



**STATE OF NEW MEXICO INVESTMENT
COUNCIL INVESTMENT OFFICE
A Component Unit of
The State of New Mexico**

FINANCIAL STATEMENTS

JUNE 30, 2010

MOSS ADAMS_{LLP}

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

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STATE OF NEW MEXICO
INVESTMENT COUNCIL INVESTMENT OFFICE
A Component Unit of the State of New Mexico

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STATE OF NEW MEXICO
INVESTMENT COUNCIL INVESTMENT OFFICE
A Component Unit of the State of New Mexico

Official Roster
Governing Board
June 30, 2010

| Name | Position |
|---|--|
| Bill Richardson, Governor | Ex officio member, Chairman |
| Katherine B. Miller, Secretary of the Department of Finance and Administration | Ex officio member |
| James Lewis, State Treasurer | Ex officio member |
| Patrick Lyons, Commissioner of Public Lands | Ex officio member |
| David Harris, CFO- UNM | Public Member, Governor's Appointment |
| Catherine Allen | Public Member, Governor's Appointment |
| Douglas Brown | Public Member, Governor's Appointment |
| Peter Frank | Public Member, Legislative Appointment |
| Leonard Lee Rawson | Public Member, Legislative Appointment |
| Craig Reeves | Public Member, Legislative Appointment |
| Michael Martin | Public Member, Legislative Appointment |

Independent Auditors' Report

The Honorable Bill Richardson, Chairman
and Members of the State Investment Council
and Mr. Hector H. Balderas, State Auditor

We have audited the accompanying financial statements of the governmental activities, general fund, the general fund budget comparison, and each fiduciary fund of the State of New Mexico Investment Council – Investment Office (Office), as of and for the year ended June 30, 2010, which collectively comprise the Office's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Office's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Office'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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Office are intended to present the financial position and changes in financial position of only that portion of the governmental activities of the State of New Mexico that is attributable to the transactions of the Office. They do not purport to and do not, present fairly the financial position of the State of New Mexico as of June 30, 2010, and the changes in financial position, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable Bill Richardson, Chairman
and Members of the State Investment Council
and Mr. Hector H. Balderas, State Auditor

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, general fund, and each fiduciary fund of the Office, as of June 30, 2010, and the respective changes in financial position thereof and the general fund budgetary comparison for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2010 on our consideration of the Office'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 4 through 12 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Office's basic financial statements. The accompanying financial information listed as supplemental information in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Office. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Mess Adams LLP

Albuquerque, New Mexico
December 14, 2010

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2010

This discussion and analysis of the State of New Mexico Investment Council – Investment Office (Office) provides a summary of the financial position and results of operations for the year ended June 30, 2010 with highlights and comparisons. The reader should review the actual financial statements, including the notes and supplemental schedules, for a more complete picture of the Office's financial activities.

Financial Position

Net Assets

All expenses of the Office are related to investment management of the permanent funds and of the eighteen external clients. As a result, these amounts are paid by the funds and clients based on relative market values managed. Accordingly, there tends to be very little change in the net assets of the Office.

The assets for the primary governmental unit consist of cash, due from other funds and capital assets consisting of furniture and equipment. The unrestricted net assets are equal to the amount of accrued vacation and sick pay liability, which is not a reimbursable expense of the funds until the compensated leave time is actually used. Except for the due to/due from balances, there have not been significant changes to assets, liabilities and net assets as compared to the prior year.

Statement of Net Assets

| | 2010 | 2009 |
|--|----------------------------|--------------------------|
| Assets | | |
| Interest in State Treasurer General Fund Investment Pool | \$ 8,036,362 | 14,279,750 |
| Due from clients | 265,563 | 225,676 |
| Capital assets, net | <u>34,094</u> | <u>27,205</u> |
| Total assets | <u>\$ 8,336,019</u> | <u>14,532,631</u> |
| Liabilities | | |
| Due to Land Grant Permanent Fund | \$ 2,773,775 | 7,643,303 |
| Due to Severance Tax Permanent Fund | 1,188,761 | 3,275,701 |
| Accounts payable | 4,258,683 | 3,505,392 |
| Accrued payroll | 80,706 | 81,030 |
| Accrued vacation and sick pay | 115,086 | 235,104 |
| Other | <u>-</u> | <u>-</u> |
| Total liabilities | <u>\$ 8,417,011</u> | <u>14,740,530</u> |
| Net Assets | | |
| Invested in capital assets | \$ 34,094 | 27,205 |
| Unrestricted | <u>(190,856)</u> | <u>(235,104)</u> |
| Total net assets (deficit) | <u>\$ (156,762)</u> | <u>(207,899)</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Year Ended June 30, 2010

Financial Position (continued)

Statement of Activities

The Statement of Activities focuses on the cost of various activities, which are funded by the Office's general and other revenues. This is intended to summarize and simplify the users' analysis of the cost of services. The governmental activities reflect the Office's basic service of collecting and optimizing revenues for its beneficiaries.

Increase in Expenses and Revenues

The primary increase for fiscal year 2010 in expenditures has been in external legal fees. Expenses are paid by the permanent funds and clients and, correspondingly, revenues recorded from the funds and clients are also higher.

Statement of Activities

| | 2010 | 2009 |
|--|----------------------|-------------------|
| Expenses | | |
| General government | <u>\$ 31,454,985</u> | <u>21,836,563</u> |
| Revenues | | |
| Program revenues | | |
| Fees from external investment trust participants | 1,479,158 | 809,722 |
| Transfers | | |
| Interfund services provided | | |
| Land Grant Permanent Fund | 21,018,875 | 14,716,517 |
| Severance Tax Permanent Fund | <u>9,008,089</u> | <u>6,307,079</u> |
| Total program revenues and transfer | 31,506,122 | 21,833,318 |
| Change in net assets | 51,137 | (3,245) |
| Net assets beginning of year (deficit) | <u>(207,899)</u> | <u>(204,654)</u> |
| Net assets end of year (deficit) | <u>\$ (156,762)</u> | <u>(207,899)</u> |

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2010**

The total revenues and expenditures for the General Administrative Fund compared to the prior year are as follows:

| | 2010 | 2009 | Increase/ (Decrease) |
|---|----------------------|-------------------|-------------------------|
| Total Revenues/Expenditures | | | |
| Revenues from external trust participants | <u>\$ 1,479,158</u> | <u>809,722</u> | <u>82.7%</u> |
| Expenditures | | | |
| Personnel services & benefits | 3,581,962 | 3,558,747 | 0.7% |
| Contractual services & custody fees | 27,257,844 | 17,547,535 | 55.3% |
| Other – Operating expenses | <u>666,316</u> | <u>727,036</u> | <u>(8.4%)</u> |
| Total expenditures | <u>\$ 31,506,122</u> | <u>21,833,318</u> | <u>44.3%</u> |

The Office expenditures for fiscal year 2010 increased in total, primarily due to increased litigation expenses. Personnel costs increased slightly over fiscal year 2009, while the operating expenses increased slightly. The expenses of the Office are paid by the funds and then allocated back through the pools to appropriately associate costs to the funds and clients for services provided by the Office. The Office budgeted, but did not spend, approximately \$4.1 million.

Financial Highlights – Fiduciary Funds

The primary governmental activity for the Office is the administration and management of five State of New Mexico permanent funds—the Land Grant Permanent Fund (LGPF), the Severance Tax Permanent Fund (STPF), the Tobacco Settlement Permanent Fund (TSPF), the Water Trust Fund (WTF), and the State Unemployment Trust Fund (SUTF). The State Investment Office, which is responsible for carrying out the policies of the State Investment Council by investment management, also provides similar services to eighteen other state agencies and political subdivisions of New Mexico.

The purpose of the permanent funds is to contribute recurring revenues for the operating budget of the State of New Mexico and the beneficiaries of the permanent funds. The investment management goal for the funds is to continue to preserve the permanent endowment funds for future generations and future benefits by growing the funds at a rate at least equal to inflation. The amount of annual distributions for the STPF, per statute, was 4.7% of the average of the year-end market values of the funds for the immediately preceding five years. The LGPF and TSPF distribution formulas are detailed below. Administrative costs are projected and added to the distribution formula to arrive at the total spending policy.

On September 23, 2003, New Mexico voters approved Constitutional Amendment No. 2, increasing the Land Grant Permanent Fund distribution formula to its beneficiaries, the public schools and 19 other specifically identified state institutions. The amendment

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2010

provides for suspension of distributions greater than 5.0% under certain circumstances. Distributions changed as follows:

- Beginning October 2003, the distribution increased to 5.0%.
- For fiscal years 2005-2012, distributions increase to 5.8%.
- For fiscal years 2013-2016, distributions decrease to 5.5%.
- Beginning fiscal year 2017, distributions decrease to 5.0%.

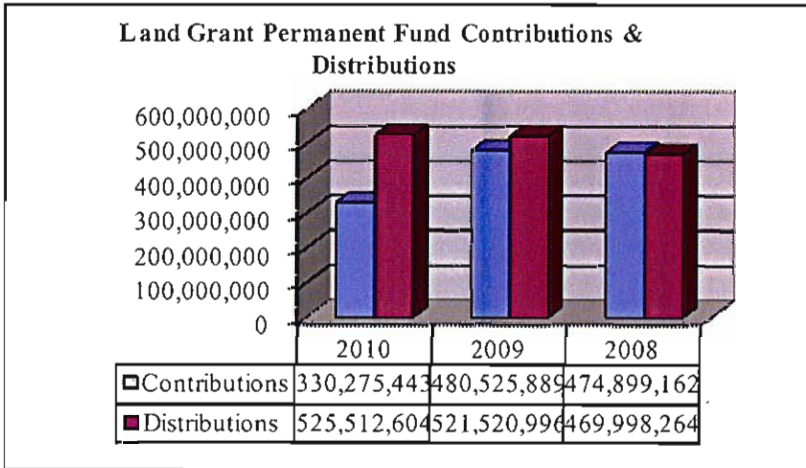
The TSPF distribution was originally established for the Tobacco Settlement Program Fund at 50% of the prior year's contributions from the legal settlement with the tobacco companies. In April 2003, the New Mexico State Legislature changed the Tobacco Settlement Permanent Fund distribution. Based on this change, in fiscal years 2003 through 2006 the distribution was changed to 100% of the current year contributions, and the distribution goes to the State General Fund rather than the Tobacco Settlement Program Fund. Beginning in fiscal year 2007, the distribution for TSPF returned to 50% of prior year's contributions. In 2009, the Legislature, by passing SB79, increased the percentage of distribution from the Tobacco Settlement Permanent Fund to the Tobacco Settlement Program Fund for fiscal years 2009 and 2010 back to 100% of the prior year's contribution received.

In April 2004, the Governmental Accounting Standards Board issued Technical Bulletin 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issues (GASB TB 2004-1), which became effective for financial statements for periods ending after June 15, 2004. GASB TB 2004-1 clarifies recognition guidance for payments received under the Master Settlement Agreement (MSA) with the settling tobacco companies. Since annual tobacco settlement reimbursements (TSRs) are based on cigarette sales from the preceding calendar year, governments should estimate accrued TSRs that derive from tobacco sales from January 1 to their respective fiscal year-ends. Accordingly, the TSPF recognized \$21,659,932 and \$23,789,467 for the years ended June 30, 2010 and 2009, respectively.

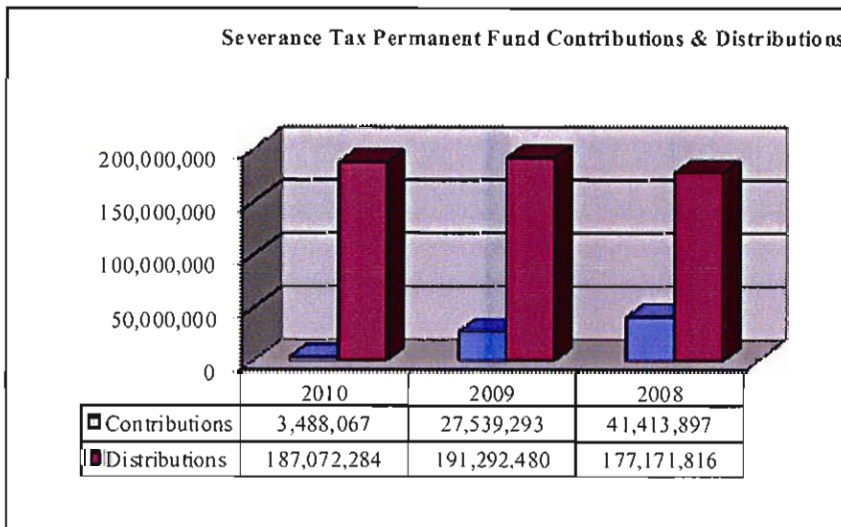
The Land Grant Permanent Fund contributions from the State Land Office (royalties and income from land grants) for fiscal year 2010 decreased 31.27% from the fiscal year 2009. Distributions to the beneficiaries of the fund increased 0.77% from the prior year.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Year Ended June 30, 2010**

The chart below details the changes in contributions and distributions for the Land Grant Permanent Fund.



The Severance Tax Permanent Fund contributions are made from the Severance Tax Bonding Fund. Severance tax revenues first pay the required debt service on severance tax bonds issued by the State. The amounts transferred from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund decreased from \$ 27.5 million in fiscal year 2009 to \$ 3.5 million in fiscal year 2010. Distributions to the State General Fund in fiscal year 2010 decreased 2.21% from the previous year.



The Tobacco Settlement Permanent Fund distribution was \$40.2 million to the State General Fund in fiscal year 2010, 100% of the amount of contributions to the tobacco settlement trust funds received in fiscal year 2010.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2010**

The amounts presented below for fiscal year 2010 indicate actual receipts and differ from the total contributions and distributions for fiscal year 2009 shown in the Fiduciary Funds Statement of Net Assets because of the presentation requirements of GASB Technical Bulletin 2004-1.

| | 2010 | 2009 | 2008 |
|--|---------------|------------|------------|
| Tobacco Settlement Permanent Fund | | | |
| Contributions | \$ 40,164,708 | 50,985,919 | 44,863,502 |
| Distributions | 40,164,708 | 50,985,919 | 22,431,751 |

The Water Trust Permanent Fund was created in 2003 but not funded by the Legislature until 2007. On July 1 of each fiscal year the Fund distributes \$4,000,000 to the water project fund. When 4.7% of the Fund is greater than \$4 million, annual distributions will be 4.7% of a 5-year rolling average of the Fund. At June 30, 2010, the WTPF was \$46.3 million.

House Bill 247, passed by the 48th Legislature in 2007, created the State Unemployment Trust Fund (SUTF) in the state treasury. Receipts to this fund come from a prorated portion of the unemployment insurance taxes collected by the Department of Workforce Solutions from New Mexico employers. House Bill 247 provides that these receipts be invested by the State Investment Officer in a manner similar to the land grant permanent fund. It also provides that earnings from the fund be available for appropriation to the Department of Workforce Solutions for the purpose of administering the unemployment insurance and employment security programs. At June 30, 2010, the SUTF was valued at \$117.8 million.

The net assets of the fiduciary funds managed by the Office increased or decreased during the fiscal year by the following amounts:

| | 2010 <u>Net Assets</u> | 2009 <u>Net Assets</u> | <u>Change</u> |
|--|---------------------------|---------------------------|----------------|
| Net Assets: | | | |
| Land Grant Permanent Fund | \$8,886,904,230 | 7,943,909,129 | 11.87% |
| Severance Tax Permanent Fund | 3,379,772,625 | 3,173,448,933 | 6.50% |
| Tobacco Settlement Permanent Fund | 132,805,921 | 121,449,922 | 9.35% |
| Water Trust Fund | 46,831,249 | 45,835,754 | 2.17% |
| State Unemployment Trust Fund | 117,801,155 | 77,067,572 | 52.85% |
| Total private purpose trust funds | <u>12,564,115,180</u> | <u>11,361,711,310</u> | <u>10.58%</u> |
| External client trust funds | <u>435,521,493</u> | <u>449,458,984</u> | <u>(3.10%)</u> |
| Total net fiduciary funds | <u>\$12,999,636,673</u> | <u>11,811,170,294</u> | <u>10.06%</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2010

Asset classes authorized by the state legislature include:

- Small, mid and large capitalization U.S. stocks
- Non-U.S. developed markets and emerging markets stocks
- U.S. debt obligations
- Private equity limited partnerships
- Real estate
- Absolute Return funds
- Derivative Instruments
- Structured Credit Instruments
- New Mexico direct equity investments
- New Mexico film projects
- Government guaranteed New Mexico home and farm loans
- Certificates of deposit in New Mexico financial institutions

The Office manages a portion of the large capitalization U.S. stocks, all investment-grade U.S. debt obligations and the New Mexico economically targeted investments for loans and certificates of deposits using staff portfolio managers. Real estate, private equity and New Mexico film projects are managed using external advisors and the other stocks and bonds are managed using external portfolio managers.

