

STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
A Component Unit of the State of New Mexico
Santa Fe, New Mexico

FINANCIAL STATEMENTS
June 30, 2012

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**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
A Component Unit of the State of New Mexico
OFFICIAL ROSTER
June 30, 2012**

GOVERNING BOARD

The Hon. Susana Martinez, Governor	<i>Ex officio</i> member, Chair
Tom Clifford, Secretary of the Department of Finance and Administration	<i>Ex officio</i> member
The Hon. James B. Lewis, State Treasurer	<i>Ex officio</i> member
The Hon. Ray Powell, State Land Commissioner	<i>Ex officio</i> member
Scott Smart, V.P. of Business Affairs, Eastern New Mexico University	Public Member, Governor's Appointment
Peter Frank, Vice Chair	Public Member, Legislative Council Appointment
Leonard Lee Rawson	Public Member, Legislative Council Appointment
Michael Martin	Public Member, Legislative Council Appointment (Resigned Aug. 28, 2012)
Harold W. Lavender	Public Member, Legislative Council Appointment
Linda Eitzen	Public Member, Governor's Appointment

Independent Auditor's Report

The Honorable Susana Martinez, Chair
and Members of the State Investment Council
and Mr. Hector H. Balderas, New Mexico State Auditor

We have audited the accompanying financial statements of the governmental activities, the general fund, the general fund budget comparison and each fiduciary fund of the State of New Mexico Investment Council – Investment Office (the Office) as of and for the year ended June 30, 2012, 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, 2012, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of governmental activities, the general fund and each fiduciary fund of the Office as of June 30, 2012, 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 November 19, 2012, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, and historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

CliftonLarsonAllen LLP

Albuquerque, New Mexico
November 19, 2012

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

This discussion and analysis of the State of New Mexico Investment Council – Investment Office (the Office) provides a summary of the financial position and results of operations for the year ended June 30, 2012, 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 external, governmental clients. As a result, these amounts are paid by the funds and clients based on relative market values managed. Accordingly, there tends to be little change in the net assets of the Office.

The assets for the primary agency unit consist of cash 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 used. Except for the reduction in due to/due from balances and related effect in the General Fund Investment Pool, there have not been significant changes to assets, liabilities and net assets as compared to the prior year.

**Table A-1
Statement of Net Assets**

	<u>FY2012</u>	<u>FY2011</u>
Assets:		
Interest in State Treasurer		
General Fund Investment Pool	\$ 13,629,911	\$ 23,087,277
Due from clients	-	883,078
Capital assets, net	<u>28,871</u>	<u>43,230</u>
Total assets	<u>\$ 13,658,782</u>	<u>\$ 24,013,585</u>
Liabilities:		
Due to Land Grant Permanent Fund	\$ 5,586,717	\$ 13,563,386
Due to Severance Tax Permanent Fund	2,071,209	5,312,882
Accounts payable	5,855,661	4,998,424
Accrued payroll	116,324	95,663
Accrued vacation and sick pay	<u>151,892</u>	<u>158,413</u>
Total liabilities	<u>13,781,803</u>	<u>24,128,768</u>
Net assets:		
Invested in capital assets	28,871	43,230
Unrestricted	<u>(151,892)</u>	<u>(158,413)</u>
Total net assets (deficits)	<u>(123,021)</u>	<u>(115,183)</u>
Total liabilities and net assets	<u>\$ 13,658,782</u>	<u>\$ 24,013,585</u>

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

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 fund beneficiaries and clients.

Increase in Expenses and Revenues

The primary increase in expenditures for fiscal year 2012 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.

**Table A-2
Statement of Activities**

	<u>FY2012</u>	<u>FY2011</u>
Expenses:		
General government	\$ 26,196,447	\$ 23,022,793
Revenues:		
Program revenues:		
Fees from external investment trust participants	470,820	883,883
Transfers:		
Interfund services provided:		
Land Grant Permanent Fund	18,817,279	15,526,343
Severance Tax Permanent Fund	6,900,510	6,654,146
Total program revenues and transfers	<u>26,188,609</u>	<u>23,064,372</u>
Change in net assets (deficit)	(7,838)	41,579
Net assets (deficit) at beginning of year	<u>(115,183)</u>	<u>(156,762)</u>
Net assets (deficit) at end of year	<u>\$ (123,021)</u>	<u>\$ (115,183)</u>

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

Financial Highlights – General Administrative Fund

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

**Table A-3
Total Revenues and Expenditures**

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>
Revenues from external trust participants	\$ 470,820	\$ 883,883	-46.7%
Expenditures:			
Personnel services and benefits	\$ 3,124,216	\$ 3,356,175	-6.9%
Contractual services and custody fees	21,836,090	19,108,197	14.3%
Other - operating expenses	<u>1,228,303</u>	<u>600,000</u>	<u>104.7%</u>
Total expenditures	<u>\$ 26,188,609</u>	<u>\$ 23,064,372</u>	<u>13.5%</u>

Revenues from external trust participants declined due to a change in methodology that includes a smaller allocable expense base of external fees incurred.

The Office expenditures for fiscal year 2012 increased in total, primarily due to increased investment management expenses. Personnel costs decreased slightly over fiscal year 2011, as certain positions remained unfilled throughout much of fiscal year 2012, while the other operating expenses increased due primarily to prior year invoices paid in the current year. 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 \$8.1 million.

Financial Highlights - Fiduciary Funds

The primary governmental activity for the Office is the administration and management of four State of New Mexico permanent funds: the Land Grant Permanent Fund (LGPF), the Severance Tax Permanent Fund (STPF), the Tobacco Settlement Permanent Fund (TSPF) and the Water Trust Fund (WTF). The State Investment Office, which is responsible for carrying out the investment management policies of the State Investment Council, also provides similar services to 17 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 Office's mission is to protect and grow the State's permanent (endowment) funds for current and future generations, through prudent, professional investment management - with a vision of becoming one of the best performing, most respected sovereign wealth funds worldwide. The amount of annual distributions for the Severance Tax Permanent Fund, per statute, is 4.7% of the average of the year-end market values of the funds for the immediately preceding five years. The Land

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

Grant Permanent Fund and Tobacco Settlement Permanent Fund distribution formulas are detailed below. Administrative costs are projected and added to the distribution formula to arrive at the total spending policy.

