues and Expenses – Budget and Actual (Non-GAAP) for ERB presented as supplemental information for the year ended June 30, 2011, as listed in the table of contents. 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.

Internal Control Over Financial Reporting

Management of ERB is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered ERB's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ERB's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of ERB's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all

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

deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses we identified one deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as finding 2011-1 to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency: Finding 2010-2 (revised and repeated).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ERB's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item 2009-1 (revised and repeated).

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

ERB's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit ERB's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Members of ERB's Retirement Board, the Audit Committee, management, the Department of Finance and Administration, the Legislative Finance Committee, and the New Mexico State Auditor, and is not intended to be, and should not be used by anyone other than these specified parties.

Moss Adams LLP

Albuquerque, New Mexico
December 8, 2011

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS
Year Ended June 30, 2011

2009-1 Unfunded Accrued Actuarial Liability	Revised and Repeated
2010-1 Retiree Disbursements	Resolved
2010-2 Financial Close and Reporting – Adjusting Journal Entries	Revised and Repeated

A. FINANCIAL STATEMENT FINDINGS

2011-1 Investments – Reconciliations and Monthly Transaction Activity – MATERIAL WEAKNESS

CONDITION

The investment portfolio transaction activity was not recorded completely, timely and accurately during the fiscal year resulting in the following material audit adjustments:

- Journal entries ranging from $12 to $30 million to record the funding of monies from the investment portfolio for retiree benefit payments were erroneously posted to the incorrect general ledger accounts for 11 of the 12 months of the fiscal year causing the amount of recorded revenues to be understated by approximately $214.5 million.
- Reconciliation with the investment portfolio custodian found that Short Term Investment Fund Activity for the month of July 2010 was posted to the incorrect general ledger account.

CRITERIA

Adequate processes and procedures are required to be implemented to prevent or detect material misstatements in order for the Board to adequately and accurately meet its current financing objectives.

EFFECT

As the result of the above matters the total amount of recorded invested securities was understated by approximately $360.1 million, investment broker payables were understated by approximately $146 million and reported revenues were understated by approximately $214.5 million.

A. FINANCIAL STATEMENT FINDINGS

2011-1 Investments – Reconciliations and Monthly Transaction Activity – MATERIAL WEAKNESS (Continued)

CAUSE

Effective July 1, 2010 of this fiscal year, the New Mexico Educational Retirement Board (NMERB) was required to change investment custodians by State mandate. The transition between the two custodians and the process of learning the reporting techniques and methodologies of the new custodian was considered to be the primary driver for the above identified matters.

RECOMMENDATION

We recommend that NMERB take into consideration the matters identified to better develop a process of reconciliation by classification which evaluates both the balances reported by the custodian and the balances recorded on the books of NMERB. The current process for investment reconcilement should be adjusted to accommodate for the reporting changes noted by the new investment custodian.

Investment portfolio transaction activity should be reconciled at least quarterly. Each reconciliation should be executed and reviewed timely to ensure accuracy. Reconciliations should compare asset balances in total and by classification of the asset detail which should include, but is not limited to, investment cash, securities, broker receivables and payables.

In addition, each reconciliation should compare the custodians balance against the balance recorded within the general ledger. Any differences should be evaluated and resolved through the quarterly reconciliation process to avoid material year end adjusting entries.

MANAGEMENT RESPONSE

As noted in the cause statement above, this condition was primarily the result of the Custodial Bank changeover. It took several months for the new Custodial bank to provide information to us in the appropriate format. To address the specific recommendation, we have implemented the changes suggested to accomplish reconciliation of both the balance sheet and the income statement elements of investment activity more timely. We are still struggling with timely reporting from the Custodian Bank, but our standard is to accomplish monthly reconciliations within 30 days of month's close and quarterly GL postings within 30 days of the close of a quarter.

A. FINANCIAL STATEMENT FINDINGS

2010-2 Financial Close and Reporting – Adjusting Journal Entries – Revised and Repeated – Significant Deficiency

CONDITION

In order to close out ERB's general ledger as of June 30, 2011, a total of 19 client adjusting entries were required to be posted as audit adjusting journal entries after the August 31, 2011 cut-off date mandated by the New Mexico Department of Finance and Administration (DFA). Adjustments related to reversal of prior year adjusting entries and to adjust cash, investment, securities lending, capital asset, investment payable, investment receivable, revenue and expense balances.

CRITERIA

Financial close and reporting procedures are mandated by DFA.

EFFECT

Without adapting the financial close and reporting procedures the required financial closing entries could be rejected by the Statewide Human Resource, Accounting, and Management Reporting System. These adjusting entries increased asset balances by approximately $82 million, increased liabilities by approximately $171 million, decreased revenues by approximately $86 million and increased expenses by approximately $1 million.

CAUSE

Over the course of the year, there were noted projects that occurred which were identified as requiring a large degree of additional time an effort to complete. As such, yearend procedures were delayed and had occurred subsequent to the mandated deadline.

RECOMMENDATION

We recommend ERB adapt its financial close and reporting procedures to allow for ample time to meet all deadlines.