Using the Annual Report

The Office complies with the required financial statement presentation of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. The financial report includes the sections described below.

Government-Wide Financial Statements

The government-wide financial statements are designed to be corporate-like. The focus of the Statement of Net Assets is designed to be similar to a bottom line for the Office and its governmental activities. This statement combines and consolidates the governmental fund's current financial resources (short-term expendable resources) with capital assets and long term liabilities.

Fund Financial Statements

Traditional users of governmental financial statements will find the fund financial statements presentation more familiar. The focus is now on major funds, rather than fund types.

The financial statements also include notes, which explain the history and purpose of the Council, significant accounting policies, investment details, statutory disclosures and other required information regarding the financial position of the funds.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Year Ended June 30, 2010

The governmental major fund presentation is presented on a sources and uses of liquid resources basis. This is the manner in which the financial plan (the budget) is typically developed.

The flow and availability of liquid resources is a clear and appropriate focus of any analysis of a government. Funds are established for various purposes and the financial statements allow the demonstration of sources and uses and/or budgeting compliance associated with the funds.

The fund financial statements also allow the government to present its fiduciary funds. While these funds represent trust responsibilities of the government, these assets are restricted in purpose and do not represent discretionary assets of the government. Therefore, these assets are not presented as part of the government-wide financial statements.

Performance-based Budgeting

The four primary performance measures are set by the Legislature in conjunction with the budget appropriation for fiscal year 2010. The Office met one of the five-year targets and none of the one-year targets.

| Performance Measures: | Fiscal Year 2010 | |
|--|------------------|----------|
| | Target | Actual |
| 1. One-year annualized investment returns to exceed internal benchmarks, in basis points | >25 bps | -250 bps |
| 2. Five-year annualized investment returns to exceed internal benchmarks, in basis points | >25 bps | 30 bps |
| 3. One-year annualized percentile performance ranking in endowment investment peer universe | <49% | 56% |
| 4. Five-year annualized percentile performance ranking in endowment investment peer universe | <49% | 81% |

The percentiles referenced in (3) and (4) above represent a range where the best possible ranking is 1 and the worst is 100.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2010**

Budgetary Comparisons

As required by the Office of the State Auditor under Section 2.2.2.10 P. (2) of 2.2.2 NMAC, the Budget Comparison—Statement for the General Administrative Fund is presented as part of the basic financial statements. This information is provided at the approved budget level to demonstrate compliance with legal requirements. The budgetary comparison schedule presents both the original and the final appropriated budget for the reporting period as well as the actual inflows, outflows and balances, stated on the government's budgetary basis. The only significant budgetary variation was approximately \$4.1 million in contractual services that were not expended.

Statutory changes to the Council and its powers

In FY 2010, the legislature passed and the Governor signed Senate Bill 18, legislation reconstituting the Council's membership and responsibilities. Among the notable changes:

- The State Investment Officer is no longer a member of the Council
- The State Investment Officer is appointed by the Council, not the Governor
- The State Investment Council is now comprised of 11 individuals, not nine
- The Legislative Council now appoints four public members
- The Governor appoints three public members, one which must be the CFO of a state university
- The remaining members (ex-officio) are: Governor, Secretary of the Dept. of Finance and Administration, State Treasurer and Commissioner for Public Lands
- Investment powers have been shifted from the State Investment Officer to the State Investment Council; the Council now has complete investment authority, and the ability to delegate day to day investment powers; previously the Council was primarily a policy-making and investment oversight body with direct approval of only specific alternative investments
- The Council was reconstituted and reappointed in March and April of 2010; The Council formally appointed Steven K. Moise as State Investment Officer, who took over for interim SIO Bob Jacksha April 1.

Financial Contact

Any questions regarding the financial statements of the Office should be directed to the Chief Financial Officer, 41 Plaza la Prensa, Santa Fe, NM 87507.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF NET ASSETS
June 30, 2010

| | Governmental Activities |
|--|----------------------------|
| ASSETS | |
| Investment in State Treasurer General Fund Investment Pool | \$ 8,036,362 |
| Accounts Receivable | 265,563 |
| Capital assets, net | 34,094 |
| Total assets | <u>\$ 8,336,019</u> |
| LIABILITIES AND NET ASSETS | |
| Current Liabilities | |
| Due to Land Grant Permanent Fund | \$ 2,773,775 |
| Due to Severance Tax Permanent Fund | 1,188,761 |
| Accounts payable | 4,258,683 |
| Accrued payroll | 80,706 |
| Accrued vacation and sick pay, current | 115,086 |
| Total current liabilities | <u>8,417,011</u> |
| Long-term Liabilities | |
| Accrued vacation and sick pay | 75,770 |
| | <u>8,492,781</u> |
| Net Assets | |
| Invested in capital assets | 34,094 |
| Unreserved | (190,856) |
| Total net assets (deficit) | <u>(156,762)</u> |
| Total liabilities and net assets | <u>\$ 8,336,019</u> |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF ACTIVITIES
Year Ended June 30, 2010

| | Governmental Activities |
|--|----------------------------|
| Expenses | |
| General government | \$ 31,454,985 |
| Revenues | |
| Program revenues | |
| Fees from external investment trust participants and other revenue | 1,479,158 |
| Transfers | |
| Interfund services provided | |
| Land Grant Permanent Fund | 21,018,875 |
| Severance Tax Permanent Fund | 9,008,089 |
| Total program revenues and transfers | <u>31,506,122</u> |
| Change in net assets | 51,137 |
| Net assets (deficit) at beginning of year | <u>(207,899)</u> |
| Net assets (deficit) at end of year | <u><u>\$ (156,762)</u></u> |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 BALANCE SHEET
 GENERAL ADMINISTRATIVE FUND
 June 30, 2010

ASSETS

| | |
|--|---------------------|
| Investment in State Treasurer General Fund Investment Pool | \$ 8,036,362 |
| Accounts receivable | 265,563 |
| Total assets | <u>\$ 8,301,925</u> |

LIABILITIES AND FUND BALANCE

| | |
|-------------------------------------|---------------------|
| Liabilities | |
| Due to Land Grant Permanent Fund | \$ 2,773,775 |
| Due to Severance Tax Permanent Fund | 1,188,761 |
| Accounts payable | 4,258,683 |
| Accrued payroll | 80,706 |
| Total liabilities | <u>8,301,925</u> |
| Fund Balance | |
| Unreserved | <u>-</u> |
| Total liabilities and fund balance | <u>\$ 8,301,925</u> |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 RECONCILIATION OF THE GENERAL ADMINISTRATIVE FUND
 BALANCE SHEET TO THE STATEMENT OF NET ASSETS
 June 30, 2010

| | | |
|---|-----------|--------------------------------|
| Total fund balance - General Administrative Fund | \$ | - |
| Amounts reported for governmental activities in the Statement of Net Assets are different because | | |
| Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund | | |
| Capital assets, net | | 34,094 |
| Some liabilities are not due and payable in the current period and therefore are not reported in the fund. | | |
| Accrued vacation and sick pay | | <u>(190,856)</u> |
| Net assets (deficit) of governmental activities | \$ | <u><u>(156,762)</u></u> |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
GENERAL ADMINISTRATIVE FUND STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCE
Year Ended June 30, 2010

| | |
|--|---------------------|
| Revenues from external investment trust participants and other revenue | \$ 1,479,158 |
| Expenditures | |
| Current | 31,489,100 |
| General government | |
| Capital outlay | <u>17,022</u> |
| Total expenditures | <u>31,506,122</u> |
| Deficiency of revenues under expenditures | <u>(30,026,964)</u> |
| Other financing sources (uses) | |
| Interfund services provided | |
| Land Grant Permanent Fund | 21,018,875 |
| Severance Tax Permanent Fund | <u>9,008,089</u> |
| Net other financing sources (uses) | <u>30,026,964</u> |
| Net change in fund balance | - |
| Fund balance at beginning of year | <u>-</u> |
| Fund balance at end of year | <u><u>\$ -</u></u> |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
RECONCILIATION OF CHANGE IN NET ASSETS PER
STATEMENT OF ACTIVITIES TO NET CHANGE IN FUND
BALANCE PER STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
Year Ended June 30, 2010

Net change in fund balance - General Administrative Fund \$ -

Amounts reported for governmental activities in the Statement
of Activities are different because

In the Statement of Activities, certain operating expenses such as
compensated absences for sick and annual leave are measured
by the amounts earned during the year. In the governmental
funds, however, expenditure for these items is measured by
the amount of financial resources used (essentially, the
amounts actually paid).

Decrease in accrued vacation and sick pay liability 44,247

Governmental funds report capital outlays as expenditures.
However, in the Statement of Activities, the cost of those
assets is allocated over the estimated useful lives and
reported as depreciation expense. In the current period
these amounts are

| | | |
|--|-----------|--------------|
| Capital assets additions | \$ 17,022 | |
| Depreciation expense | (10,132) | |
| Deficit of capital asset additions over depreciation expense | | <u>6,890</u> |

Change in net assets of governmental activities \$ 51,137

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 BUDGET COMPARISON-STATEMENT FOR THE GENERAL
 ADMINISTRATIVE FUND
 Year Ended June 30, 2010

| | Original Budget | Final Budget | Actual Revenue/ Expenditures | Variance Positive/ (Negative) |
|---|--------------------|-------------------|------------------------------------|-------------------------------------|
| Revenues from external investment trust participants | \$ 950,000 | 850,000 | 1,479,158 | 629,158 |
| Expenditures | | | | |
| Personnel services and benefits | 3,462,800 | 3,562,800 | 3,581,962 | (19,162) |
| Contractual services | 30,479,800 | 30,379,800 | 27,257,844 | 3,121,956 |
| Other - operating expenses | 996,900 | 996,900 | 666,316 | 330,584 |
| Total expenditures | 34,939,500 | 34,939,500 | 31,506,122 | 3,433,378 |
| Expenditures in excess of revenues | (33,989,500) | (34,089,500) | (30,026,964) | 4,062,536 |
| Transfers | | | | |
| Interfund transfers in | | | | |
| Land Grant Permanent Fund | 21,389,286 | 21,389,286 | 21,018,875 | |
| Severance Tax Permanent Fund | 9,166,837 | 9,166,837 | 9,008,089 | |
| Total transfers | 30,556,123 | 30,556,123 | 30,026,964 | |
| Excess of revenues and transfers over expenditures | \$ (3,433,377) | (3,533,377) | - | |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL - INVESTMENT OFFICE
 FIDUCIARY FUNDS
 STATEMENT OF NET ASSETS
 June 30, 2010

| ASSETS | Private-Purpose Trust Funds | | | | | | | | | | Total |
|--|-----------------------------|------------------------------|-----------------------------------|-------------------|-------------------------------|-----------------------------------|---------------------------------|-----------------------|--|--|-------|
| | Land Grant Permanent Fund | Severance Tax Permanent Fund | Tobacco Settlement Permanent Fund | Water Trust Fund | State Unemployment Trust Fund | Total Private-Purpose Trust Funds | External Investment Trust Funds | Total | | | |
| Cash and cash equivalents | \$ 562,282,223 | 190,778,254 | 52,911,115 | 11,358,991 | 117,140,173 | 934,470,756 | 311,535,675 | 966,006,431 | | | |
| Investment in state treasurer general fund investment pool | 32,454,369 | 10,724 | - | - | 1,093,700 | 33,558,793 | - | 33,558,793 | | | |
| Due from brokers | 50,906,833 | 12,365,011 | 772,137 | 355,767 | - | 64,399,748 | 4,254,464 | 68,654,212 | | | |
| Due from custodian | 155,716 | 50,638 | 1,996 | 908 | - | 209,258 | 11,223 | 220,481 | | | |
| Due from general administrative fund | 2,773,775 | 1,188,761 | - | - | - | 3,962,536 | - | 3,962,536 | | | |
| Due from other state agencies | - | 3,488,067 | - | - | - | 3,488,067 | - | 3,488,067 | | | |
| Accrued investment income | 19,844,482 | 5,245,851 | 343,131 | 147,312 | 23,950 | 25,604,726 | 2,231,641 | 27,836,367 | | | |
| Accrued tobacco settlement income | - | - | 21,659,932 | - | - | 21,659,932 | - | 21,659,932 | | | |
| | 668,417,398 | 213,127,306 | 75,688,311 | 11,862,978 | 118,257,823 | 1,087,353,816 | 38,033,003 | 1,125,386,819 | | | |
| Investments | | | | | | | | | | | |
| Government-sponsored enterprise and agency issues (GSE) | - | 43,962,210 | - | - | - | 43,962,210 | - | 43,962,210 | | | |
| Corporate bonds | - | 1,403,295 | - | - | - | 1,403,295 | - | 1,403,295 | | | |
| Investment pools | | | | | | | | | | | |
| Core bonds | 1,398,938,804 | 149,596,876 | 31,154,408 | 13,944,892 | - | 1,593,634,980 | 207,619,955 | 1,801,254,935 | | | |
| Large cap. active | 2,074,058,917 | 816,385,137 | 24,322,569 | 13,058,831 | - | 2,927,825,454 | 55,563,685 | 2,983,389,139 | | | |
| Large cap. active ETF | 2,770,194 | - | - | - | - | 2,770,194 | 28,058,514 | 30,828,708 | | | |
| Large cap. index | 780,717,134 | - | - | - | - | 780,717,134 | 50,361,605 | 1,090,651,961 | | | |
| Large cap index ETF | 1,969,772 | - | - | - | - | 1,969,772 | 16,160,821 | 18,130,593 | | | |
| Mid/Small cap. | 1,265,770,245 | 381,594,632 | 9,574,855 | 4,289,446 | - | 1,661,229,178 | 20,540,692 | 1,681,769,870 | | | |
| Mid/Small cap. ETF | 1,706,848 | - | - | - | - | 1,706,848 | 6,477,815 | 8,184,663 | | | |
| Non-U.S. developed markets | 366,662,603 | 178,277,711 | 5,078,768 | 2,072,497 | - | 552,091,579 | 36,638,219 | 588,729,798 | | | |
| Non-U.S. emerging markets | 668,176,747 | 306,813,006 | 3,016,986 | 1,349,086 | - | 979,355,825 | 13,729,585 | 993,085,410 | | | |
| Hedge funds | 730,359,226 | 220,266,908 | 8,205,911 | 3,573,619 | - | 962,405,664 | - | 962,405,664 | | | |
| Structured Credit | 283,938,202 | 123,611,312 | - | - | - | 407,549,514 | - | 407,549,514 | | | |
| Common stock - public | 1,259,741 | 785,533 | - | - | - | 2,045,274 | - | 2,045,274 | | | |
| Conventional mortgage pass-through certificates | - | 109,182 | - | - | - | 109,182 | - | 109,182 | | | |
| Private equity | 855,884,877 | 571,905,628 | - | - | - | 1,427,790,505 | - | 1,427,790,505 | | | |
| Real estate | 329,867,707 | 166,342,118 | - | - | - | 496,209,825 | - | 496,209,825 | | | |
| New Mexico film investments | - | 97,036,854 | - | - | - | 97,036,854 | - | 97,036,854 | | | |
| NMSU Equity | - | 2,846,380 | - | - | - | 2,846,380 | - | 2,846,380 | | | |
| Total investments | 8,762,081,017 | 3,315,827,525 | 86,035,976 | 38,288,371 | 118,257,823 | 12,202,232,889 | 435,150,891 | 12,637,383,780 | | | |
| Total assets | 9,430,498,415 | 3,528,954,831 | 161,724,287 | 50,151,349 | 118,257,823 | 13,289,386,705 | 473,183,894 | 13,762,770,599 | | | |
| LIABILITIES | | | | | | | | | | | |
| Liabilities | | | | | | | | | | | |
| Due to brokers | 58,727,666 | 21,639,376 | 540,280 | 272,201 | - | 81,179,523 | 1,293,533 | 82,473,056 | | | |
| Due to custodian | 441,073,802 | 111,943,473 | 6,682,593 | 3,031,201 | - | 562,731,069 | 36,174,050 | 598,905,119 | | | |
| Due to other state agencies | - | - | 21,695,493 | 16,698 | 456,668 | 22,168,859 | 194,818 | 22,363,677 | | | |
| Distributions payable to beneficiaries | 43,792,717 | 15,599,357 | - | - | - | 59,392,074 | - | 59,392,074 | | | |
| Total liabilities | 543,594,185 | 149,182,206 | 28,918,366 | 3,320,100 | 456,668 | 725,471,525 | 37,662,401 | 763,133,926 | | | |
| NET ASSETS | | | | | | | | | | | |
| Net assets held in trust | \$ 8,886,904,230 | 3,379,772,625 | 132,805,921 | 46,831,249 | 117,801,155 | 12,564,115,180 | 435,521,493 | 12,999,636,673 | | | |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
FIDUCIARY FUNDS
STATEMENT OF CHANGES IN NET ASSETS
Year Ended June 30, 2010