In September 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 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 increased to 5.8%.
- For fiscal years 2013-2016, distributions decrease to 5.5%.
- Beginning fiscal year 2017, distributions decrease to 5.0%.

The Tobacco Settlement Permanent Fund distribution was originally established at 50% of the prior year's contributions from legal settlements with certain 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 increased to 100% of the current year contributions, and the distribution went to the State General Fund rather than the Tobacco Settlement Permanent Fund. Beginning in fiscal year 2007, the distribution for the Tobacco Settlement Permanent Fund 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 through 2011 to 100% of the prior year's contribution received. In 2011, the Legislature passed HB79, which extended this period of 100% distributions of the prior year's contribution received through fiscal year 2013.

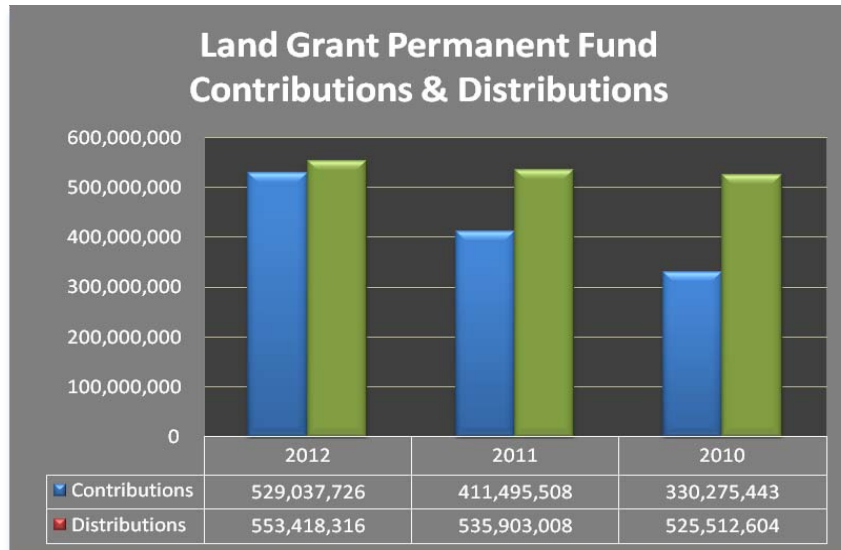
In April 2004, the Governmental Accounting Standards Board issued Technical Bulletin 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issues (GASB TB 2004-1), which became effective for financial statements for periods ending after June 15, 2004. GASB TB 2004-1 clarifies recognition guidance for payments received under the Master Settlement Agreement (MSA) with the settling tobacco companies. Since annual tobacco settlement reimbursements are based on cigarette sales from the preceding calendar year, governments should estimate accrued tobacco settlement reimbursements that derive from tobacco sales from January 1 to their respective fiscal year-ends. Accordingly, the Tobacco Settlement Permanent Fund recognized \$19,806,003 and \$21,440,254 for the years ended June 30, 2012 and 2011, respectively.

The Land Grant Permanent Fund

The Land Grant Permanent Fund contributions from the State Land Office (mineral royalties and income from land grants) for fiscal year 2012 increased 29% from fiscal year 2011. Distributions to the beneficiaries of the fund increased 3% from the prior year.

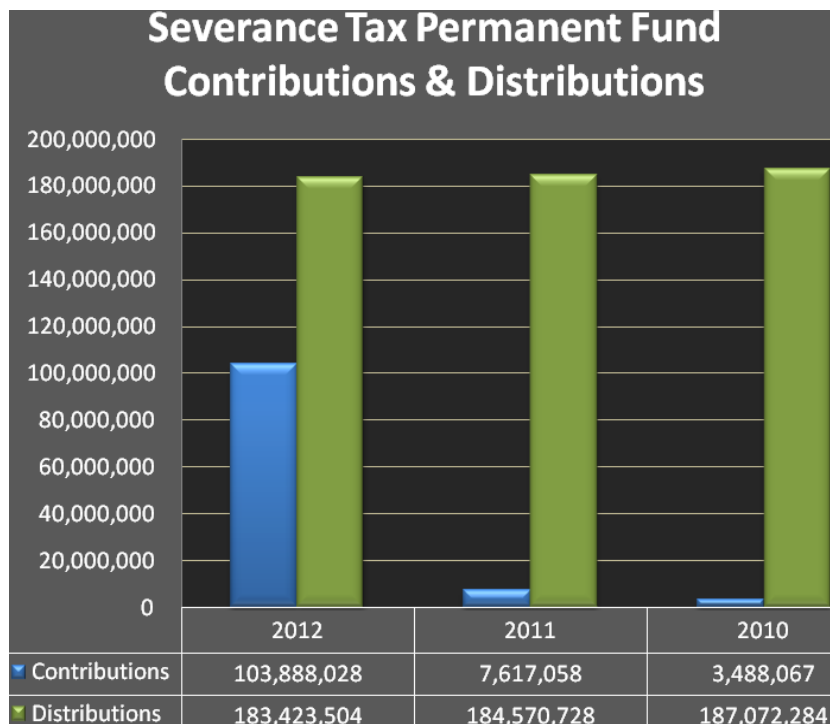
The chart on the next page details the changes in contributions and distributions from the Land Grant Permanent Fund.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**



The Severance Tax Permanent Fund

Severance Tax Permanent Fund contributions are received from the Severance Tax Bonding Fund. Severance tax revenues first pay the required debt service on severance tax bonds issued by the State. Amounts transferred from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund increased from \$7.6 million in fiscal year 2011 to \$103.9 million in fiscal year 2012. Distributions to the State General Fund in fiscal year 2012 decreased 1% from the previous year.



**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

The Tobacco Settlement Permanent Fund

The Tobacco Settlement Permanent Fund distribution was \$37.7 million to the State General Fund in fiscal year 2012, which was 100% of the amount of contributions to the tobacco settlement trust funds received in fiscal year 2012.

The amounts presented below for fiscal year 2012 indicate actual receipts and differ from the total contributions and distributions for fiscal year 2012 shown in the Fiduciary Funds Statement of Net Assets because of the presentation requirements of GASB Technical Bulletin 2004-1.