A. FINANCIAL STATEMENT FINDINGS

2010-2 Financial Close and Reporting – Adjusting Journal Entries – Revised and Repeated – Significant Deficiency (Continued)

MANAGEMENT RESPONSE

Under normal circumstances we should not have any difficulty completing our closing processes according to the DFA mandated closing schedule, but this year was anything but normal, and the schedule does not allow for any complications. We have extremely limited staff resources. The refunds overpayment issue discussed in Note 3 to the financial statements, and discussed at length with the auditors, put enormous stress on already tight resources, so admittedly we were behind. Staff is better trained and we have adjusted procedures and implemented tools to ensure that, barring major unforeseen events, we can now ensure timely fiscal year end closing.

A. FINANCIAL STATEMENT FINDINGS

2009-1 Unfunded Actuarial Accrued Liability – Revised and Repeated-Compliance

CONDITION

At June 30, 2011, utilizing the current rates of member and employer contributions, asset experience, benefit changes, interest on the unfunded liability and retiree payments, it will take an infinite period of time to eliminate the unfunded amount of the actuarial accrued liability (i.e. the unfunded actuarial accrued liability will never be paid down). The unfunded actuarial accrued liability increased from approximately $4.9 billion at June 30, 2010 to approximately $5.7 billion at June 30, 2011.

CRITERIA

The Governmental Accounting Standards Board (GASB) No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* defines, for accounting purposes, the maximum acceptable period for the unfunded actuarial liability.

Per GASB No. 25, Paragraph 36, f, 1. "Maximum amortization period -- The maximum acceptable amortization period for the total unfunded actuarial liability is 30 years."

In addition, internal ERB policy requires the amortization period for the unfunded actuarial accrued liability to be less than thirty years.

EFFECT

The maximum acceptable amortization period for the unfunded actuarial accrued liability of thirty years was exceeded at June 30, 2011.

CAUSE

ERB has not been able to achieve funding of required contributions at the 100% level in recent years. Actual contributions have averaged 85.17% of the total annual required contribution over the course of the last three fiscal years.

RECOMMENDATION

We recommend that ERB continue to monitor the unfunded actuarial liability and the related amortization period. We also recommend that legislation be enacted providing for 100% of the annual required contribution to be made every year.

A. FINANCIAL STATEMENT FINDINGS

2009-1 Unfunded Actuarial Accrued Liability – Revised and Repeated – Compliance (Continued)

MANAGEMENT RESPONSE

ERB has little ability to control the UAAL or the funding period. Both the benefits and contributions are set by the legislature, and without further changes in one or the other or both, and without a major market recovery, the funding period is projected to increase significantly over the next few years, as the rest of the FY 2008 and FY 2009 losses are phased into the actuarial value of assets. However, the Board and ERB Management will continue looking at modifications to plan design and opportunities to increase contribution rates in order to decrease the Unfunded Actuarial Accrued Liability (UAAL) and the funding period. Reducing the funding period to the GASB 25 limit of 30 years is a goal that our most reasonable projections and estimates indicate will be several years in the future.

The Board has been working to address the funding status for several years. In 2005 the State Legislature passed Senate Bill 181, which gradually increased both employer and employee contribution rates over a period of time. Originally scheduled for full implementation in 2012, the scheduled FY 2011 increase in employer contributions was postponed by the legislature. When fully implemented the total combined contribution rate will be 21.8% of payroll. In the 2009 Legislative session, several changes to plan design were adopted that have significantly reduced the Normal Cost Percentage. These included changing retirement eligibility from either 25 years of service or age plus years of service equaling 75 (rule of 75), to 30 years of service or age plus years of service equaling 80 (rule of 80). A lower Normal Cost Percentage means less of the contributions received will be needed to fund current Normal Costs and more will work toward reducing the UAAL. A change affecting funding was also implemented, requiring employers of ERB retirees working under the Return to Work program to contribute to the fund an amount equal to the employer share, and the employee share. In the 2011 Legislative session, the responsibility for paying the employee share of the contribution was transferred to the Return to Work retiree although no additional retirement benefits will accrue to that member for the additional contributions. Furthermore, those employee contributions are nonrefundable. In addition, the Board has approved and is submitting to the Legislature's Investment and Pension Oversight Committee in December 2011 recommendations for consideration by the 2012 Legislature with the objective of achieving 80% (+-2%) funding by 2030 and 95% funding (+-5%) by 2040.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
EXIT CONFERENCE
Year Ended June 30, 2011

Board staff prepared the Management's Discussion & Analysis ("MD&A"), financial statements, statements, schedules, and notes for the fiscal years ended June 30, 2011 and 2010. The contents of this report were discussed during an exit conference with the Audit Committee of the Board of Directors and management of ERB on December 9, 2011. The following individuals attended this exit conference:

Educational Retirement Board

Members of the Audit Committee –
Mary Lou Cameron, Audit Committee Chairperson
Russell Goff, Audit Committee Member

Agency Management –
Jan Goodwin, Executive Director
Rick Scroggins, Deputy Director
Bob Westervelt, Chief Financial Officer

Moss Adams LLP

Scott Eliason, Partner
Lisa Todd, Senior Manager
Jim Cox, Senior

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