| | Private-Purpose Trust Funds | | | | | | | Total Private- Purpose Trust Funds | External Investment Trust Funds | Total |
|--|------------------------------------|---------------------------------------|--|------------------------|--|---|--|---|--|---------------|
| | Land Grant Permanent Fund | Severance Tax Permanent Fund | Tobacco Settlement Permanent Fund | Water Trust Fund | State Unemployment Trust Fund | Total Private- Purpose Trust Funds | External Investment Trust Funds | | | |
| Additions | | | | | | | | | | |
| Contributions to external investment trust funds | | | | | | | | 7,884,415 | | 7,884,415 |
| Investment earnings | | | | | | | | | | |
| Interest and dividends | 187,732,389 | 60,760,401 | 2,392,209 | 1,020,076 | 264,030 | 252,169,105 | 16,170,485 | | 268,339,590 | |
| Net increase in fair value of investments | 975,088,761 | 340,927,856 | 8,963,790 | 3,975,419 | - | 1,328,955,826 | 56,846,424 | | 1,385,802,250 | |
| Total investment gain | 1,162,821,150 | 401,688,257 | 11,355,999 | 4,995,495 | 264,030 | 1,581,124,931 | 73,016,909 | | 1,654,141,840 | |
| Total additions | 1,162,821,150 | 401,688,257 | 11,355,999 | 4,995,495 | 264,030 | 1,581,124,931 | 80,901,324 | | 1,662,026,255 | |
| Deductions | | | | | | | | | | |
| Distributions from external investment trust funds | | | | | | | | | | |
| Interagency transfers (in) out | | | | | | | | | | |
| Distributions to beneficiaries of the | | | | | | | | | | |
| Land Grant Permanent Fund | 525,512,604 | | | | | | | | | 525,512,604 |
| Distributions to State General Fund by the | | | | | | | | | | |
| Severance Tax Permanent Fund | | 187,072,284 | | | | | | | | 187,072,284 |
| Distribution to beneficiary of the | | | | | | | | | | |
| Tobacco Settlement Permanent Fund | | | 40,164,708 | | | | | | | 40,164,708 |
| Distribution to beneficiary of the | | | | | | | | | | |
| Water Permanent Fund | | | | 4,000,000 | | | | | | 4,000,000 |
| Distribution to beneficiary of the | | | | | | | | | | |
| State Unemployment Permanent Fund | | | | | 456,668 | | | | | 456,668 |
| State Land Office | (330,275,443) | | | | | (330,275,443) | | | | (330,275,443) |
| Severance Tax Bonding Fund | | (3,488,067) | | | | (3,488,067) | | | | (3,488,067) |
| Tobacco settlement proceeds | | | (40,164,708) | | | (40,164,708) | | | | (40,164,708) |
| State Unemployment Permanent Fund | | | | | (40,926,221) | (40,926,221) | | | | (40,926,221) |
| Interfund services used | | | | | | | | | | |
| General Administrative Fund | 21,018,875 | 9,008,089 | | | | | | | | 30,026,964 |
| Internal service fees | 3,570,013 | 2,772,259 | | | | | | | | 6,342,272 |
| Net deductions | 219,826,049 | 195,364,565 | | 4,000,000 | (40,469,533) | 378,721,061 | 94,838,815 | | 473,559,876 | |
| Change in net assets | 942,995,101 | 206,323,692 | 11,355,999 | 995,495 | 40,733,583 | 1,202,402,870 | (13,937,491) | | 1,188,466,379 | |
| Net assets at beginning of year | 7,943,909,129 | 3,173,448,933 | 121,449,922 | 45,835,754 | 77,067,572 | 11,361,711,310 | 449,458,984 | | 11,811,770,294 | |
| Net assets at end of year | 8,886,904,230 | 3,379,772,625 | 132,805,921 | 46,831,249 | 117,801,155 | 12,564,115,180 | 435,521,493 | | 12,999,636,673 | |

See Notes to Financial Statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 1. ORGANIZATION AND BACKGROUND

The State of New Mexico Investment Council (Council) is responsible for the investment activities of certain State of New Mexico trust funds. The Council is composed of eleven members: the Governor, the State Treasurer, the Commissioner of Public Lands, the Secretary of the Department of Finance and Administration (DFA), four public members appointed by the Legislative Council, and three public members appointed by the Governor, one which must be the Chief Financial Officer of a State institution of higher education. The Governor is designated as Chairman of the Council, which is required to meet at least once each month.

Within the constraints of New Mexico law, the Council establishes policies for the investment of trust funds entrusted to it. Policies established by the Council are carried out by personnel of the State Investment Office (Investment Office or Office) under the direction of the State Investment Officer. The Office currently manages certain assets identified as the Land Grant Permanent Fund, the Severance Tax Permanent Fund, Tobacco Settlement Permanent Fund, the Water Trust Fund and the State Unemployment Trust Fund. The following is a brief description of the purpose and sources of these five funds:

Land Grant Permanent Fund (LGPF). The Fergusson Act of 1898 and the Enabling Act of 1910 granted certain lands held by the federal government to the territory of New Mexico. Under the terms of these grants, it was stipulated that such lands, totaling 13.4 million acres, were to be held in trust for the benefit of the public schools and other specific public institutions. Royalties and principal from land sales are transferred by the State Land Office to the Investment Office, which adds these amounts to the LGPF. Gains and losses on investment transactions are credited or charged to the LGPF and do not directly affect distributions to the beneficiaries.

On September 23, 2003, New Mexico voters approved Constitutional Amendment No. 2 that changed the LGPF distributions. Beginning with the October 2003 distribution, the annual distributions from the LGPF are five percent (5.0 percent) of the average of the year-end market values of the LGPF for the immediately preceding five calendar years. In addition to the five percent (5.0 percent) annual distribution made, an additional annual distribution shall be made pursuant to the following schedule: in fiscal years 2005 through 2012, an amount equal to eight-tenths percent (0.8 percent) of the average of the year-end market values of the LGPF for the immediately preceding five calendar years; and in fiscal years 2013 through 2016, an amount equal to one-half percent (0.5 percent) of the average of the year-end market values of the LGPF for the immediately preceding five calendar years.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 1. ORGANIZATION AND BACKGROUND (CONTINUED)

The legislature, by a three-fifths' vote of the members elected to each house, may suspend any additional distributions noted above. No additional distribution shall be made in any fiscal year if the average of the year-end market values of the LGPF for the immediately preceding five calendar years is less than five billion eight hundred million dollars (\$5,800,000,000).

Severance Tax Permanent Fund (STPF). The State of New Mexico levies a severance tax on certain natural resources extracted from land within the State. Severance tax revenues are first applied to pay the required debt service on Severance Tax Bonds issued by the State. Remaining severance tax revenues are then transferred to the Investment Office, which adds these amounts to the STPF. Other State agencies are responsible for administering the severance tax and determining the amounts required to service the outstanding Severance Tax Bonds. On November 5, 1996, New Mexico voters approved Constitutional Amendment No. 1 which, among other things, provides that annual distributions from the STPF shall be one hundred two percent (102%) of the amount distributed in the immediately preceding fiscal year until the annual distributions equal four and seven-tenths percent (4.7 percent) of the average of the year-end market values of the fund for the immediately preceding five years. Thereafter, the amount of the annual distributions shall be four and seven-tenths percent (4.7 percent) of the average of the year-end market values of the fund for the immediately preceding five years. The provisions of this amendment took place upon certification of the election results by the Secretary of State and were put into effect beginning with the December 1996 income distributions.

Tobacco Settlement Permanent Fund (TSPF). The State of New Mexico receives funds into the Tobacco Settlement Permanent Fund pursuant to the master settlement agreement entered into between the tobacco product manufacturers and various states, including New Mexico, which was executed on November 23, 1998. Money in this fund is invested pursuant to Chapter 6, Article 8 NMSA 1978. Income from investment of the fund is credited to the fund.

In 2009, State Bill 79 amended Section 6-4-9 NMSA 1978 related to the Tobacco Settlement Permanent Funds. This legislation temporarily changes the distribution of this fund as follows: in fiscal years 2009 through 2010, a distribution shall be made from the Tobacco Settlement Permanent Fund to the general fund in an amount equal to one hundred percent of the total amount of money distributed to the Tobacco Settlement Permanent Fund in that fiscal year. In fiscal year 2011 and in each fiscal year

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 1. ORGANIZATION AND BACKGROUND (CONTINUED)

thereafter, an annual distribution will be made from the TSPF to the Tobacco Settlement Program Fund of an amount equal to fifty percent of the total amount of money distributed to the TSPF in the immediately preceding fiscal year until that amount is less than an amount equal to four and seven-tenths percent (4.7 percent) of the average of the year-end market values of the TSPF for the immediately preceding five calendar years. Thereafter, the amount of the annual distribution shall be four and seven-tenths percent (4.7 percent) of the average of the year-end market values of the TSPF for the immediately preceding five calendar years.

Chapter 312, Laws of 2003 mandates that the Tobacco Settlement Permanent Fund shall be considered a reserve fund of the state. Based on this, for fiscal year ended June 30, 2010, The New Mexico State Department of Finance and Administration has recorded the balance of the Tobacco Settlement Permanent Fund within their Governmental Fund, State General Fund balance. The State Investment Council has also included this balance within their Fiduciary Fund financial statements as a Private-Purpose Trust Fund.

Water Trust Fund (WTF): The water trust fund was created in the State Treasury. The State Investment Council established the water trust fund in August 2006 upon receiving a \$40,000,000 general fund appropriation per Chapter 109, Section 12, Laws of 2006. The funds consist of money appropriated, donated, or otherwise accrued to the fund. Money in the fund shall be invested by the state investment officer as land grant permanent funds are invested pursuant to Chapter 6, Article 8 NMSA 1978. Earnings from investment of the fund shall be credited to the fund. On July 1 of each fiscal year, an annual distribution shall be made from the water trust fund to the water project fund in the amount of four million dollars (\$4,000,000) until that amount is less than an amount equal to four and seven-tenths percent of the average of the year-end market values of the water trust fund for the immediately preceding five calendar years. Thereafter, the amount of the annual distribution shall be four and seven-tenths percent (4.7 percent) of the average of the year-end market values of the water trust fund for the immediately preceding five calendar years.

State Unemployment Trust Fund (SUTF): House Bill 247, passed by the 48th Legislature in 2007, created the State Unemployment Trust Fund (SUTF) in the state treasury. Receipts to this fund come from a prorate portion of the unemployment insurance taxes collected by the Department of Workforce Solutions from New Mexico employers. House Bill 247 provides that these receipts be invested by the state investment officer in a manner similar to the land grant permanent fund. It also provides that earnings from the fund be available for appropriation to the Department of Workforce Solutions for the purpose of administering the unemployment insurance and employment security programs.

The Office also manages external investment trust funds identified within the Fiduciary Funds for other legally separate entities.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Office conform to generally accepted accounting principles for State governmental units. The more significant of these accounting policies are summarized below:

Financial Reporting Entity. For financial reporting purposes, the financial statements include all funds controlled by the Council. Control by the Council was determined on the basis of oversight responsibility derived from the ability to significantly influence operations and accountability for fiscal matters. The Investment Office is a component unit of the primary government of the State of New Mexico. The Investment Office does not have any component units. The Office understands that the State does not present audited combined financial statements for all agencies of the State.

Basis of Presentation and Basis of Accounting. The Office implemented provisions of GASB No. 34, 37 and 38 effective for the fiscal year ending June 30, 2002. As part of Statement No. 34, there is a reporting requirement regarding the local government's infrastructure (road, bridges, etc.). The Office does not own any infrastructure assets and therefore is unaffected by this requirement.

Government-Wide Financial Statements: The statement of net assets and the statement of activities display information about the primary government. These statements include the financial activities of the overall government, except for fiduciary activities. This government-wide focus is more on the sustainability of the Office as an entity and the change in aggregate financial position resulting from the activities of the fiscal period.

The statement of activities presents a comparison between direct expenses and revenues for the governmental activities. All expenses of the Office are considered direct expenses and are clearly identifiable to the investment function of the Office. Program revenues include external fees, and other revenues include transfers from the permanent funds for interfund services provided.

Governmental Fund Financial Statements: The fund financial statements are similar to the government-wide financial statements. Emphasis in these statements is on the administrative fund due to the limited fund structure of the Office. This presentation is deemed appropriate to (a) demonstrate legal compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Office's actual experience conforms to the budget or fiscal plan. Since the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements, a reconciliation is presented on the page following each statement, which briefly explains the adjustments necessary to transform the fund-based financial statements into the government-wide presentation.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

As permitted by GASB Statement No. 20, the Office has elected to not apply pronouncements of the Financial Accounting Standards Board (FASB) originally issued subsequent to November 30, 1989.

The Office's fiduciary funds are presented separately in the fund financial statements. Since, by definition, these assets are being held for the benefit of third parties and cannot be used to address activities or obligations of the government, these funds are not incorporated into the government-wide financial statements.

Measurement Focus, Basis of Accounting. The government-wide and agency fund financial statements are reported using the economic financial resources measurement focus. The government-wide financial statements and the fiduciary fund financial statements are presented on the accrual basis of accounting. The governmental funds are reported under the modified accrual basis of accounting, using the current financial resources measurement focus. Under this method, revenues are recognized when measurable and available. The Office considers all revenues reported in both the government-wide and governmental funds to be measurable and available since they are collected from the permanent funds and investment pools under the management of the Office. The Office considers revenues to be available if they are collected within 60 days of the current fiscal year end. Revenues from external investment trust participants are susceptible to accrual. On the government-wide financial statement, expenditures are recorded when the related fund liability is incurred except for accrued vacation and sick pay which is recognized as an expenditure to the extent they have been earned. General capital asset acquisitions are reported as expenditures in governmental funds and are capitalized and depreciated over the estimated useful life in the government-wide financial statement.

General Administrative Fund. The General Administrative Fund accounts for all the administrative activities of the Office. The financing sources for the General Administrative Fund are transfers of revenue from the LGPF, STPF and other sources as authorized by the Budget Division of the Department of Finance and Administration.