**Table A-4
Tobacco Settlement Permanent Fund**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Contributions	\$ 37,686,626	\$ 37,515,754	\$ 40,164,708
Distributions	<u>\$ 37,686,626</u>	<u>\$ 37,515,754</u>	<u>\$ 40,164,708</u>

The Water Trust Fund

The Water Trust Fund (WTF) was created in 2003 but not funded by the Legislature until 2007. On July 1 of each fiscal year, the WTF distributes \$4 million to water projects. When 4.7% of the WTF is greater than \$4 million, annual distributions will be 4.7% of a 5-year rolling average of the WTF. At June 30, 2012, the WTF was \$44.9 million.

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

**Table A-5
Fiduciary Funds Net Assets**

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Land Grant Permanent Fund	\$10,795,721,087	\$ 10,766,530,632	0.3%
Severance Tax Permanent Fund	3,880,616,288	3,966,034,159	-2.2%
Tobacco Settlement Permanent Fund	149,016,666	148,798,796	0.1%
Water Trust Fund	<u>44,897,957</u>	<u>49,657,986</u>	<u>-9.6%</u>
Total private purpose trust funds	<u>14,870,251,998</u>	<u>14,931,021,573</u>	<u>-0.4%</u>
External client trust funds	<u>539,160,733</u>	<u>521,114,000</u>	<u>3.5%</u>
Total net fiduciary funds	<u>\$15,409,412,731</u>	<u>\$ 15,452,135,573</u>	<u>-0.3%</u>

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2012**

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
- 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 and the New Mexico economically targeted investments for loans and certificates of deposits using staff portfolio managers. Real estate and private equity 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 provide readers with a broad overview of the Office's finances in a manner similar to a private-sector business. The statement of net assets presents information on all of the Office's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets serve as a useful indicator of whether the financial position of the Office is improving or deteriorating. The statement of activities presents information showing how the Office's net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

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 Office, 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
June 30, 2012**

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.

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 \$7.2 million in contractual services that was not expended.

Statutory Changes to the Council and its Powers

No new legislation was passed in fiscal year 2012 pertaining to the State Investment Council's enacting statute.

In fiscal year 2011, the legislature passed and the Governor signed Senate Bill 86, legislation authorizing the office to retain contingent fee attorneys. Other notable fiscal year 2011 legislation included:

- SB 82, which removed the State Investment Officer or designees from four governmental agency boards; and
- HB 52, which allows greater discretion in investing the Tobacco Settlement Permanent Fund.

Economic Outlook

The Land Grant Permanent Fund finished fiscal year 2012 with a return of 0.74%. The Severance Tax Permanent fund finished at 0.19%.

The investment strategy of the permanent funds is one that seeks to gain from the long-term performance of the financial markets and underlying economy. The funds are presently in the process of further diversification, particularly in moving from publicly-traded assets (primarily stocks and bonds) to privately held assets (such as real estate, private equity and real assets), and from publicly-traded equity investments (the stock market) to a more diversified mix of income-producing and less volatile investments.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

Financial Contact

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

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF NET ASSETS
June 30, 2012**

	<u>Governmental Activities</u>
ASSETS	
Investment in State Treasurer General Fund Investment Pool	\$ 13,629,911
Capital assets, net	<u>28,871</u>
TOTAL ASSETS	<u>\$ 13,658,782</u>
 LIABILITIES AND NET ASSETS	
LIABILITIES	
Due to Land Grant Permanent Fund	\$ 5,586,717
Due to Severance Tax Permanent Fund	2,071,209
Accounts payable	5,855,661
Accrued payroll	116,324
Accrued vacation and sick pay, current	<u>151,892</u>
Total liabilities	<u>13,781,803</u>
 NET ASSETS (DEFICIT)	
Invested in capital assets	28,871
Unrestricted	<u>(151,892)</u>
Total net assets (deficit)	<u>(123,021)</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 13,658,782</u>

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF ACTIVITIES
Year Ended June 30, 2012**

	<u>Governmental Activities</u>
EXPENSES	
General government	\$ <u>26,196,447</u>
REVENUES	
Program revenues:	
Fees from external investment trust participants and other revenue	470,820
Transfers:	
Land Grant Permanent Fund	18,817,279
Severance Tax Permanent Fund	<u>6,900,510</u>
Total program revenues and transfers	<u>26,188,609</u>
CHANGE IN NET ASSETS (DEFICIT)	(7,838)
NET ASSETS (DEFICIT), BEGINNING OF YEAR	<u>(115,183)</u>
NET ASSETS (DEFICIT), END OF YEAR	<u>\$ (123,021)</u>

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
BALANCE SHEET - GENERAL ADMINISTRATIVE FUND
June 30, 2012**

ASSETS	
Investment in State Treasurer General Fund Investment Pool	\$ <u>13,629,911</u>
TOTAL ASSETS	\$ <u>13,629,911</u>
LIABILITIES AND FUND BALANCE	
LIABILITIES	
Due to Land Grant Permanent Fund	\$ 5,586,717
Due to Severance Tax Permanent Fund	2,071,209
Accounts payable	5,855,661
Accrued payroll	<u>116,324</u>
Total liabilities	<u>13,629,911</u>
FUND BALANCE	
Unassigned	<u>-</u>
TOTAL LIABILITIES AND FUND BALANCE	\$ <u>13,629,911</u>

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
RECONCILIATION OF THE BALANCE SHEET - GENERAL ADMINISTRATIVE
FUND TO THE STATEMENT OF NET ASSETS
June 30, 2012**

**Total Fund Balance - General Administrative Fund
(General Administrative Fund Balance Sheet) \$ -**

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 funds.

Capital assets, net 28,871

Some liabilities are not due and payable in the current period and therefore are not reported as liabilities in the fund.

Accrued vacation and sick pay (151,892)

**Net assets (deficit) of governmental activities
(Statement of Net Assets) \$ (123,021)**

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
 IN FUND BALANCE - GENERAL ADMINISTRATIVE FUND
 Year Ended June 30, 2012**

	Governmental Activities
REVENUES FROM EXTERNAL INVESTMENT TRUST PARTICIPANTS AND OTHER REVENUE	\$ 470,820
EXPENDITURES	
Current	26,188,609
General government:	
Capital outlay	-
Total expenditures	26,188,609
Deficiency of revenues under expenditures	(25,717,789)
OTHER FINANCING SOURCES	
Interfund services provided:	
Land Grant Permanent Fund	18,817,279
Severance Tax Permanent Fund	6,900,510
Net other financing sources	25,717,789
NET CHANGE IN FUND BALANCE	-
FUND BALANCE, BEGINNING OF YEAR	-
FUND BALANCE, END OF YEAR	\$ -

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCE - GENERAL ADMINISTRATIVE FUND
 TO THE STATEMENT OF ACTIVITIES
 Year Ended June 30, 2012

Net Change in Fund Balance - General Administrative Fund
(Statement of Revenues, Expenditures, and Changes in Fund Balances) \$ -

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

Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:

Decrease in accrued vacation and sick pay liability	6,521
---	-------

Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Capital outlay	\$ -	
Depreciation expense	<u>(14,359)</u>	
Excess of capital outlay over depreciation expense		<u>(14,359)</u>

Change in net assets of governmental activities (Statement of Activities)	\$ <u>(7,838)</u>
--	--------------------------

The accompanying notes are an integral part of the financial statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF REVENUES AND EXPENDITURES - GENERAL ADMINISTRATIVE FUND -
BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS)
Year Ended June 30, 2012

	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance From Final Budget Positive (Negative)
	Original	Final		
REVENUES FROM EXTERNAL INVESTMENT TRUST PARTICIPANTS AND OTHER REVENUE	\$ 950,200	\$ 950,200	\$ 470,820	\$ (479,380)
EXPENDITURES				
Personnel services and benefits	3,635,300	3,635,300	3,124,216	(511,084)
Contractual services	29,837,300	29,037,300	21,836,090	(7,201,210)
Other - operating expenses	793,600	1,593,600	1,228,303	(365,297)
Total expenditures	<u>34,266,200</u>	<u>34,266,200</u>	<u>26,188,609</u>	<u>(8,077,591)</u>
Expenditures in excess of revenues	<u>(33,316,000)</u>	<u>(33,316,000)</u>	<u>(25,717,789)</u>	<u>\$ 7,598,211</u>
TRANSFERS				
Interfund transfers in:				
Land Grant Permanent Fund	24,376,890	24,376,890	18,817,279	
Severance Tax Permanent Fund	8,939,110	8,939,110	6,900,510	
Total transfers	<u>33,316,000</u>	<u>33,316,000</u>	<u>25,717,789</u>	
EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER (UNDER) EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	

The accompanying notes are an integral part of the financial statements.

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF NET ASSETS - FIDUCIARY FUNDS
June 30, 2012

	Land Grant Permanent Fund	Severance Tax Permanent Fund	Private-Purpose Tobacco Settlement Permanent Fund
ASSETS			
Cash and cash equivalents	\$ 434,147,575	\$ 123,735,487	\$ 2,975,280
Investment in State Treasurer General Fund Investment Pool	49,083,955	2,345	-
Due from brokers	341,112,866	88,982,999	8,437,169
Due from general administrative fund	5,586,717	2,071,209	-
Due from other state agencies	-	103,888,028	-
Accrued investment income	23,978,216	7,167,197	461,082
Accrued tobacco settlement income	-	-	19,806,003
	<u>853,909,329</u>	<u>325,847,265</u>	<u>31,679,534</u>
INVESTMENTS			
Government-sponsored enterprise and agency issues (GSE)	-	39,061,910	-
Corporate bonds	-	1,022,534	-
Investment pools:			
Core bonds	2,156,704,982	506,382,223	53,323,554
Large cap. active	1,053,529,382	949,927,882	41,522,604
Large cap. index	2,448,490,610	133,526,953	23,259,557
Mid/Small cap.	527,535,841	283,818,148	11,982,282
Non-U.S. developed markets	833,722,596	266,963,796	6,829,672
Non-U.S. emerging markets	617,504,480	207,907,612	3,018,407
Hedge funds	651,702,713	213,395,875	14,678,674
National Private Equity Pool	31,175,299	10,391,748	-
Structured Credit	472,390,827	125,297,378	-
Real Estate Pool	60,095,121	20,031,707	-
Real Asset Pool	23,788,921	7,929,643	-
Enhanced Index Pool	392,069,472	43,563,270	-
Common stock - public	1,558,665	1,084,961	-
Conventional mortgage pass-through certificates	-	38,302	-
Private equity	1,006,617,597	696,646,798	-
Real estate	419,378,539	201,605,499	-
New Mexico film investments	-	30,000,000	-
UNM fixed income	-	2,091,270	-
UNM Equity	-	2,973,622	-
	<u>10,696,265,045</u>	<u>3,743,661,131</u>	<u>154,614,750</u>
Total investments			
Total assets	<u>11,550,174,374</u>	<u>4,069,508,396</u>	<u>186,294,284</u>
LIABILITIES			
Due to brokers	699,678,697	169,908,432	17,289,247
Due to other state agencies	8,656,397	3,698,384	19,988,371
Distributions payable to beneficiaries	46,118,193	15,285,292	-
	<u>754,453,287</u>	<u>188,892,108</u>	<u>37,277,618</u>
Total liabilities			
NET ASSETS HELD IN TRUST	<u>\$ 10,795,721,087</u>	<u>\$ 3,880,616,288</u>	<u>\$ 149,016,666</u>

<u>Trust Funds</u>			
<u>Water Trust Fund</u>	<u>Total Private-Purpose Trust Funds</u>	<u>External Investment Trust Funds</u>	<u>Total</u>
\$ 1,053,283	\$ 561,911,625	\$ 10,059,429	\$ 571,971,054
-	49,086,300	-	49,086,300
2,138,021	440,671,055	40,419,969	481,091,024
-	7,657,926	-	7,657,926
-	103,888,028	-	103,888,028
130,856	31,737,351	2,287,880	34,025,231
-	19,806,003	-	19,806,003
<u>3,322,160</u>	<u>1,214,758,288</u>	<u>52,767,278</u>	<u>1,267,525,566</u>
-	39,061,910	-	39,061,910
-	1,022,534	-	1,022,534
12,699,499	2,729,110,258	265,026,198	2,994,136,456
20,205,895	2,065,185,763	63,894,414	2,129,080,177
-	2,605,277,120	114,476,033	2,719,753,153
4,709,368	828,045,639	45,817,944	873,863,583
2,795,912	1,110,311,976	47,462,829	1,157,774,805
1,114,477	829,544,976	35,346,978	864,891,954
4,318,383	884,095,645	-	884,095,645
-	41,567,047	-	41,567,047
-	597,688,205	-	597,688,205
-	80,126,828	-	80,126,828
-	31,718,564	-	31,718,564
-	435,632,742	-	435,632,742
-	2,643,626	-	2,643,626
-	38,302	-	38,302
-	1,703,264,395	-	1,703,264,395
-	620,984,038	-	620,984,038
-	30,000,000	-	30,000,000
-	2,091,270	-	2,091,270
-	2,973,622	-	2,973,622
<u>45,843,534</u>	<u>14,640,384,460</u>	<u>572,024,396</u>	<u>15,212,408,856</u>
<u>49,165,694</u>	<u>15,855,142,748</u>	<u>624,791,674</u>	<u>16,479,934,422</u>
4,201,881	891,078,257	84,901,843	975,980,100
65,856	32,409,008	729,098	33,138,106
-	61,403,485	-	61,403,485
<u>4,267,737</u>	<u>984,890,750</u>	<u>85,630,941</u>	<u>1,070,521,691</u>
\$ <u>44,897,957</u>	\$ <u>14,870,251,998</u>	\$ <u>539,160,733</u>	\$ <u>15,409,412,731</u>