Fiduciary Funds. Fiduciary funds consist of trust funds as follows:

Private-Purpose Trust Funds. The LGPF, STPF, TSPF, WTF, and SUTF are accounted for under the accrual basis of accounting and use a capital maintenance measurement focus. This means that all assets and liabilities associated with their activity are included on the balance sheet. The funds operate under legal constraints that specify distributions to ensure that an income stream will be available in future years to designated beneficiaries.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

External Investment Trust Funds. Pursuant to New Mexico law Section 6-8-7G of NMSA 1978, as amended, the Office manages several equity and bond investment pools to provide long-term investment opportunities for State agencies and designated institutions that have funds available for a long-term investment program that will extend for more than one year. See exhibit 3 for detail summaries of investment pool activity by external participant.

Budgetary Accounting. The State legislature annually approves transfers from the LGPF and STPF to the Office's General Administrative Fund. These transfers are made to fund the operating costs of the State Investment Office's General Administrative Fund. These transfers are reflected as Interfund Transfers in these financial statements. Any transfers made in excess of the actual accrued costs of the General Administrative Costs are reverted back to the LGPF and STPF. The reversion payable to the LGPF and STPF are reflected as Due to LGPF and Due to STPF.

Beginning with fiscal year 2005, the General Appropriation Act of 2004 established the modified accrual basis of accounting for governmental funds in accordance with the Manual of Model Accounting Practices issued by the Department of Finance and Administration as the budgetary basis of accounting for the State of New Mexico. The change in policy resulted in the recognition of budgetary control from a fiscal year to an appropriation period. As a result of this change, a reconciliation of budgetary basis to GAAP basis is not required.

Budgetary Matters. The Office is required to submit a budget request for the General Fund to DFA and the Legislative Finance Committee by September 1 of each year. Consistent with the General Appropriations Act of 2004, the Office prepares the budget using the modified accrual budgetary basis of accounting. The expenditures reported in the budget report agree to the amounts reported in the accompanying general administrative fund statement of revenues, expenditures, and changes in net assets.

In applying the "susceptible to accrual" concept to intergovernmental revenues pursuant to GASB Statement No. 33, the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenues when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met, under most circumstances, should be reported as advances by the provider and deferred revenue by the recipient.

Budgetary Data. The State Legislature makes annual appropriations to the Office. Legal compliance is monitored through the establishment of an annual budget. Annual budgets are adopted each fiscal year for the General Administrative Fund.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Expenditures may not legally exceed appropriations at the object expenditure classification level. Budget amendments require approval by the State's Financial Control Division of the Department of Finance and Administration. Unexpended and unencumbered amounts in the General Fund lapse at year-end.

The Office is required to submit a budget report for the General Administrative Fund to the Department of Finance and Administration and the Legislative Finance Committee by September 1 of each year. The report submitted by the Office also details revenues and expenditures or expenses for the preceding year. The budget for the General Administrative Fund 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 paid by the statutory deadline (Section 6-10-4 NMSA 1978) that must be paid out of the next year's budget. A reconciliation of budgetary basis to GAAP basis will be necessary if any accounts payable at the end of the fiscal year are not paid by the statutory deadline. The Council has not included such reconciliation for fiscal year 2010 as all payables were paid by the statutory deadline.

The Department of Finance and Administration makes recommendations and adjustments to the appropriation request which becomes the Governor's proposal to the Legislature. The Legislative Finance Committee holds hearings on the appropriation request, also submitting recommendations and adjustments before presentation to the Legislature.

Both the Department of Finance and Administration and the Legislative Finance Committee's recommended appropriation proposals are presented to the Legislature for approval of the final budget plan. All subsequent budget transfers and increases must be authorized by the Director of the State Budget Control Division. Legal budget control for expenditures and encumbrances is by appropriation unit.

Investments

Basis of Accounting. Investments are stated at fair value in accordance with GASB Statement No. 31, with increases or decreases in fair value recognized in the statement of changes in net assets at the end of each month. Investment transactions are recorded on the trade date. Dividends are recognized as income when declared. Current fair value of investments may fluctuate markedly from what is recorded at June 30 of each year.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
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June 30, 2010

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Investment Pools. The Office's investments are reported in the following categories: private-purpose trust funds and external investment trust funds. Both types of funds are participants in the Office's Large Cap. Active, Large Cap. Active ETF, Large Cap. Index, Large Cap. Index ETF, Core Bonds, Mid/Small Cap., Mid/Small Cap ETF, Non-U.S. Developed Markets, Non-U.S. Emerging Markets, and Structured Credit investment pools. The pools are detailed as follows:

The Large Cap Active Pool is managed internally and by five external managers using fundamental research techniques. This pool seeks to exceed the performance of the S&P 500 Index by emphasizing stock selection and by overweighting or underweighting economic sectors.

The Large Cap Index Pool is managed internally. The objective of the pool is to generate returns within 25 basis points of the S&P 500 Index.

The Core Bonds Pool is managed internally and invests in all major segments of the broad investment-grade debt obligation markets. The primary objective of the Core Bonds Pool is to add significant value over the returns of the broad U.S. bond market and to produce relatively high total returns for the risk assumed. The Core Bonds Pool uses the BC Aggregate Index as its benchmark.

The Structured Credit Pool is managed internally investing in various classes of securities of collateralized debt obligations, collateralized loan obligations and other structured finance instruments.

The Mid/Small Cap Pool is managed internally and by two external managers controlling five accounts. Overall, the manager mix is intended to capture the returns of the appropriate small or mid cap index.

The Non-U.S. Developed Markets Pool is an international equity fund with one external manager. The benchmark is the Morgan Stanley Capital International Europe Australia and Far East (MSCI EAFE) Index. The third-party managers of the described investments may trade in foreign exchange contracts in the normal course of investing activities in order to manage exposure to currency risks. Such contracts, which are generally for a period of less than one year, are used to purchase and sell foreign currency at a guaranteed future price. These contracts are recorded at fair value using foreign currency forward exchange rates.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
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June 30, 2010

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

The Non-U.S. Emerging Markets Pool is an externally managed international equity fund based upon the MSCI Emerging Markets Free Index. As of June 30, 2010 the fund had one active external manager.

The Absolute Return Pool is managed by 13 external managers and consists of 16 actual funds of investments. The objective of the pool is to increase the diversification, decrease the volatility of the Land Grant, Severance Tax, Tobacco, and Water Trust fund assets and to add incremental value. The Absolute Return Pool uses 90 day treasury bills plus 200 basis points as its benchmark.

Private Equity. Private equity investments are recorded at estimated fair value as reported by the investees. If market declines exist which are considered to be other than temporary, an adjustment is made to reduce the fair value. Increases to fair value are reported when a definable event occurs, such as an additional round of financing to a third-party investor at a higher price or a public offering of the investee company's stock. Income is recognized when the investees report distributions received in excess of the capital invested.

Other Investments. Investments in mortgage pass-through certificates, the New Mexico Small Business Investment Corporation (SBIC), certificates of deposit, New Mexico Film investments, and mortgage loans are reported at cost, which approximates fair value. The Office invests in collateralized mortgage obligations issued by the Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA). The United States government explicitly backs GNMA mortgage securities programs and implicitly backs FHLMC and FNMA mortgage securities programs.

Portfolio Restrictions. The Constitution or the laws of the State of New Mexico require a "prudent investor standard" for all investments of the LGPF, STPF, TSPF, WTF, and SUTF including the differential rate investments of the STPF for economic development purposes within the State of New Mexico. Such investments are primarily intended to stimulate residential construction, provide a source of capital to small business enterprises and create additional jobs by providing incentives to major corporations to construct large facilities in the State. External investment trust funds managed pursuant to a joint powers agreement are subject to the same standard of care.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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June 30, 2010

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Vacation and Sick Pay. Certain amounts of vacation and sick pay earned and not taken are obligations of the Office and recorded as payables. Sick leave accumulated in excess of 600 hours, not to exceed 120 hours, is payable semiannually at a rate equal to 50 percent of the employee's hourly wage. Upon termination, vacation pay up to 240 hours becomes immediately payable. Vacation in excess of 240 hours and the first 600 hours of sick leave are forfeited upon termination. Upon retirement, sick leave is limited to 400 hours accumulated in excess of 600 hours at the 50% hourly rate. Accrued vacation and sick pay is recorded as a liability, and the net change during the current year is recorded as an expense in the General Administrative Fund.

Net Assets Held in Trust. Amounts reserved for designated beneficiaries are required to be segregated in accordance with State law.

Interfund Receivables and Payables. The Office has numerous transactions between funds and other State agencies, including interfund transfers for services provided and used for all administrative activities of the Office, transfers of investment income and transfers of resources for investment. At June 30, 2010 \$2,773,775 and \$1,188,761 were due from the general administrative fund to the LGPF and STPF, respectively.

Cash and Cash Equivalents. Interest in the pooled investments on deposit with the State Treasurer's Office (STO) and The Northern Trust Company short-term investment fund are considered cash and cash equivalents.

Capital Assets. Capital assets are recorded at historical cost and depreciated over their estimated useful lives with no salvage value. Additions, improvements and other capital outlays greater than \$5,000 that significantly extend the useful life of assets are capitalized. The Office includes software in capital assets as required by the State General Services Department (GSD) Rule. Other costs incurred for repairs and maintenance are expensed as incurred.

Estimated useful life is management's estimate of how long the asset is expected to meet service demands. Straight-line depreciation is used based on the estimated useful lives of three to seven years for furniture and equipment.

Encumbrances. Due to the change in budgetary accounting as discussed above, encumbrances no longer remain after periods as any remaining amounts are reverted. As a result, there are no differences between measurement focus at June 30, 2010.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

External Trust Fund Accounting Policies

Units of Participation. Each pool is composed of units of participation of unlimited quantity. Each unit of participation represents an equal beneficial interest in the respective pool and no unit has priority or preference over any other. Each purchase or sale of units requires written authorization as defined in the joint powers agreements executed between the Office and each participant. All units are purchased by cash payment. Each unit of participation is recorded in book entry form by the Office and consists of an account for each participant that maintains the following information:

1. Name of participant;
2. Date of all unit purchases and sales;
3. Number of units purchased or sold;
4. Valuation of each unit owned; and
5. Total valuation of all units owned.

Initial Valuation. At the inception of each pool, all initial purchases were made by the participants for a valuation price of \$1,000 per unit.

Method of Valuation. The Office uses the following method of determining the value of each investment held in the pools:

- For purposes of this procedure, the recorded closing price for each investment is provided by a recognized pricing service and/or the custodian.
- In the case of a stock where a dividend has been declared and not yet paid, then the amount of such dividend accrual is included in the per unit value.
- An investment purchased and awaiting payment against delivery is included for valuation purposes as a security held and the cost thereof recorded as an account payable.
- For the purposes of valuation of an investment, with the exception of investments sold but not delivered, ascertained brokers; commissions or other expenses which would be incurred on a sale are not deducted.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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NOTES TO FINANCIAL STATEMENTS
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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Valuation of Units. With respect to the valuation of investments determined as provided above, there is added the following:

- All uninvested cash;
- The value of any rights or stock dividends which may have been declared but not received as of the valuation date; and
- All cash dividends and interest that are determined to be earned but not received.

All expenses, including management fees, chargeable to the respective pool as due or accrued are deducted from the valuation as determined above. The net per unit value is then determined by dividing the number of existing units into the total valuation calculated above.

Purchases and Sales. A written Notice of Intent to purchase or sell units must be received by the Office on or before the fifth business day preceding the valuation date. All notices must be signed by an authorized representative as specified in the applicable joint powers agreement. The Office reserves the right to limit a participant's sale to the participant's proportional interest in the current net cash position of the respective pooled investment fund, unless the Office receives a written Notice of Intent thirty (30) days prior to the effective date of the sale. All purchases or sales of units are effective as of the first day following the valuation date.

Cash payment for all additions must be received by the Office in the form of a wire transfer or by interagency cash transfer through the DFA, on or before the third business day following the valuation date. The Office reserves the right to return funds received after this date and cancel that participant's Notice of Intent to purchase units.

Expenses and Management Fee. The Office assesses each pool a management fee that will at least cover the costs of the management services provided and the costs related to maintaining each pool and the individual participant's related account. The amount of the management fee is based on each participant's proportionate ownership of the net assets managed by the Office. The Office reviews the management fee periodically and adjusts the fee, if necessary.

Reporting. The Office provides each participant with a monthly statement that contains net asset value, units owned and change in net asset value from the previous month's transactions. The Office provides each participant with a statement that details the respective participant's total investment.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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NOTES TO FINANCIAL STATEMENTS
June 30, 2010

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3. CASH AND CASH EQUIVALENTS

Investment in the State General Fund Investment Pool: The Statements of Net Assets include an investment in State Treasurer General Fund Investment Pool maintained at the State Treasurer's Office (STO). All deposit accounts maintained at the State Treasurer's Office participate in an overnight repurchase agreement program administered by the State Treasurer.

The investment in the State Treasurer Investment Pool (STIP) is in accounts that are pooled with other state funds on deposit in the State Treasurer's name at commercial banking and other financial institutions. Information regarding the adequacy of collateralization of deposits is not known to individual agencies and is the responsibility of the State Treasurer. To obtain pledged collateral, investment risk, and insurance coverage information for the Department's State Treasurer deposits, a copy of separately issued financial statements can be obtained from the State Treasurer's Office.

Deposits: Cash and cash equivalents are held by the custodian, Northern Trust Company. Northern Trust Company cash is invested in short-term investment funds and are insured or registered with securities held by the government or its agent in the government's name.

Custodial Credit Risk – Deposits. The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government 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. As of June 30, 2010, the Office's cash and cash equivalent deposits were not exposed to custodial credit risk.

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June 30, 2010

NOTE 3. CASH AND CASH EQUIVALENTS (CONTINUED)

Investments in the STIP and Cash and cash equivalents balances as of June 30, 2010 were as follows:

| | SHARE | STO | The Northern | |
|-----------------------------|-------|----------------------|--------------------|----------------------|
| | Fund | Funds | Trust | Totals |
| | | | Company | |
| General Administrative Fund | 17300 | \$ 8,036,362 | - | 8,036,362 |
| Subtotal | | <u>\$ 8,036,362</u> | - | <u>8,036,362</u> |
| Land Grant Permanent Fund | 60100 | \$ 32,454,369 | 22,934,595 | 55,388,964 |
| Severance Tax | | | | |
| Permanent Fund | 60200 | 10,724 | 43,394,189 | 43,404,913 |
| Tobacco Settlement | | | | |
| Permanent Fund | 95200 | - | 45,365,041 | 45,365,041 |
| Water Permanent Fund | 10120 | - | 7,917,156 | 7,917,156 |
| State Unemployment | | | | |
| Trust Fund | 10340 | 1,093,700 | 117,140,173 | 118,233,873 |
| Large Cap. Active Pool | 09400 | - | 213,790,909 | 213,790,909 |
| Large Cap. Index Pool | 62800 | - | 4,971,846 | 4,971,846 |
| Core Bonds Pool | 77000 | - | 220,204,657 | 220,204,657 |
| Mid/Small Cap. Pool | 22000 | - | 41,564,012 | 41,564,012 |
| Non-U.S. Developed | | | | |
| Markets Pool | 21800 | - | 5,221,628 | 5,221,628 |
| Non-U.S. Emerging | | | | |
| Markets Pool | 61100 | - | 15,992,408 | 15,992,408 |
| Active ETF Pool | 10330 | - | 52,014 | 52,014 |
| Index ETF Pool | 10320 | - | 691,770 | 691,770 |
| Mid/Small Cap. ETF Pool | 10310 | - | 286,288 | 286,288 |
| Absolute Return Pool | 72100 | - | 204,842,222 | 204,842,222 |
| Structured Credit Pool | 20140 | - | 21,637,523 | 21,637,523 |
| Subtotal | | <u>\$ 33,558,793</u> | <u>966,006,431</u> | <u>999,565,224</u> |
| Total | | <u>\$ 41,595,155</u> | <u>966,006,431</u> | <u>1,007,601,586</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 4. INVESTMENTS AND SECURITIES LENDING

In accordance with NMSA 6-8, the Council is authorized to invest in domestic and international stocks, debt obligations of the U.S. government, its agencies or instrumentalities, debt obligations of any U.S. or foreign corporation, partnerships, or trusts with an investment-grade rating from a national rating service, real estate investments, national private equity investments, repurchase agreements secured by U.S. obligations or other securities backed by the U.S., and absolute return funds. In addition, the Council is authorized to invest in other differential-rate investments as specified in statute including New Mexico private equity, SBAs, CDs, film projects, and various other loan guarantees. Numerous restrictions, either statute or policy in origin, define various elements of the investments. Examples include investment size, limitation of percentage ownership of a particular fund or investment, percent the investment type comprises of the entire fund, and requiring guarantees or other forms of assurance of repayment. The investment policy has been structured in accordance with the Uniform Prudent Investor Act, NMSA 45-7 (600-612).