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
STATEMENT OF CHANGES IN NET ASSETS - FIDUCIARY FUNDS
Year Ended June 30, 2012**

	Land Grant Permanent Fund	Severance Tax Permanent Fund	Private-Purpose Tobacco Settlement Permanent Fund
REVENUES			
Investment earnings:			
Interest and dividends	\$ 250,169,108	\$ 91,545,725	\$ 2,851,474
Net decrease in fair value of investments	<u>(179,147,624)</u>	<u>(92,194,598)</u>	<u>(2,507,500)</u>
Total investment income (loss)	<u>71,021,484</u>	<u>(648,873)</u>	<u>343,974</u>
OTHER FINANCING SOURCES (USES)			
Interagency transfers in (out):			
State Land Office	529,037,726	-	-
Severance Tax Bonding Fund	-	103,888,028	-
Tobacco settlement proceeds	-	-	37,686,626
Distributions to beneficiaries of the Land Grant Permanent Fund	(553,418,316)	-	-
Distributions to State General Fund by the Severance Tax Permanent Fund	-	(183,423,504)	-
Distribution to beneficiary of the Tobacco Settlement Permanent Fund	-	-	(37,686,626)
Distribution to beneficiary of the Water Trust Fund	-	-	-
Contributions to external investment trust funds	-	-	-
Distributions from external investment trust funds	-	-	-
Interfund services used:			
General Administrative Fund	(18,817,279)	(6,900,510)	-
Internal service fees	<u>1,366,840</u>	<u>1,666,988</u>	<u>(126,104)</u>
Total other financing sources (uses)	<u>(41,831,029)</u>	<u>(84,768,998)</u>	<u>(126,104)</u>
CHANGE IN NET ASSETS	29,190,455	(85,417,871)	217,870
NET ASSETS, BEGINNING OF YEAR	<u>10,766,530,632</u>	<u>3,966,034,159</u>	<u>148,798,796</u>
NET ASSETS, END OF YEAR	<u>\$ 10,795,721,087</u>	<u>\$ 3,880,616,288</u>	<u>\$ 149,016,666</u>

Trust Funds

Water Trust Fund	Total Private- Purpose Trust Funds	External Investment Trust Funds	Total
\$ 974,227	\$ 345,540,534	\$ 14,775,595	\$ 360,316,129
(1,684,090)	(275,533,812)	(12,051,443)	(287,585,255)
(709,863)	70,006,722	2,724,152	72,730,874
-	529,037,726	-	529,037,726
-	103,888,028	-	103,888,028
-	37,686,626	-	37,686,626
-	(553,418,316)	-	(553,418,316)
-	(183,423,504)	-	(183,423,504)
-	(37,686,626)	-	(37,686,626)
(4,000,000)	(4,000,000)	-	(4,000,000)
-	-	24,495,588	24,495,588
-	-	(8,708,004)	(8,708,004)
-	(25,717,789)	-	(25,717,789)
(50,166)	2,857,558	(465,003)	2,392,555
(4,050,166)	(130,776,297)	15,322,581	(115,453,716)
(4,760,029)	(60,769,575)	18,046,733	(42,722,842)
49,657,986	14,931,021,573	521,114,000	15,452,135,573
<u>\$ 44,897,957</u>	<u>\$ 14,870,251,998</u>	<u>\$ 539,160,733</u>	<u>\$ 15,409,412,731</u>

The accompanying notes are an integral part of the financial statements.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 1 – ORGANIZATION AND BACKGROUND

The State of New Mexico Investment Council (the 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 of 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 the 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, the Tobacco Settlement Permanent Fund, the Water Trust Fund, and client funds. The following is a brief description of the purpose and sources of these four 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.

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).

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 1 – ORGANIZATION AND BACKGROUND (CONTINUED)

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 became effective upon certification of the election results by the Secretary of State and became effective 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 2011, House Bill 79 amended Section 6-4-9 NMSA 1978 related to the Tobacco Settlement Permanent Fund. This legislation temporarily changes the distribution of this fund as follows: in fiscal years 2011 through 2013, 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 2014 and in each fiscal year 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, 2012, 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.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 1 – ORGANIZATION AND BACKGROUND (CONTINUED)

Water Trust Fund (WTF). 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 fund consists of money appropriated, donated, or otherwise accrued to the fund. Money in the Water Trust Fund shall be invested as in the Land Grant Permanent Fund by the state investment officer 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.

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:

Use of Estimates in Preparing Financial Statements

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.

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.

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. The government-wide presentation is focused 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.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 are 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.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, and WTF 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.

External Investment Trust Funds. Pursuant to New Mexico law Section 6-8-71 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 participants.

Reservations and Designations

In the governmental fund financial statements, fund balances are classified as nonspendable, restricted or unrestricted (committed, assigned or unassigned). Restricted represents those portions of fund balance where constraints placed on the resources are either externally imposed or imposed by law through constitutional provisions or legislation. Committed fund balance represents amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the Legislative and Executive branches of the State. Assigned fund balance is constrained by the Legislature's and Executive Branch's intent to be used for specific purposes or, in some cases, by legislation.

The Office's fund balances represent: 1) Restricted Purposes, which include balances that are legally restricted for specific purposes due to constraints that are externally imposed by creditors, grantors, contributors or laws or regulations of other governments; 2) Committed Purposes, which include balances that can only be used for specific purposes pursuant to constraints imposed by formal action of the Legislative and Executive branches; 3) Assigned Purposes, which includes balances that are constrained by the government's intent to be used for specific purposes but are neither restricted or committed; 4) Unassigned, which includes all other spendable amounts. As of June 30, 2012, the Office's fund balance was all unassigned.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

When expenditures are incurred for purposes for which both restricted and unrestricted fund balances are available, any restricted fund balance must be spent first. When expenditures are incurred for purposes for which amounts in any of unrestricted fund balance classifications can be used, committed amounts should be reduced first, followed by assigned amounts and then unassigned amounts.

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 reversions 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, 2012**

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 2012 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.

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. Index, Core Bonds, Structured Credit, Mid/Small Cap., Non-U.S. Developed Markets, Non-U.S. Emerging Markets and Absolute Return investment pools. The pools are detailed as follows:

Domestic Equity Pools

The Large Cap Active Pool is managed internally and by five external managers. This pool seeks to match the performance of the Russell 1000 stock index plus a small premium from active management. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Large Cap Index Pool is managed externally. The objective of the pool is to match the rate of return of the Russell 1000 index. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital.

The Mid/Small Cap Pool is managed externally by four external managers. The objective of the Mid/Small Cap Pool is to match the performance of the Russell 2500 index, plus a small premium from active management. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital.

Fixed Income Pools

The Core Bonds Pool is managed externally by three managers and invests in all major segments of the broad investment-grade debt obligation markets. The primary objective of the Core Bonds Pool is to achieve the rate of return of the Barclay's Capital Universal Bond Index, plus a small premium from active management. The role of this pool in the asset mixes of the SIC's portfolios is to provide preservation of capital and income generation.

The Structured Credit Pool is managed externally, investing in various classes of fixed income securities oriented toward credit. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital and income generation.

International Equity Pools

The Non-U.S. Developed Markets Pool is an international equity fund with one external manager. The objective of the pool is to match the rate of return on the MSCI EAFE index. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital and diversification to the domestic equity pools.

The Non-U.S. Emerging Markets Pool is an externally managed international equity fund managed by one manager. The objective of the pool is to match the rate of return on the MSCI Emerging Markets index. The role of this pool in the asset mixes of the SIC's portfolios is to provide growth of capital and diversification to the domestic equity pools.

Alternative Asset Pools

The Absolute Return Pool is managed by three fund-of-fund managers with a multitude of underlying hedge fund managers. The objective of the pool is to provide a rate of return of LIBOR plus 200-300 basis points of premium. The role of the pool in the asset mixes of SIC portfolios is to preserve capital and diversify the investment risks of the other investment pools.

The Real Estate Pool contains primarily open- and closed-end comingled real estate funds, dominated by stable, core real estate properties. The objective of the pool is to match the rate of return on the NCREIF-ODCE index, plus a small premium from active management. The role the pool in the asset mixes of SIC portfolios is to provide modest growth of capital, income generation, and to diversify the investment risk of the equity pools.

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NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Real Return Pool contains a diversified mix of assets which have a positive return correlation with inflation and interest rates. The objective of the pool is to match the rate of return of a custom mix of benchmarks representing similar assets. The role of the pool in the asset mixes of SIC portfolios is to provide modest growth of capital, income generation, and to diversify the investment risk of the equity pools.

The Private Equity Pool contains more than 100 private equity funds diversified across the sectors of private equity. The objective of the pool is to provide a higher rate of return than the Venture Economics All Private Equity Index. The role of the pool in SIC portfolios is to provide growth of capital.

Private Equity

Private equity investments are recorded at estimated fair value as reported by the general partner fund managers. 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, and WTF, 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.

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

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2012, \$5,586,717 and \$2,071,209 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 J.P. Morgan 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, encumbrances no longer remain outstanding at year end as any remaining amounts are reverted. As a result, there are no differences between measurement focus at June 30, 2012.

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

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

NOTE 3 - CASH AND CASH EQUIVALENTS

General Fund Investment Pool Not Reconciled

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

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

As of June 30, 2012, the General Fund Investment Pool has not been reconciled at the business unit/fund level. Essentially, independent, third-party verification/confirmation of the New Mexico State Investment Council – Investment Office's balances at the business unit/fund level is not possible.

Under the direction of the State Controller/Financial Control Division Director, the Financial Control Division of the New Mexico Department of Finance & Administration (DFA/FCD) is taking aggressive action to resolve this serious problem. DFA/FCD has commenced the Cash

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NOTE 3 - CASH AND CASH EQUIVALENTS (CONTINUED)

Management Remediation Project (Remediation Project) in partnership with the New Mexico State Treasurer's Office, the New Mexico Department of Information Technology, and a contracted third party PeopleSoft Treasury expert.

The purpose of the Remediation Project is to design and implement the changes necessary to reconcile the General Fund Investment Pool in a manner that is complete, accurate, and timely. The Remediation Project will make changes to the State's current SHARE system configuration, cash accounting policies and procedures, business practices, and banking structure. The scheduled implementation date for the changes associated with the Remediation Project is February 1, 2013. An approach and plan to address the population of historical reconciling items will be developed during the Remediation Project, but a separate initiative will be undertaken to resolve the historical reconciling items. It is DFA's responsibility to perform the monthly book-to-bank reconciliation.

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

Investment in the State General Fund Investment Pool

State law (Section 8-6-3 NMSA 1978) requires the agency's cash be managed by the New Mexico State Treasurer's Office. Accordingly, the investments of the agency consist of an interest in the General Fund Investment Pool managed by the New Mexico State Treasurer's Office. At June 30, 2012 the agency had the following invested in the General Fund Investment Pool:

General Fund Investment Pool:	
General Administrative Fund	\$13,629,911
Fiduciary Funds	\$49,086,300

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

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

For additional GASB 40 disclosure information regarding cash held by the New Mexico State Treasurer, the reader should see the separate audit report for the New Mexico State Treasurer's Office for the fiscal year ended June 30, 2012.