Credit Risk – Debt Investments. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill their obligations. In order to assess credit risk, the Office is required to disclose credit ratings of its debt investments. U.S. government obligations and obligations guaranteed by the U.S. government are not considered to have credit risk and accordingly, do not require disclosure. Currently, the Office does have a policy for the Core Bond Fund that all securities must be rated investment grade by one or more national rating agencies at the time of purchase. The High-Yield Bond Fund policy requires that the securities be rated at least CCC- or equivalent by one or more of the national rating agencies at the time of purchase. Securities that fall below investment grade after purchase may be held at the discretion of the staff.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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NOTE 4. INVESTMENTS AND SECURITIES LENDING

The Office's investments and their exposure to credit risk at June 30, 2010 are as follows:

| Investment | Rating | Fair Value |
|--|--------|------------------------|
| Commercial Mortgage-Backed | AAA | \$ 15,800,190 |
| Non-Government Backed C.M.O.s | AAA | 35,358,667 |
| Asset Backed Securities | A | 4,142,354 |
| Corporate Bonds | A | 4,981,200 |
| Corporate Convertible Bonds | CCC | 29,548,966 |
| Investments subject to credit risk - S&P Ratings | | <u>\$89,831,377</u> |
| Asset Backed Securities | Aaa | 21,887,001 |
| Commercial Mortgage-Backed | Aaa | 75,693,070 |
| Government Agencies | Aaa | 116,182,095 |
| Government Bonds | Aaa | 436,060,641 |
| Guaranteed Fixed Income | Aaa | 37,958,580 |
| Non-Government Backed C.M.O.s | Aaa | 7,392,457 |
| Asset Backed Securities | Aa | 63,075,244 |
| Commercial Mortgage-Backed | Aa | 14,076,880 |
| Corporate Bonds | Aa | 73,803,203 |
| Asset Backed Securities | A | 9,076,018 |
| Corporate Bonds | A | 271,445,213 |
| Asset Backed Securities | Baa | 4,829,722 |
| Corporate Bonds | Baa | 173,993,665 |
| Non-Government Backed C.M.O.s | Baa | 9,650,967 |
| Asset Backed Securities | Ba | 72,839,780 |
| Corporate Bonds | Ba | 5,880,547 |
| Asset Backed Securities | B | 32,780,742 |
| Corporate Convertible Bonds | Caa | 255,040 |
| Asset Backed Securities | Caa | 24,964,766 |
| Non-Government Backed C.M.O.s | Caa | 32,474,681 |
| Asset Backed Securities | Ca | 24,146,121 |
| Corporate Bonds | Ca | 71,200 |
| Non-Government Backed C.M.O.s | Ca | 11,294,069 |
| Non-Government Backed C.M.O.s | C | 599 |
| Investments subject to credit risk - Moody's Ratings | | <u>\$1,519,832,301</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 4. INVESTMENTS AND SECURITIES LENDING (CONTINUED)

| Investment | Rating | Fair Value |
|---|-----------|--------------------------|
| <i>Investments subject to credit risk - not rated</i> | | |
| Asset Backed Securities | not rated | \$ 49,676,357 |
| Corporate Bonds | not rated | 23,943,652 |
| Government Bonds | not rated | 5,000,000 |
| Municipal/Provincial Bonds | not rated | 2,750,000 |
| Non-Government Backed C.M.O.s | not rated | 1,994 |
| Investments subject to credit risk - not rated | | <u>\$ 81,372,003</u> |
| <i>Investments "NOT" subject to credit risk</i> | | |
| Private Equity, Equity Securities and Real Estate | | \$ 10,805,349,035 |
| NM Film Investments | | 97,036,854 |
| Government Agencies | | 43,962,210 |
| Investments "NOT" subject to credit risk | | <u>10,946,348,099</u> |
| Total Investments | | <u>\$ 12,637,383,780</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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June 30, 2010

NOTE 4. INVESTMENTS AND SECURITIES LENDING (CONTINUED)

Interest Rate Risk – Debt Investments. Interest rate risk is the risk that changes in interest rates could adversely affect the fair value of an investment. The Council does not have a policy for interest rate risk management, but its practice is to address interest risk through the management of debt investment duration.

A summary of the investments at June 30, 2010 and their exposure to interest rate risk are as follows:

| Investment | Fair Value | Less than 1 Year | 1-5 Years | 6-10 Years | Greater than 10 Years |
|---|--------------------------|------------------|----------------|----------------|-----------------------|
| <i>Investments subject to interest rate risk</i> | | | | | |
| Corporate Convertible Bonds | \$ 255,040 | \$ 255,040 | \$ - | \$ - | \$ - |
| Asset Backed Securities | 307,409,703 | - | 110,093,765 | 11,496,473 | 185,819,465 |
| Commercial Mortgage-Backed | 105,570,141 | - | - | 38,278,471 | 67,291,670 |
| Corporate Bonds | 549,134,175 | 50,003,450 | 233,764,793 | 137,258,908 | 128,107,024 |
| Government Agencies | 116,647,177 | 465,082 | 47,447,430 | 52,432,785 | 16,301,880 |
| Government Bonds | 441,060,641 | - | 165,752,580 | 211,617,456 | 63,690,605 |
| Government Mortgage Backed Securities | 332,842,807 | 9,873 | 4,089,194 | 2,645,949 | 326,097,791 |
| Guaranteed Fixed Income | 37,958,580 | - | 37,958,580 | - | - |
| Municipal/Provincial Bonds | 2,750,000 | - | - | - | 2,750,000 |
| Non-Government Backed C.M.O.s | 125,721,801 | - | - | 37,660,479 | 88,061,322 |
| Subtotal | \$ 2,019,350,065 | \$ 50,733,445 | \$ 599,106,342 | \$ 491,390,521 | \$ 878,119,757 |
| <i>Investments not subject to interest rate risk</i> | | | | | |
| Securities, Equity, Real Estate, and NM Film Investments | 10,608,442,668 | | | | |
| Total Investments | <u>\$ 12,627,792,733</u> | | | | |

Concentration of Credit Risk – Investments. Concentration risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments in any one issuer that represent 5% or more of total investments are considered to be exposed to concentrated credit risk and are required to be disclosed. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. As of June 30, 2010, the Office was not exposed to concentration of credit risk as no single issuer represented 5% of total investments.

Foreign Currency Risk – Investments. Foreign currency risk is the risk that changes in exchange rates could adversely affect an investment's or deposits fair value. This risk is eliminated in the Core Bond and High-Yield Bond pools by adhering to the SIC policy that all securities be denominated in U.S. dollars, and is managed in the equity funds by limiting the size of the internationally-invested funds.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
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June 30, 2010

NOTE 4. INVESTMENTS AND SECURITIES LENDING (CONTINUED)

A summary of the investments at June 30, 2010 and their exposure to foreign currency risk are as follows:

| Investment | Foreign Currency | Amount | % of Total Investments |
|--|------------------------|-------------------|------------------------|
| Common Stock | Australian dollar | \$ 37,317,735 | 0.27% |
| Common Stock | Brazilian real | 41,744,924 | 0.31% |
| Common Stock | British pound sterling | 107,970,652 | 0.79% |
| Common Stock | Danish krone | 4,639,138 | 0.03% |
| Common Stock | Egyptian pound | 8,450,071 | 0.06% |
| Common Stock | Euro | 134,855,130 | 0.99% |
| Common Stock | Hong Kong dollar | 95,448,434 | 0.70% |
| Common Stock | Hungarian forint | 2,180,489 | 0.02% |
| Common Stock | Indian rupee | 48,939,843 | 0.36% |
| Common Stock | Indonesian rupiah | 11,176,329 | 0.08% |
| Common Stock | Japanese yen | 107,086,163 | 0.78% |
| Common Stock | Malaysian ringgit | 2,942,366 | 0.02% |
| Common Stock | Mexican peso | 28,797 | 0.00% |
| Common Stock | New Israeli shekel | 3,980,062 | 0.03% |
| Common Stock | New Taiwan dollar | 50,435,123 | 0.37% |
| Common Stock | New Zealand dollar | 481,083 | 0.00% |
| Common Stock | Norwegian krone | 3,297,089 | 0.02% |
| Common Stock | Polish zloty | 8,235,210 | 0.06% |
| Common Stock | Singapore dollar | 11,908,723 | 0.09% |
| Common Stock | South African rand | 29,685,939 | 0.22% |
| Common Stock | South Korean won | 76,332,318 | 0.56% |
| Common Stock | Swedish krona | 13,513,661 | 0.10% |
| Common Stock | Swiss franc | 37,033,241 | 0.27% |
| Common Stock | Thai baht | 18,251,341 | 0.13% |
| Common Stock | Turkish lira | 18,380,737 | 0.13% |
| Cash | Argentine peso | 6,137 | 0.00% |
| Cash | Australian dollar | 70,687 | 0.00% |
| Cash | British pound sterling | 466,253 | 0.00% |
| Cash | Danish krone | 59,525 | 0.00% |
| Cash | Egyptian pound | 506,183 | 0.00% |
| Cash | Euro | 372,639 | 0.00% |
| Cash | Hong Kong dollar | 1,874,373 | 0.01% |
| Cash | Hungarian forint | 251,933 | 0.00% |
| Cash | Indian rupee | 157,527 | 0.00% |
| Cash | Japanese yen | 973,998 | 0.01% |
| Cash | Mexican peso | 848 | 0.00% |
| Cash | New Israeli shekel | 72,711 | 0.00% |
| Cash | New Taiwan dollar | 1,602,974 | 0.01% |
| Cash | New Zealand dollar | 13,971 | 0.00% |
| Cash | Norwegian krone | 10,372 | 0.00% |
| Cash | Polish zloty | 118,992 | 0.00% |
| Cash | Singapore dollar | 75,125 | 0.00% |
| Cash | South African rand | 222,807 | 0.00% |
| Cash | South Korean won | 68,222 | 0.00% |
| Cash | Swedish krona | 48,764 | 0.00% |
| Cash | Swiss franc | 164,279 | 0.00% |
| Cash | Thai baht | 14 | 0.00% |
| Cash | Turkish lira | 676,660 | 0.00% |
| Partnerships | Euro | 152,143,326 | 1.12% |
| Preferred Stock | Brazilian real | 22,892,767 | 0.17% |
| Preferred Stock | Euro | 1,953,563 | 0.01% |
| Preferred Stock | South Korean won | 11,540,020 | 0.08% |
| Rights/Warrants | Euro | 2,368 | 0.00% |
| Rights/Warrants | Hong Kong dollar | 1,899 | 0.00% |
| Rights/Warrants | Norwegian krone | 5,461 | 0.00% |
| Foreign Currency Investments and Cash and Cash Equivalents | | 1,070,668,996 | 7.85% |
| Non-Foreign Currency Investments and Cash and Cash Equivalents | | 12,574,316,370 | 92.15% |
| Total Investments and Cash and Cash Equivalents | | \$ 13,644,985,366 | 100.00% |

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June 30, 2010

NOTE 4. INVESTMENTS AND SECURITIES LENDING (CONTINUED)

Securities Lending. State statutes and Office policies permit the Office to use investments of the LGPF, STPF, TSPF, and WTF to enter into securities lending transactions (i.e., loans of securities to broker dealers and other entities for collateral of 102% of the fair value of securities lent with a simultaneous agreement to return the collateral for the same securities in the future). At year-end, the Office has no net credit risk exposure to borrowers because the amounts the Office owed the borrowers of securities exceeded the amounts the borrowers of securities owed the Office. The contract with the lending agent requires it to indemnify the Office if the borrowers fail to return the securities (or if collateral is inadequate to replace the securities lent) or if the counterparty fails to pay the Office for income distributions by the securities' issuers while the securities are on loan. Securities loaned to brokers at June 30, 2010 consisted of U.S. Treasury notes and bonds and U.S. and international equity securities with a fair value of approximately \$444,845,858. Security lending gross income totaled approximately \$2,194,113 for the year ended June 30, 2010; related fees were approximately \$307,306. The unrealized gain on securities lending for fiscal year 2010 of \$142,510,603 has been included in the statement of changes in fiduciary net assets.

All securities are loaned for a term not to exceed one year, and loans may be terminated by either party upon receipt of written instructions by the lending agent. The lending agent, as agent of the Office, is required to invest the cash collateral received in connection with the securities loaned in permitted investments as set forth in the agreement between the parties.

NOTE 5. PENSION PLAN – PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

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

Funding Policy. Plan members are required to contribute 7.42% of their gross salary. The Office is required to contribute 16.59% of the gross covered salary. The contribution requirements of plan members and the Office are established in State statute under Chapter 10, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 5. PENSION PLAN – PUBLIC EMPLOYEES RETIREMENT ASSOCIATION (CONTINUED)

The Office’s contributions to PERA for the fiscal years ending June 30, 2010, 2009 and 2008 were \$392,907, \$419,489, and \$387,605, respectively, which equal the amount of the required contributions for each fiscal year.

There are employees who are making contributions to a deferred compensation plan funded through salary reductions in accordance with the provisions of Section 457 of the Internal Revenue Code. Neither the Office nor the State of New Mexico makes any contributions to this plan. All contributions withheld from the participants by the Office have been remitted to PERA, which administers the plan.

NOTE 6. CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets is as follows:

| | Balance June 30, 2009 | Additions | Deletions | Balance June 30, 2010 |
|-----------------------------|-----------------------------|--------------|-----------|--------------------------------------|
| Furniture and equipment | \$ 424,334 | 17,022 | - | 441,356 |
| Accumulated depreciation | (397,129) | (10,133) | - | (407,262) |
| Total capital assets | <u>\$ 27,205</u> | <u>6,889</u> | <u>-</u> | <u>34,094</u> |

Depreciation expense recognized by the Office in fiscal year 2010 was \$10,133. This amount was recognized as an expense in the general fund statement of activities.

NOTE 7. CHANGES IN ACCRUED VACATION AND SICK PAY

A summary of changes in accrued vacation and sick pay is as follows:

| | |
|--------------------------|-------------------|
| Balance at June 30, 2009 | \$ 235,104 |
| Additions | 166,177 |
| Deletions | <u>(210,425)</u> |
| Balance at June 30, 2010 | <u>\$ 190,856</u> |

Of the balance outstanding at June 30, 2010, \$115,086 is estimated to be due within one year of the statement date.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 8. COMMITMENTS

The Office has commitments for capital contributions to the various private equity partnerships, real estate investments and film projects in which it has investments. As of June 30, 2010, the Office was an investor in two hundred and forty nine private equity limited partnerships, 2 film projects and various real estate investments. When making an investment in a limited partnership, the Office commits, on the part of either the Land Grant Permanent Fund or the Severance Tax Permanent Fund, to a capital commitment that will be drawn down by the limited partnership over the life of the partnership, typically twelve to fifteen years. As of June 30, 2010, unfunded commitments to private equity partnerships were approximately \$2,663,283,241, unfunded commitments to film loans were approximately \$15,000,000, and unfunded commitments to real estate investments were approximately \$200,073,930. Due to the nature of these investments, the Office cannot predict when these capital contributions will be called.

In addition to the above investment commitments, the Office leases office space and equipment under noncancelable operating leases. Total rent expense for the year ended June 30, 2010 was \$272,489. Minimum annual lease payments under these leases for the years ended June 30 are as follows:

| | |
|------------|--------------------|
| 2011 | 270,960 |
| 2012 | 276,325 |
| 2013 | 280,240 |
| 2014 | 280,189 |
| 2014 | 284,339 |
| thereafter | <u>778,957</u> |
| | <u>\$2,171,010</u> |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 9. BUDGETARY MATTERS

The Office is required to submit a budget request for the General Fund to DFA and the Legislative Finance Committee by September 1 of each year. Consistent with the General Appropriations Act of 2004, the Office prepares the budget using the modified accrual budgetary basis of accounting. Total budgeted expenditures for fiscal year 2010 were \$34.9 million of which only \$31.5 million were incurred. However, personnel services and benefits were over expended by \$19,162. The expenditures reported in the budget report agree to the amounts reported in the accompanying general administrative fund statement of revenues, expenditures, and changes in net assets.

NOTE 10. JOINT POWERS AGREEMENTS

The Office manages investments under joint powers agreements that may be terminated by either party upon thirty days' notice to the other party. The revenues and expenditures of the investment pools are recorded in the accompanying financial statements, and the net changes to the participants' assets are recorded in the External Investment Trust Funds financial statements. In addition, each participant reports their net assets in their individual financial statements. At June 30, 2010, these joint powers agreements were as follows:

- (a) The Office entered into a Joint Powers Agreement with the New Mexico Retiree Healthcare Authority (NMRHCA) dated June 25, 1992, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMRHCA in accordance with guidelines established in NMRHCA's investment policy. At June 30, 2010, the NMRHCA had total net assets held in trust of \$156,457,561.
- (b) The Office entered into a Joint Powers Agreement with the New Mexico Institute of Mining & Technology (NMIMT) dated November 24, 1992, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMIMT in accordance with guidelines established in NMIMT's investment policy. At June 30, 2010, the NMIMT had total net assets held in trust of \$44,032,624.
- (c) The Office entered into a Joint Powers Agreement with the New Mexico School for the Blind and Visually Impaired (NMSBVI) dated March 25, 1993, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMSBVI in accordance with guidelines established in NMSBVI's investment policy. At June 30, 2010, the NMSBVI had total net assets held in trust of \$7,645,548.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 10. JOINT POWERS AGREEMENTS (CONTINUED)

- (d) The Office entered into a Joint Powers Agreement with the Commissioner of Public Lands (the Commissioner) dated March 11, 1994, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the Commissioner in accordance with guidelines established in the Commissioner's investment policy. At June 30, 2010, the Commissioner had total net assets held in trust of \$8,633,408.
- (e) The Office entered into a Joint Powers Agreement with the New Mexico Interstate Stream Commission (Commission) dated March 11, 1994, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the Commission in accordance with guidelines established in the Commission's investment policy. At June 30, 2010, the Commission had total net assets held in trust of \$14,812,468.
- (f) The Office entered into a Joint Powers Agreement with the New Mexico Military Institute (NMMI) dated July 1, 1997, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMMI in accordance with guidelines established in NMMI's investment policy. At June 30, 2010, the NMMI had total net assets held in trust of \$17,069,473.
- (g) The Office entered into a Joint Powers Agreement with the New Mexico Department of Game and Fish (NMDGF) dated July 28, 1998, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMDGF in accordance with guidelines established in NMDGF's investment policy. At June 30, 2010, the NMDGF had total net assets held in trust of \$862,882.
- (h) The Office entered into a Joint Powers Agreement with Eastern New Mexico University (ENMU) dated December 4, 1998, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to ENMU in accordance with guidelines established in ENMU's investment policy. At June 30, 2010, the ENMU had total net assets held in trust of \$7,903,577.
- (i) The Office entered into a Joint Powers Agreement with the Springer Municipal School District (SMSD) dated February 5, 1999, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to SMSD in accordance with guidelines established in SMSD's investment policy. At June 30, 2010, the SMSD had total net assets held in trust of \$134,054.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 10. JOINT POWERS AGREEMENTS (CONTINUED)

- (j) The Office entered into a Joint Powers Agreement with the City of Albuquerque (the City) dated March 29, 2000, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the City in accordance with guidelines established in the City's investment policy. At June 30, 2010, the City had total net assets held in trust of \$17,863,356.
- (k) The Office entered into a Joint Powers Agreement with the New Mexico Public Regulation Commission, Superintendent of Insurance (the Agency) dated September 18, 2000, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the Agency in accordance with guidelines established in the Agency's investment policy. At June 30, 2010, the Agency had total net assets held in trust of \$31,977,167.
- (l) The Office entered into a Joint Powers Agreement with the County of Los Alamos (County) dated October 4, 2000, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the County in accordance with guidelines established in the County's investment policy. At June 30, 2010, the County had total net assets held in trust of \$35,279,850.
- (m) The Office entered into a Joint Powers Agreement with the New Mexico Public School Insurance Authority (NMPSIA) dated April 30, 2004, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMPSIA in accordance with guidelines established in NMPSIA's investment policy. At June 30, 2010, the NMPSIA had total net assets held in trust of \$31,508,043.
- (n) The Office entered into a Joint Powers Agreement with the New Mexico Highlands University (NMHU) dated December 10, 2004, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMHU in accordance with guidelines established in NMHU's investment policy. At June 30, 2010, the NMHU had total net assets held in trust of \$2,110,086.
- (o) The Office entered into a Joint Powers Agreement with the Children Youth and Family Department (CYFD) dated January 1, 2006, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to CYFD in accordance with guidelines established in CYFD's investment policy. At June 30, 2010 the CYFD had total net assets held in trust of \$2,218,226.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 10. JOINT POWERS AGREEMENTS (CONTINUED)

- (p) The Office entered into a Joint Powers Agreement with the New Mexico Mortgage Finance Authority (NMMFA) dated November 16, 2005, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMMFA in accordance with guidelines established in NMFA's investment policy. At June 30, 2010, the NMMF had total net assets held in trust of \$26,826,217.
- (q) The Office entered into a Joint Powers Agreement with the New Mexico Higher Education Department (NMHED) dated April 3, 2007, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to NMHED in accordance with guidelines established in NMHED's investment policy. At June 30, 2010, the NMHED had total net assets held in trust of \$19,710,144.
- (r) The Office entered into a Joint Powers Agreement with the City of Las Cruces (Client) dated September 28, 2007, pursuant to the Joint Powers Agreement Act, Sections 11-1-1 through 11-1-7, NMSA 1978. Under this agreement, the Office invests certain monies belonging to the Client in accordance with guidelines established in the Client's investment policy. At June 30, 2010, the Client had total net assets held in trust of \$10,453,016.

NOTE 11. POST EMPLOYMENT BENEFITS – STATE RETIREE HEALTH CARE PLAN

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

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

**NOTE 11. POST EMPLOYMENT BENEFITS – STATE RETIREE HEALTH
CARE PLAN (CONTINUED)**

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

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

Funding Policy. The Retiree Health Care Act (Section 10-7C-13 NMSA 1978) authorizes the RHCA Board to establish the monthly premium contributions that retirees are required to pay for healthcare benefits. Each participating retiree pays a monthly premium according to a service based subsidy rate schedule for the medical plus basic life plan plus an additional participation fee of five dollars if the eligible participant retired prior to the employer's RHCA effective date or is a former legislator or former governing authority member.

Former legislators and governing authority members are required to pay 100% of the insurance premium to cover their claims and the administrative expenses of the plan. The monthly premium rate schedule can be obtained from the RHCA or viewed on their website at www.nmrhca.state.nm.us.

The 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. The statute requires each participating employer to contribute 1.3% of each participating employee's annual salary; each participating employee is required to contribute .65% of their salary. Employers joining the program after 1/1/98 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.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

**NOTE 11. POST EMPLOYMENT BENEFITS – STATE RETIREE HEALTH
CARE PLAN (CONTINUED)**

The Office's contributions to the RHCA for the years ended June 30, 2010, 2009 and 2008 were \$33,933, \$33,784 and \$30,859 respectively, which equal the required contributions for each year.

NOTE 12. RISK MANAGEMENT

The Office, as a “State Agency” defined in the New Mexico Tort Claims Act, is insured through the Risk Management Division of the State of New Mexico. The Office pays annual premiums to the Risk Management Division for coverage provided in the following areas:

1. Liability and civil rights protection for claims made by others against the State of New Mexico;
2. Coverages to protect the State of New Mexico’s property and assets; and
3. Fringe benefit coverages for State of New Mexico employees.

At June 30, 2010, the Office had no claims that the Risk Management Division had determined not to cover. Denial of coverage by the Risk Management Division would result in the responsibility for coverage reverting to the Office.

NOTE 13. SHORT-TERM DEBT

The Office had no short-term debt activity during the year or an outstanding balance at year-end.

NOTE 14. NON-REVERTING FUND

6-8-5(B), NMSA 1978, authorizes the State Investment Council (SIC) to prepare an operating budget as follows: *“The state investment officer shall annually prepare a budget for administering and investing all funds managed by the investment office, which shall be reviewed by the council. Any funds provided for the operating budget of the investment office shall be appropriated from the assets of the land grant permanent fund, the severance tax permanent fund, funds available for investment pursuant to Subsection G of Section 6-8-7 NMSA 1978 or any other funds managed by the investment office, as authorized by law.”* The state constitution has vested sole authority for appropriation the state legislature; therefore, the legislature annually appropriates funds for the SIC operating budget from the sources specified in this statute.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2010

NOTE 14. NON-REVERTING FUND (CONTINUED)

General reversion language in the appropriations act, Chapter 3, Section 3(E), New Mexico Laws of 2008, specifies in part: *Unencumbered balances in agency accounts remaining at the end of fiscal year 2010 shall revert to the general fund by October 1, 2010, unless otherwise indicated in the General Appropriation Act of 2008 or otherwise provided by law.* Absent any specific language mandating reversion of surplus operating funds at fiscal year-end, unexpended/unencumbered operating funds revert back to their original funding source.

NOTE 15. SUBSEQUENT EVENTS

On July 30, 2010, the State Unemployment Trust Fund was liquidated and \$118,257,725 was transferred from the Office to the State of New Mexico Department of Workforce Solutions.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
CHANGES IN LAND GRANT PERMANENT TRUST FUND
HELD FOR BENEFICIARIES
Year Ended June 30, 2010

Exhibit 1

| Beneficiary | Balance June 30, 2009 | State Land Office Transfers | Distributions to Beneficiaries | Other Increases In Capital Accounts, net | Balance June 30, 2010 | Participation Percentage June 30, 2010 |
|---|--------------------------|-----------------------------------|-----------------------------------|---|--------------------------|--|
| Carrie Tingley Hospital | - | 2,722 | (79) | (5) | 2,638 | 0.00030% |
| Charitable, penal and reform | \$ 72,490,396 | 2,379,307 | (4,781,321) | 10,391,561 | 80,479,943 | 0.905602% |
| Public schools | 6,606,456,859 | 279,790,040 | (437,127,589) | 946,502,484 | 7,395,621,794 | 83.219326% |
| Eastern New Mexico University | 6,765,907 | 343,649 | (445,886) | 961,411 | 7,625,081 | 0.085801% |
| Improvements to the Rio Grande | 22,180,983 | 339,783 | (1,453,879) | 3,179,722 | 24,246,609 | 0.272835% |
| Miners' Colfax Medical Center | 83,502,639 | 2,068,570 | (5,491,589) | 11,969,521 | 92,049,141 | 1.035784% |
| New Mexico Boys School | 549,401 | 194 | (35,788) | 78,689 | 592,496 | 0.006667% |
| New Mexico Highlands University | 2,342,898 | 41,530 | (153,689) | 335,853 | 2,566,592 | 0.028881% |
| New Mexico Institute of Mining and Technology | 16,261,103 | 912,993 | (1,085,530) | 2,340,014 | 18,428,580 | 0.207368% |
| New Mexico Military Institute | 269,275,085 | 9,828,623 | (17,789,968) | 38,620,685 | 299,934,425 | 3.375016% |
| New Mexico School for the Deaf | 163,965,542 | 6,984,799 | (10,853,958) | 23,501,434 | 183,597,817 | 2.065937% |
| New Mexico School for the Blind and Visually Impaired | 163,536,729 | 6,979,934 | (10,823,778) | 23,439,631 | 183,130,516 | 2.060678% |
| New Mexico State Hospital | 19,180,648 | 552,252 | (1,262,780) | 2,747,807 | 21,217,927 | 0.238755% |
| New Mexico State University | 39,505,457 | 2,114,434 | (2,626,981) | 5,665,148 | 44,658,058 | 0.502515% |
| Northern New Mexico Community College | 1,832,183 | 41,654 | (120,434) | 262,737 | 2,016,140 | 0.022687% |
| Penitentiary of New Mexico | 159,620,780 | 7,989,996 | (10,600,005) | 22,894,386 | 179,905,157 | 2.024385% |
| Public Buildings - Capitol | 93,449,049 | 2,961,491 | (6,161,957) | 13,391,072 | 103,639,655 | 1.166207% |
| The University of New Mexico | 128,397,958 | 3,378,052 | (8,447,972) | 18,400,249 | 141,728,287 | 1.594799% |
| The University of New Mexico Saline Lands | 480,448 | - | (31,289) | 68,819 | 517,978 | 0.005829% |
| Water reservoirs | 91,758,107 | 3,523,890 | (6,061,534) | 13,143,293 | 102,363,756 | 1.151849% |
| Western New Mexico University | 2,356,957 | 41,530 | (154,598) | 337,751 | 2,581,640 | 0.029050% |
| | \$ 7,943,909,129 | 330,275,443 | (525,512,604) | 1,138,232,262 | 8,886,904,230 | 100.00% |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 DETAIL OF INTERAGENCY TRANSFERS
 Year Ended June 30, 2010

Exhibit 2

| Agency Initiating Transfer/Fund | Transferring Cash Account | Agency Receiving Transfer/Fund | Receiving Cash Account |
|---|---------------------------------|--|------------------------------|
| State Land Office <i>A total of \$330,275,443 was received from the State Land office for FY10. Funds transferred are from royalties and principal from land sales generated by the State Land Office (see footnote 1).</i> | 53900/26400/77700 | State Investment Office/ Land Grant Permanent Fund | 60100 |
| Department of Finance and Administration/ Local Government <i>A total of \$71,585 was received for FY 10 as the Land Grant Permanent Fund's portion of the Federal Grazing Act.</i> | 34100/73800 | State Investment Office/ Land Grant Permanent Fund | 60100 |
| State Treasurer's Office/ Severance Tax Bonding Fund <i>A total of \$27,472,206 was transferred from the Severance Tax Bonding Fund during 2010. Of this amount, \$30,119,536 was a receivable from FY09 and \$2,647,330 was reverted in November 2009, a receivable from FY10. \$3,488,067 has been recorded as a receivable at June 30, 2010</i> <i>Funds transferred are remaining severance tax revenues remaining after paying Severance Tax Bonding debt service (see footnote 1).</i> | 39400/41000 | State Investment Office/ Severance Tax Permanent Fund | 60200 |
| Department of Finance and Administration/ Tobacco Settlement Proceeds <i>A total of \$42,924,243 was received for FY 10 as the Tobacco Settlement Permanent Fund's portion of the Tobacco Settlement Proceeds (see footnote 1). The difference between what was received and what was recorded in the statement of changes in net assets is due to accrued amounts recorded as a receivables at June 30, 2009 and 2010.</i> | 39401 | State Investment Office/ Tobacco Settlement Permanent Fund | 95200 |
| State Investment Office/ Land Grant Permanent Fund <i>A total of \$525,179,970 was distributed for FY 10 to the various beneficiaries of the Land Grant Permanent Fund (see footnote 1)</i> | 60100 | Land Grant Permanent Fund beneficiaries | Various |
| State Investment Office/ Severance Tax Permanent Fund <i>A total of \$187,423,967 was distributed for FY 10 to the State General Fund (see footnote 1).</i> | 60200 | Department of Finance and Administration/ State General Fund | 85300 |
| State Investment Office/ Tobacco Settlement Permanent Fund <i>A total of \$42,924,243 was distributed for FY 09 to the Tobacco Settlement Program Fund (see footnote 1). The difference between what was paid and what was recorded in the statement of changes in net assets is due to the payables at June 30, 2009 and 2010.</i> | 95200 | Department of Finance and Administration/ Tobacco Settlement Program Fund | 69700 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