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NOTE 3 - CASH AND CASH EQUIVALENTS (CONTINUED)

Deposits

Cash and cash equivalents are held by the custodian, J.P. Morgan. SIC cash held by J.P. Morgan is invested in short-term investment funds which are insured or registered with securities held by the government or its agent in the government's name.

Custodial Credit Risk

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, 2012, the Office's cash and cash equivalent deposits were not exposed to custodial credit risk.

Investments in the State Treasurer Investment Pool (STIP) and cash and cash equivalents balances as of June 30, 2012 were as follows:

	<u>SHARE Fund</u>	<u>State Treasurer's Office Funds</u>	<u>J.P. Morgan</u>	<u>Total</u>
General Administration Fund	17300	\$ 13,629,911	\$ -	\$ 13,629,911
Subtotal		<u>13,629,911</u>	<u>-</u>	<u>13,629,911</u>
Land Grant Permanent Fund	60100	49,083,955	211,711,506	260,795,461
Severance Tax Permanent Fund	60200	2,345	41,605,102	41,607,447
Tobacco Settlement Permanent Fund	95200	-	86,699	86,699
Water Trust Fund	10120	-	19,387	19,387
Large Cap. Active Pool	09400	-	55,000,951	55,000,951
Large Cap. Index Pool	62800	-	3,345,863	3,345,863
Core Bonds Pool	77000	-	64,893,304	64,893,304
Mid/Small Cap. Pool	22000	-	32,999,773	32,999,773
Non-U.S. Developed Markets Pool	21800	-	2,523,234	2,523,234
Non-U.S. Emerging Markets Pool	61100	-	16,890,560	16,890,560
Private Equity Pool	11380	-	27,094,587	27,094,587
Real Estate Pool	11390	-	483,635	483,635
Real Asset Pool	11540	-	488,773	488,773
Absolute Return Pool	72100	-	6,340,987	6,340,987
Enhanced Index Pool	11530	-	1,811,393	1,811,393
Structured Credit Pool	20140	-	106,675,300	106,675,300
Subtotal		<u>49,086,300</u>	<u>571,971,054</u>	<u>621,057,354</u>
TOTAL		<u>\$ 62,716,211</u>	<u>\$571,971,054</u>	<u>\$634,687,265</u>

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
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NOTE 4 - INVESTMENTS

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 investments as specified in statute, including New Mexico private equity, SBAs, CDs, film projects and various other loan guarantees. Numerous restrictions, either statutorily or policy in origin, define various elements of the investments. Examples include investment size, limitation of percentage ownership of a particular fund or investment, percentage 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 its 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 not have a policy for the Core Bond Fund that restricts purchases of securities to those above a certain rating as rated by one or more national rating agencies.

The Office's investments and their exposure to credit risk at June 30, 2012 are as follows:

<u>Investment</u>	<u>Rating</u>	<u>Fair Value</u>
Investments subject to credit risk		
Commercial Mortgage-Backed	AAA	\$ 78,070,315
Asset-Backed Securities	AAA	48,065,569
Non-Government-Backed C.M.O.s	AAA	23,850,904
Corporate Bonds	AAA	2,933,391
Mortgage Backed Securities	AA+	706,985,676
Non-Government-Backed C.M.O.s	AA+	38,017,241
Government Bonds	AA+	34,918,699
Asset-Backed Securities	AA+	31,205,574
Corporate Bonds	AA+	21,411,805
Corporate Bonds	AA	15,857,482
Asset-Backed Securities	AA	15,630,620
Government Bonds	AA	1,636,373
Municipal Bonds	AA	1,832,217
Corporate Bonds	AA-	36,639,049
Municipal Bonds	AA-	16,870,999

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
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NOTE 4 - INVESTMENTS (CONTINUED)

Investment	Rating	Fair Value
Investments subject to credit risk (continued)		
Commercial Mortgage-Backed	AA-	3,401,306
Corporate Bonds	A+	47,116,166
Municipal Bonds	A+	35,928,308
Commercial Mortgage-Backed	A+	19,089,898
Non-Government-Backed C.M.O.s	A+	1,340,823
Government Bonds	A+	1,294,090
Corporate Bonds	A	79,006,615
Commercial Mortgage-Backed	A	20,863,074
Government Bonds	A	10,602,874
Asset-Backed Securities	A	3,600,792
Non-Government-Backed C.M.O.s	A	318,432
Corporate Bonds	A-	180,217,754
Municipal Bonds	A-	15,280,424
Commercial Mortgage-Backed	A-	10,716,514
Asset-Backed Securities	A-	2,833,331
Non-Government-Backed C.M.O.s	A-	903,085
Certificate of Deposit	A-1+	4,818,636
Corporate Bonds	BBB+	80,304,763
Commercial Mortgage-Backed	BBB+	11,178,329
Asset-Backed Securities	BBB+	2,434,225
Corporate Bonds	BBB	131,816,626
Commercial Mortgage-Backed	BBB	13,142,293
Asset-Backed Securities	BBB	12,600,661
Government Bonds	BBB	11,349,070
Corporate Bonds	BBB-	150,715,346
Commercial Mortgage-Backed	BBB-	7,234,497
Corporate Bonds	BB+	71,415,343
Government Bonds	BB+	5,852,663
Corporate Bonds	BB	70,724,052
Government Bonds	BB	2,799,000
Corporate Bonds	BB-	45,376,714
Corporate Bonds	B+	30,558,145
Corporate Bonds	B	11,546,060

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NOTE 4 - INVESTMENTS (CONTINUED)

<u>Investment</u>	<u>Rating</u>	<u>Fair Value</u>
Investments subject to credit risk (continued)		
Corporate Bonds	B-	21,256,392
Corporate Bonds	CCC+	1,161,563
Asset-Backed Securities	CCC	32,756,261
Non-Government-Backed C.M.O.s	CCC	19,501,182
Corporate Bonds	CCC	14,128,988
Non-Government-Backed C.M.O.s	CC	27,333,147
Non-Government-Backed C.M.O.s	D	20,411,381
Investments subject to credit risk - S&P Ratings		<u>2,412,390,415</u>
Investments subject to credit risk - not rated		
Asset-Backed Securities	not rated	69,637,477
Corporate Bonds	not rated	46,606,833
Non-Government-Backed C.M.O.s	not rated	28,090,111
Commercial Mortgage-Backed	not rated	24,926,008
Government Bonds	not rated	6,560,414
Money Markets	not rated	5,185,377
Investments subject to credit risk - not rated		<u>181,006,220</u>
Investments "NOT" subject to credit risk		
Private Equity, Equity Securities and Real Estate		12,549,950,311
NM Film Investments		30,000,000
Government Agencies		39,061,910
Investments "NOT" subject to credit risk		<u>12,619,012,221</u>
TOTAL INVESTMENTS		<u>\$ 15,212,408,856</u>