Exhibit 3
 Page 1 of 9

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Core Bonds Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|-----------------|------------------------------------|--------------|---------------|---------------------------------|---------------------------------|
| City of Albuquerque - Open Space MGM | | \$ 23,774,831 | (17,000,000) | - | 3,311,550 | 10,086,381 |
| City of Albuquerque - Urban Enhancement | | 6,737,732 | - | - | 1,039,243 | 7,776,975 |
| Eastern New Mexico University | | 2,029,532 | - | - | 313,040 | 2,342,572 |
| Los Alamos County - Cemetery | | 88,728 | - | 36,355 | 14,451 | 139,534 |
| Los Alamos County - General Fund | | 1,978,829 | - | 810,363 | 322,172 | 3,111,364 |
| Los Alamos County - Permanent Fund | | 2,845,995 | - | 2,193,981 | 602,170 | 5,642,146 |
| NM Children's, Youth, Family Department Next Generation Fund | | 805,570 | - | - | 124,252 | 929,822 |
| NM Children's, Youth, Family Department Trust Fund | | 805,570 | - | - | 124,252 | 929,822 |
| NM Commissioner of Public Lands - Oil and Gas | | 5,703,383 | (1,751,686) | - | 843,072 | 4,794,769 |
| NM Department of Game and Fish | | 291,278 | - | - | 44,926 | 336,204 |
| NM Highlands University - Endowment Fund | | 694,071 | - | - | 107,056 | 801,127 |
| NM Higher Education Department | | 32,983,196 | (30,674,000) | - | 3,722,686 | 6,031,882 |
| NM Institute of Mining and Technology - Employee Benefit Trust | | 328,063 | - | - | 50,601 | 378,664 |
| NM Institute of Mining and Technology - Endowment Fund | | 8,256,497 | - | - | 1,273,502 | 9,529,999 |
| NM Institute of Mining and Technology - Plant Debt Allocated Funds | | 9,893,066 | - | - | 1,525,931 | 11,418,997 |
| NM Interstate Stream Comm. - Improvements on the Rio Grande | | 538,260 | - | - | 83,023 | 621,283 |
| NM Interstate Stream Comm. - Irrigation Works Construction | | 5,633,577 | - | - | 868,935 | 6,502,512 |
| NM Military Institute - Legislative Scholarship | | 2,068,661 | - | 13,792 | 319,658 | 2,402,111 |
| NM Military Institute LFC/VC Maintenance Endowment | | 1,363,194 | - | - | 210,263 | 1,573,457 |
| NM Military Institute Patterson Account | | 1,229,390 | - | - | 189,624 | 1,419,014 |
| NM Military Institute Trust Scholarship | | 1,346,813 | - | - | 208,862 | 1,582,193 |
| NM Mortgage Finance Authority | | 14,154,339 | - | 26,518 | 2,183,198 | 16,337,537 |
| NM Mortgage Finance Authority - IFT Housing Trust Fund | | 5,538,481 | - | 1,214,674 | 957,001 | 7,710,156 |
| NM Public Regulation Commission - Patients' Comp. Fund | | 19,293,667 | - | - | 2,975,901 | 22,269,568 |
| NM Public Schools Insurance Authority - Benefits | | 6,137,414 | - | - | 946,649 | 7,084,063 |
| NM Public Schools Insurance Authority - Risk | | 4,091,684 | - | - | 631,111 | 4,722,795 |
| NM Retiree Health Care Authority | | 52,612,318 | - | - | 8,115,045 | 60,727,363 |
| NM School for the Blind and Visually Impaired | | 7,566,970 | (1,000,000) | - | 1,079,578 | 7,646,548 |
| NM Institute of Mining and Technology | | 4,462,118 | - | - | 688,248 | 5,150,366 |
| Springer Municipal School District | | 23,690 | (3,000) | - | 3,557 | 24,247 |
| | | \$ 223,276,917 | (50,428,686) | 4,295,683 | 32,879,557 | 210,023,471 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Large Cap. Active Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|------------------------|---------------------------------|--------------|---------------|------------------------------|------------------------------|
| Los Alamos County - Cemetery | \$ | 110,933 | (14,186) | - | 17,205 | \$ 113,952 |
| City of Las Cruces | | 3,326,550 | - | - | 488,334 | 3,814,884 |
| Los Alamos County - General Fund | | 2,473,673 | (316,305) | - | 383,496 | 2,540,864 |
| Los Alamos County - Permanent Fund | | 3,557,676 | - | 369,516 | 684,376 | 4,611,568 |
| NM Commissioner of Public Lands - Oil and Gas | | 2,550,121 | (944,801) | - | 435,193 | 2,040,513 |
| NM Children's, Youth, Family Department Next Generation Fund | | 116,399 | - | - | 17,088 | 133,487 |
| NM Children's, Youth, Family Department Trust Fund | | 116,399 | - | - | 17,088 | 133,487 |
| NM Higher Education Department | | 14,929,858 | (14,094,000) | - | 4,081,499 | 4,917,357 |
| NM Interstate Stream Comm. - Improvements on the Rio Grande | | 411,886 | - | - | 60,467 | 472,353 |
| NM Interstate Stream Comm. - Irrigation Works Construction | | 6,292,577 | - | - | 923,743 | 7,216,320 |
| NM Military Institute LFC/VC Maintenance Endowment | | 224 | - | - | 33 | 257 |
| NM Retiree Health Care Authority | | 25,429,797 | - | - | 3,733,097 | 29,162,894 |
| | | \$ 59,316,093 | (15,369,292) | 369,516 | 10,841,619 | \$ 55,157,936 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS

Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Large Cap. ETF Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|---------------------|---------------------------------------|-------------|---------------|------------------------------------|------------------------------------|
| Eastern New Mexico University | \$ | 1,145,554 | - | - | 165,658 | \$ 1,311,212 |
| NM Commissioner of Public Lands - Oil and Gas | | 2,229,024 | (795,219) | - | 364,321 | 1,798,126 |
| NM Department of Game and Fish | | 290,743 | - | - | 42,045 | 332,788 |
| NM Institute of Mining and Technology - Employee Benefit Trust | | 261,083 | - | - | 37,756 | 298,839 |
| NM Institute of Mining and Technology - Endowment Fund | | 7,543,037 | - | - | 1,090,780 | 8,633,817 |
| NM Mortgage Finance Authority | | 2,427,490 | - | - | 351,034 | 2,778,524 |
| NM Public Regulation Commission - Patients' Comp. Fund | | 3,910,319 | - | - | 565,461 | 4,475,780 |
| NM Institute of Mining and Technology | | 7,863,162 | (750,000) | - | 1,028,677 | 8,141,839 |
| Springer Municipal School District | | 9,111 | - | - | 1,318 | 10,429 |
| NM Highlands University - Endowment Fund | | 368,718 | - | - | 53,319 | 422,037 |
| | \$ | 26,048,241 | (1,545,219) | - | 3,700,369 | \$ 28,203,391 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Large Cap. Index Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|---|-----------------------|---------------------------------------|--------------|---------------|------------------------------------|------------------------------------|
| Los Alamos County - Cemetery | | \$ 107,272 | (7,334) | - | 17,795 | \$ 117,733 |
| City of Las Cruces | | 1,598,903 | - | - | 259,557 | 1,858,460 |
| Los Alamos County - General Fund | | 2,392,145 | (163,611) | - | 396,663 | 2,625,197 |
| Los Alamos County - Permanent Fund | | 3,440,427 | - | 604,808 | 715,437 | 4,760,672 |
| NM Higher Education Department | | 14,272,810 | (13,541,000) | - | 3,857,069 | 4,588,879 |
| NM Military Institute Legislative Scholarship | | 1,645,433 | - | 372,934 | 224,694 | 2,243,061 |
| NM Military Institute - Endowment Fund | | 1,086,361 | - | - | 176,354 | 1,262,715 |
| NM Military Institute Patterson Account | | 979,241 | - | - | 158,928 | 1,138,169 |
| NM Military Institute Trust Scholarship | | 1,258,859 | - | 27,784 | 201,202 | 1,487,845 |
| NM Retiree Health Care Authority | | 24,012,379 | - | - | 3,898,055 | 27,910,434 |
| | | \$ 50,793,830 | (13,711,945) | 1,005,526 | 9,905,754 | \$ 47,993,165 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Large Cap. Index ETF Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|---------------------------|------------------------------------|-------------|---------------|---------------------------------|---------------------------------|
| Eastern New Mexico University | \$ | 1,865,979 | - | - | 262,956 | \$ 2,128,935 |
| NM Institute of Mining and Technology - Employee Benefit Trust | | 300,314 | - | - | 42,319 | 342,633 |
| NM Public Regulation Commission - Patients' Comp. Fund | | 1,560,972 | - | - | 219,974 | 1,780,946 |
| NM Public Schools Insurance Authority - Benefits | | 6,410,877 | - | - | 903,426 | 7,314,303 |
| NM Public Schools Insurance Authority - Risk | | 4,273,891 | - | - | 602,280 | 4,876,171 |
| Springer Municipal School District | | 13,431 | - | - | 1,894 | 15,325 |
| NM Highlands University - Endowment Fund | | 352,832 | - | - | 49,722 | 402,554 |
| | \$ | 14,778,296 | - | - | 2,082,571 | \$ 16,860,867 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Mid/Small Cap. Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|---|---------------------|------------------------------------|-------------|---------------|---------------------------------|---------------------------------|
| Los Alamos County - Cemetery | | \$ 79,837 | (5,127) | - | 16,270 | \$ 90,980 |
| Los Alamos County - General Fund | | 1,780,258 | (362,773) | - | 377,995 | 1,795,480 |
| Los Alamos County - Permanent Fund | | 2,560,389 | - | 454,826 | 661,086 | 3,676,301 |
| City of Las Cruces | | 2,753,449 | - | - | 550,008 | 3,303,457 |
| NM Higher Education Department | | 6,467,432 | (5,753,000) | - | 1,836,223 | 2,550,655 |
| NM Military Institute Legislative Scholarship | | 414,641 | - | 188,998 | 64,949 | 668,588 |
| NM Military Institute LFCVC Maintenance Endowment | | 275,519 | - | - | 55,035 | 330,554 |
| NM Military Institute Patterson Account | | 248,125 | - | - | 49,564 | 297,689 |
| NM Military Institute Trust Scholarship | | 318,700 | - | 68,226 | 57,197 | 444,123 |
| NM Retiree Health Care Authority | | 5,703,163 | - | - | 1,139,220 | 6,842,383 |
| | | \$ 20,601,513 | (6,120,900) | 712,050 | 4,807,547 | \$ 20,000,210 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Mid/Small Cap. ETF Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|-------------------------|---------------------------------|-------------|---------------|------------------------------|------------------------------|
| Eastern New Mexico University | \$ | 935,931 | - | - | 195,263 | \$ 1,131,194 |
| NM Department of Game and Fish | | 81,244 | - | - | 16,950 | 98,194 |
| NM Institute of Mining and Technology - Employee Benefit Trust | | 61,314 | - | - | 12,793 | 74,107 |
| NM Public Regulation Commission - Patients' Comp. Fund | | 1,632,333 | - | - | 340,555 | 1,972,888 |
| NM Public Schools Insurance Authority - Benefits | | 1,567,276 | - | - | 326,981 | 1,894,257 |
| NM Public Schools Insurance Authority - Risk | | 1,044,841 | - | - | 217,986 | 1,262,827 |
| Springer Municipal School District | | 24,461 | - | - | 5,102 | 29,563 |
| NM Highlands University - Endowment Fund | | 200,897 | - | - | 41,912 | 242,809 |
| | | \$ 5,548,297 | - | - | 1,157,542 | \$ 6,705,839 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS
Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Non-U.S. Developed Markets Pool | | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|---------------------------------|------------|---------------------------------------|-------------|---------------|------------------------------------|------------------------------------|
| | | | | | | | |
| Eastern New Mexico University | \$ | 782,045 | - | - | 60,757 | \$ 842,802 | |
| City of Las Cruces | | 1,370,615 | - | - | 106,483 | 1,477,098 | |
| Los Alamos County - Cemetery | | 55,828 | - | 6,577 | 4,389 | 66,794 | |
| Los Alamos County - General Fund | | 1,244,915 | - | 146,655 | 97,863 | 1,489,433 | |
| Los Alamos County - Permanent Fund | | 1,790,466 | - | 947,635 | (39,895) | 2,698,206 | |
| NM Children's, Youth, Family Department Next Generation Fund | | 32,994 | - | - | 2,562 | 35,556 | |
| NM Children's, Youth, Family Department Trust Fund | | 32,994 | - | - | 2,562 | 35,556 | |
| NM Department of Game and Fish | | 43,823 | - | - | 3,407 | 47,230 | |
| NM Institute of Mining and Technology - Employee Benefit Trust | | 58,795 | - | - | 4,568 | 63,363 | |
| NM Higher Education Department | | 4,095,784 | (3,904,000) | - | 825,011 | 1,016,795 | |
| NM Military Institute - Legislative Scholarship | | 441,863 | - | 29,767 | 220,371 | 692,001 | |
| NM Military Institute LFC/VC Maintenance Endowment | | 292,010 | - | - | 22,686 | 314,696 | |
| NM Military Institute Patterson Account | | 263,168 | - | - | 20,444 | 283,612 | |
| NM Military Institute Trust Scholarship | | 338,259 | - | 108,173 | 12,235 | 458,667 | |
| NM Public Regulation Commission - Patients' Comp. Fund | | 789,107 | - | - | 61,304 | 850,411 | |
| NM Public Schools Insurance Authority - Benefits | | 823,187 | - | - | 63,955 | 887,142 | |
| NM Public Schools Insurance Authority - Risk | | 548,801 | - | - | 42,636 | 591,437 | |
| NM Retiree Health Care Authority | | 22,957,248 | - | - | 1,783,562 | 24,740,810 | |
| Springer Municipal School District | | 22,380 | - | - | 1,738 | 24,118 | |
| NM Highlands University - Endowment Fund | | 128,770 | - | - | 10,004 | 138,774 | |
| | \$ | 36,113,052 | (3,904,000) | 1,238,807 | 3,306,642 | \$ 36,754,501 | |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year ended June 30, 2010

For fiscal year ended June 30, 2010, activity by participating agency was as follows:

| Participant | Non U.S. Emerging Markets Pool | Beginning Balance June 30, 2009 | Withdrawals | Contributions | Net Investment income (loss) | Ending Balance June 30, 2010 |
|--|--------------------------------|---------------------------------|-------------|---------------|------------------------------|------------------------------|
| Eastern New Mexico University | | \$ 119,348 | - | - | 27,514 | \$ 146,862 |
| Los Alamos County - Cemetery | | 32,678 | (16,285) | - | 7,880 | 24,273 |
| Los Alamos County - General Fund | | 728,441 | (114,329) | - | 170,364 | 784,476 |
| Los Alamos County - Permanent Fund | | 1,047,626 | (570,766) | - | 517,581 | 994,441 |
| NM Children's, Youth, Family Department Next Generation Fund | | 8,325 | - | - | 1,923 | 10,248 |
| NM Children's, Youth, Family Department Trust Fund | | 8,325 | - | - | 1,923 | 10,248 |
| NM Department of Game and Fish | | 39,386 | - | - | 9,080 | 48,466 |
| NM Higher Education Department | | 1,931,364 | (2,034,000) | - | 709,392 | 606,756 |
| NM Military Institute - Legislative Scholarship | | 125,526 | - | 248,009 | (193,172) | 180,363 |
| NM Military Institute LFC/VC Maintenance Endowment | | 74,212 | - | - | 17,109 | 91,321 |
| NM Military Institute Patterson Account | | 67,207 | - | - | 15,494 | 82,701 |
| NM Military Institute Trust Scholarship | | 86,405 | - | 14,824 | 17,984 | 119,213 |
| NM Public Regulation Commission - Patients' Comp. Fund | | 510,002 | - | - | 117,572 | 627,574 |
| NM Public Schools Insurance Authority - Benefits | | 1,401,867 | - | - | 323,178 | 1,725,045 |
| NM Public Schools Insurance Authority - Risk | | 934,558 | - | - | 215,445 | 1,150,003 |
| NM Retiree Health Care Authority | | 5,759,265 | - | - | 1,327,703 | 7,086,968 |
| Springer Municipal School District | | 24,681 | - | - | 5,690 | 30,371 |
| NM Highlands University - Endowment Fund | | 83,529 | - | - | 19,255 | 102,784 |
| | | \$ 12,982,745 | (2,735,380) | 262,833 | 3,311,915 | \$ 13,822,113 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS
June 30, 2010

Exhibit 4
Page 1 of 2

| Depository Institution | Account Name | Deposit Type | Balance Per Books | Balance per Statement |
|----------------------------------|---|-------------------|--------------------|-----------------------|
| Admin Fund | | | | |
| <i>Cash and Cash Equivalents</i> | | | | |
| NM STO | Fund 173 - General Administrative Fund | Interest in SGFIP | \$ 8,036,362 | 8,036,362 |
| | Total Admin Fund | | 8,036,362 | 8,036,362 |
| Fiduciary Funds | | | | |
| <i>Cash and Cash Equivalents</i> | | | | |
| NM STO | Fund 601 - Land Grant Permanent Fund | Interest in SGFIP | 32,454,369 | 32,454,369 |
| NM STO | Fund 602 - Severance Tax Permanent Fund | Interest in SGFIP | 10,724 | 10,724 |
| NM STO | State Unemployment Trust Fund | Interest in SGFIP | 1,093,700 | 1,093,700 |
| Northern Trust | Land Grant Permanent Fund | Money Market | 22,934,595 | 22,934,595 |
| Northern Trust | Severance Tax Permanent Fund | Money Market | 39,484,090 | 39,484,090 |
| Northern Trust | ST NMSU Equity | Money Market | 462,692 | 462,692 |
| Northern Trust | ST UNM Equity | Money Market | 3,447,407 | 3,447,407 |
| Northern Trust | Tobacco Settlement Permanent Fund | Money Market | 45,365,041 | 45,365,041 |
| Northern Trust | Water Trust Fund | Money Market | 7,917,156 | 7,917,156 |
| Northern Trust | State Unemployment Trust Fund | Money Market | 117,140,173 | 117,140,173 |
| Northern Trust | All Cap SIC Managed | Money Market | 7,894,910 | 7,894,910 |
| Northern Trust | Alliance Bernstein | Money Market | 2,565,799 | 2,565,799 |
| Northern Trust | Alliance Bernstein EM | Money Market | 12,791,516 | 12,791,516 |
| Northern Trust | Beckman | Money Market | 1,138,569 | 1,138,569 |
| Northern Trust | Carret Asset Management | Money Market | 476,717 | 476,717 |
| Northern Trust | Credit and Structured Finance Cash | Money Market | 21,637,523 | 21,637,523 |
| Northern Trust | Citigroup | Money Market | 27,521,835 | 27,521,835 |
| Northern Trust | Denali | Money Market | 2,218,907 | 2,218,907 |
| Northern Trust | Ernest Partners (Mid Cap) | Money Market | 4,804,680 | 4,804,680 |
| Northern Trust | Ernest Partners (Small Cap) | Money Market | 5,213,484 | 5,213,484 |
| Northern Trust | First Quadrant | Money Market | 16,756,345 | 16,756,345 |
| Northern Trust | Fixed Income Pool | Money Market | 220,204,657 | 220,204,657 |
| Northern Trust | Fox | Money Market | 5,756,024 | 5,756,024 |
| Northern Trust | Hedge Fund Pooled Cash Account | Cash | 204,842,221 | 204,842,221 |
| Northern Trust | Hester | Money Market | 17,479,073 | 17,479,073 |
| Northern Trust | Jarislowsky Fraser | Money Market | 59,788 | 59,788 |
| Northern Trust | S&P 500 Active Pool | Money Market | 97,265,856 | 97,265,856 |
| Northern Trust | Large Cap ETF Pool | Money Market | 52,014 | 52,014 |
| Northern Trust | Lombardia | Money Market | 331,255 | 331,255 |
| Northern Trust | Mid/Small Cap ETF | Money Market | 286,288 | 286,288 |
| Northern Trust | Non-US SIC Managed | Money Market | 3,200,892 | 3,200,892 |
| Northern Trust | S&P Active Derivatives | Money Market | 55,363,983 | 55,363,983 |
| Northern Trust | S&P Index 500 Derivatives | Money Market | 527,094 | 527,094 |
| Northern Trust | S&P Index 500 Pool | Money Market | 4,444,752 | 4,444,752 |
| Northern Trust | S&P Index ETF Pool | Money Market | 691,770 | 691,770 |
| Northern Trust | Simms | Money Market | 155,240 | 155,240 |
| Northern Trust | Simms | Money Market | 2,596,041 | 2,596,041 |
| Northern Trust | Thonburg | Money Market | 12,978,043 | 12,978,043 |
| | Total Fiduciary Funds | | 999,565,223 | 999,565,223 |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS (CONTINUED)
June 30, 2010

Exhibit 4
Page 2 of 2

| Depository Institution | Account Name | Deposit Type | Balance Per Books | Balance per Statement |
|-------------------------------|--|-------------------------------------|--------------------------|--------------------------|
| <i>Investments on Deposit</i> | | | | |
| Northern Trust | All Cap SIC Managed | Equity | \$ 341,352,538 | \$ 341,352,538 |
| Northern Trust | Alliance Bernstein | Equity | 460,575,530 | 460,575,530 |
| Northern Trust | Alliance Bernstein EM | Equity | 555,018,871 | 555,018,871 |
| Northern Trust | Beckman | Equity | 266,715,400 | 266,715,400 |
| Northern Trust | Citigroup | Equity | 358,433,638 | 358,433,638 |
| Northern Trust | Denali | Equity | 195,292,708 | 195,292,708 |
| Northern Trust | Ernest Partners (Mid Cap) | Equity | 367,370,565 | 367,370,565 |
| Northern Trust | Ernest Partners (Small Cap) | Equity | 132,110,046 | 132,110,046 |
| Northern Trust | First Quadrant | Equity | 353,699,259 | 353,699,259 |
| Northern Trust | Fox | Equity | 148,754,757 | 148,754,757 |
| Northern Trust | Hester | Equity | 254,204,435 | 254,204,435 |
| Northern Trust | Jarislowsky Fraser | Equity | 407,331 | 407,331 |
| Northern Trust | S&P 500 Active Pool | Equity | 1,222,166,269 | 1,222,166,269 |
| Northern Trust | Large Cap Active ETF Pool | Equity | 30,828,707 | 30,828,707 |
| Northern Trust | Lombardia | Equity | 390,706,920 | 390,706,920 |
| Northern Trust | Mid/Small Cap ETF | Equity | 8,184,664 | 8,184,664 |
| Northern Trust | Non-US SIC Managed | Equity | 430,893,200 | 430,893,200 |
| Northern Trust | S&P Index 500 Pool | Equity | 1,048,238,021 | 1,048,238,021 |
| Northern Trust | S&P Index 500 ETF Pool | Equity | 18,130,593 | 18,130,593 |
| Northern Trust | Simms | Equity | 129,950,913 | 129,950,913 |
| Northern Trust | Thomburg | Equity | 423,732,778 | 423,732,778 |
| Northern Trust | Fixed Income Pool | Core Bonds | 1,801,254,936 | 1,801,254,936 |
| | <i>Total Investments on Deposit</i> | | <u>8,938,022,079</u> | <u>8,938,022,079</u> |
| <i>Other Investments</i> | | | | |
| Northern Trust | Structured Credit Finance | Structured Credit | \$ 407,549,513 | \$ 407,549,513 |
| Northern Trust | Altair Stars | Hedge Investments | 10,474,371 | 10,474,371 |
| Northern Trust | Austin | Hedge Investments | 50,205,117 | 50,205,117 |
| Northern Trust | Circle T Explorer | Hedge Investments | 479,149 | 479,149 |
| Northern Trust | Crestline Investors | Hedge Investments | 239,940,301 | 239,940,301 |
| Northern Trust | CT Preferred Investors | Hedge Investments | 12,014,852 | 12,014,852 |
| Northern Trust | EIM Fund of Fund | Hedge Investments | 112,140,826 | 112,140,826 |
| Northern Trust | Entrust | Hedge Investments | 1,617,186 | 1,617,186 |
| Northern Trust | K2 Advisors | Hedge Investments | 54,257,030 | 54,257,030 |
| Northern Trust | K2 Alternative | Hedge Investments | 45,714,051 | 45,714,051 |
| Northern Trust | Guggenheim | Hedge Investments | 107,840,712 | 107,840,712 |
| Northern Trust | Mariner Select | Hedge Investments | 112,157,429 | 112,157,429 |
| Northern Trust | Tag Relative Value Offshore | Hedge Investments | 109,011,082 | 109,011,082 |
| Northern Trust | Vintage-HFV Multi-Strategy | Hedge Investments | 74,078,581 | 74,078,581 |
| N/A | Various | Securities on Loan | 290,477,977 | 290,477,977 |
| N/A | Various | NMSU Equity | 2,846,380 | 2,846,380 |
| N/A | Various | Government Sponsored Entities | 43,962,210 | 43,962,210 |
| N/A | Various | Direct Equity Investment | 3,448,569 | 3,448,569 |
| N/A | Various | Mortgages and Mortgage Certificates | 109,182 | 109,182 |
| N/A | Various | Private Equity Investments | 1,427,790,505 | 1,418,199,458 |
| N/A | Various | Real Estate Holding | 496,209,825 | 496,209,825 |
| N/A | Various | Film Loans | 97,036,854 | 97,036,854 |
| | <i>Total Other Investments</i> | | <u>3,699,361,702</u> | <u>3,689,770,655</u> |
| | <i>Total Fiduciary Fund Investments</i> | | <u>12,637,383,781</u> | <u>12,627,792,734</u> |
| | Total Fiduciary Fund Cash and Investments | | <u>\$ 13,636,949,004</u> | <u>\$ 13,627,357,957</u> |

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

The Honorable Bill Richardson, Chairman
and Members of the State Investment Council
and Mr. Hector H. Balderas, State Auditor

We have audited the accompanying financial statements of the governmental activities, general fund, the general fund budget comparison, and each fiduciary fund of the State of New Mexico Investment Council – Investment Office (Office) as of and for the year ended June 30, 2010, and have issued our report thereon dated December 14, 2010. 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

In planning and performing our audit, we considered the Office's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Office's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Office'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 the entity's internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as finding 2007-1 to be a material weakness.

The Honorable Bill Richardson, Chairman
and Members of the State Investment Council
and Mr. Hector H. Balderas, State Auditor

Compliance and Other Matter

As part of obtaining reasonable assurance about whether the Office'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 statements 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 are required to be reported under *Government Auditing Standards* which is described in the accompanying schedule of findings and responses as finding 2010-2.

We also noted one other matters that are required to be reported pursuant to Government Auditing Standards paragraphs 5.14 and 5.16, and pursuant to Section 12-6-5, NMSA 1978, which is described in the accompanying schedule of findings and responses as finding 2010-1.

The Office's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the agency's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of Office management, the State Investment Council, the Office of the State Auditor, the New Mexico Department of Finance and Administration, the New Mexico State Legislature, or its committees, and is not intended to be and should not be used by anyone other than these specified parties.

Mess Adams LLP

Albuquerque, New Mexico
December 14, 2010

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATUS OF PRIOR YEAR AUDIT FINDINGS
June 30, 2010

| Description | Status |
|-------------------------------------|----------|
| 07-1 Use of General Ledger Software | Repeated |

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
CURRENT YEAR FINDINGS AND RESPONSES
June 30, 2010

07-1 Use of General Ledger Software

CONDITION

As noted in the previous years, the Council records, reconciles, and reports investment balances using Microsoft Excel. Software is utilized to maintain inventories of investment balances; however, the software is not a double entry accounting system. Double entry accounting is primarily performed in Excel and is maintained in various electronic files.

CRITERIA

Per the State Auditor Rule 2.2.2.10 J, Section 12-6-5, NMSA 1978 states that any violation of good accounting practices be included in the annual audit report.

EFFECT

The use of Microsoft Excel increases the risk for errors in linkage and rollforwards of accounts, which increases the risk of misstatement. During the current year audit, two material audit adjustments were identified and recorded.

CAUSE

The nature of operations of the Investment Office is not conducive to the use of standard off-the-shelf accounting software packages. At June 30, 2010, the Council had not yet identified a custom package that would be suitable for their needs.

RECOMMENDATION

We strongly recommend management select and implement a general ledger software package as soon as is practical.

MANAGEMENT RESPONSE

The State Investment Council is targeting FY12 for implementation of a general ledger software package. We have identified at least two vendors who may be qualified to accomplish said implementation.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
CURRENT YEAR FINDINGS AND RESPONSES (CONTINUED)
June 30, 2010

10-1 Payroll files

CONDITION

During our audit, we noted that 1 of 3 personnel files reviewed did not have the approved pay rate form in their file.

CRITERIA

Per the State Auditor Rule 2.2.2.10 J, Section 12-6-5, NMSA 1978 states that any violation of good accounting practices be included in the annual audit report.

EFFECT

Inadequate supporting documentation of approved pay rates increases the risk of unauthorized or incorrect employee compensation.

CAUSE

The Council did not follow its personnel policies to ensure that all personnel files contain appropriate pay rate support.

RECOMMENDATION

We recommend management implement a process to periodically review personnel files to ensure all personnel are compensated based on current, approved pay rates.

MANAGEMENT RESPONSE

The State Investment Council entered into a Memorandum of Understanding with the State Personnel Office in FY11 under the State Personnel Office has assumed all HR functions of the agency. The process should eliminate this finding in the future.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
CURRENT YEAR FINDINGS AND RESPONSES (CONTINUED)
June 30, 2010

10-2 Budget Overage (State Compliance)

CONDITION

The Council exceeded its approved budget for Personnel Services and Benefits of \$3,562,800 by \$19,162.

CRITERIA

State Audit Rule 2.2.2.10 P. Appropriations to Agencies: (1) The budgetary comparison presented in the financial statements must be at least at the same appropriation level as the approved budget to demonstrate compliance with legal requirements. If actual expenditures exceed budgeted expenditures at the legal level of budgetary control, that fact must be reported in a finding and disclosed in the notes to the financial statements. If budgeted expenditures exceed budgeted revenues (after prior-year cash balance and any applicable federal receivables required to balance the budget), that fact must also be reported in a finding since budget deficits are generally not allowed. If the agency budgets cash or fund balance that did not exist at the beginning of the fiscal year, a finding should be reported.

EFFECT

The Council is not in compliance with State statute.

CAUSE

The Office had an overall budget surplus of \$4,062,536 in fiscal year 2010. However, the Office did not process the necessary budget adjustment requests which resulted in actual expenditures exceeding approved budgeted expenditures by \$19,126 for the personnel services and benefits line item.

RECOMMENDATION

We recommend that the Council identify a budgetary report in SHARE and compare the budget amounts to actual expenditures by program code and expenditure line on a regular basis in order to identify potential budget overages in order to prepare the necessary budget adjustment requests.

MANAGEMENT RESPONSE

The State Investment Council currently produces budget projections bi-weekly. In conjunction with this process the Office runs the NMS Single-Year CAFR Budget Status Report. With these processes in place, this finding should not be repeated in the future.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXIT CONFERENCE
June 30, 2010**

An exit conference was held on December 14, 2010, and attended by the following:

New Mexico State Investment Council

Steven Moise, State Investment Officer
Stuart Hamilton, Interim Chief Financial Officer
Evan Land, In House Council
Peter Frank, Public Member

Moss Adams LLP

Brandon Valentini, Partner
Julie Alliman, Manager

Financial Statement Preparation

The financial statements were prepared with the assistance of Moss Adams LLP.