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
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NOTE 4 - INVESTMENTS (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 State Investment 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, 2012 and their exposure to interest rate risk is as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Life not Available</u>	<u>Less than 1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>Greater than 10 Years</u>
Investments subject to interest rate risk						
Asset-Backed Securities	\$ 218,764,510	\$ -	\$ 147,556,044	\$ 55,676,585	\$ 4,063,830	\$ 11,468,051
Certificate of Deposit	4,818,636	-	4,818,636	-	-	-
Commercial Mortgage-Backed	188,622,234	-	126,563,325	-	5,282,094	56,776,815
Corporate Bonds	1,147,681,211	-	168,103,172	400,202,621	407,112,641	172,262,777
Derivatives/Interest Rate SWAP	(378,324)	-	(191,642)	373,984	983,839	(1,544,505)
Government Bonds	479,443,101	-	101,207,213	152,564,824	136,701,258	88,969,806
Money Market	5,185,377	5,185,377	-	-	-	-
Mortgage Backed Securities	737,702,049	-	22,732,387	892,737	9,544,780	704,532,145
Municipal/Provincial Bonds	69,911,948	-	-	483,584	1,303,650	68,124,714
Non-Government Backed C.M.O.s	159,766,304	97	55,312,708	-	7,181,112	97,272,387
U.S. Treasury Bonds/Bills/Notes	1,172,878	-	1,172,878	-	-	-
Subtotal	<u>\$ 3,012,689,924</u>	<u>\$ 5,185,474</u>	<u>\$ 627,274,721</u>	<u>\$ 610,194,335</u>	<u>\$ 572,173,204</u>	<u>\$ 1,197,862,190</u>
Investments not subject to interest rate risk						
Securities, Equity, Real Estate, and NM Film Investments	<u>12,199,718,932</u>					
TOTAL INVESTMENTS	<u>\$ 15,212,408,856</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, 2012, the Office was not exposed to concentration of credit risk as no single issuer represented 5% of total investments.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
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NOTE 4 - INVESTMENTS (CONTINUED)

Foreign Currency Risk –Investments

Foreign currency risk is the risk that changes in exchange rates could adversely affect an investment's or deposit's fair value. This risk is eliminated in the Core Bond and High-Yield Bond pools by adhering to the State Investment Council 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.

A summary of the investments and cash and cash equivalents at June 30, 2012 and their exposure to foreign currency risk are as follows:

<u>Investment</u>	<u>Foreign Currency</u>	<u>Amount</u>	<u>% of Total Investments</u>
Common Stock	Australian dollar	\$ 99,961,338	0.63%
Common Stock	Brazilian real	54,748,665	0.35%
Common Stock	British pound sterling	266,102,992	1.68%
Common Stock	Czech koruna	3,761,568	0.02%
Common Stock	Danish krone	13,185,506	0.08%
Common Stock	Euro	297,491,634	1.88%
Common Stock	Hong Kong dollar	165,366,891	1.04%
Common Stock	Indonesian rupiah	23,364,615	0.15%
Common Stock	Israeli shekel	6,653,256	0.04%
Common Stock	Japanese yen	248,485,238	1.57%
Common Stock	Mexican peso	2,697,863	0.02%
Common Stock	New Taiwan dollar	45,816,287	0.29%
Common Stock	New Turkish lira	36,080,260	0.23%
Common Stock	New Zealand dollar	1,379,056	0.01%
Common Stock	Norwegian krone	10,633,357	0.07%
Common Stock	Polish zloty	16,963,953	0.11%
Common Stock	Singapore dollar	20,239,052	0.13%
Common Stock	South African rand	41,495,735	0.26%
Common Stock	South Korean won	117,917,988	0.74%
Common Stock	Swedish krona	35,387,974	0.22%
Common Stock	Swiss franc	98,086,880	0.62%
Common Stock	Thai baht	22,844,915	0.14%
Cash	Australian dollar	44,363	0.00%
Cash	Brazilian real	(135,420)	(0.00)%
Cash	British pound sterling	331,032	0.00%
Cash	Czech koruna	205,738	0.00%
Cash	Danish krone	1,158	0.00%
Cash	Euro	566,008	0.00%
Cash	Hong Kong dollar	628,657	0.00%

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NOTE 4 - INVESTMENTS (CONTINUED)

<u>Investment</u>	<u>Foreign Currency</u>	<u>Amount</u>	<u>% of Total Investments</u>
Cash	Indonesian rupiah	44,825	0.00%
Cash	Israeli shekel	7,732	0.00%
Cash	Japanese yen	1,131,910	0.01%
Cash	Mexican peso	51,054	0.00%
Cash	New Taiwan dollar	2,524,242	0.02%
Cash	New Turkish lira	73,679	0.00%
Cash	New Zealand dollar	29,983	0.00%
Cash	Norwegian krone	37,953	0.00%
Cash	Philippine peso	19,828	0.00%
Cash	Polish zloty	73,085	0.00%
Cash	Singapore dollar	90,566	0.00%
Cash	South African rand	1,858,556	0.01%
Cash	South Korean won	129	0.00%
Cash	Swedish krona	19,557	0.00%
Cash	Swiss franc	34,450	0.00%
Derivatives	Thai baht	(58)	(0.00)%
Global Depositary Receipt	Euro	3,861,682	0.02%
Partnerships	Euro	196,209,781	1.24%
Preferred Stock	Brazilian real	8,900,046	0.06%
Preferred Stock	British pound sterling	36,786	0.00%
Preferred Stock	Euro	6,520,594	0.04%
Preferred Stock	South Korean won	7,546,567	0.05%
Rights/Warrants	Australian dollar	14,868	0.00%
Rights/Warrants	Euro	2,080,914	0.01%
Real Estate Investment Trust	Euro	3,447,032	0.02%
Real Estate Investment Trust	Japanese yen	2,083,587	0.01%
Real Estate Investment Trust	British pound sterling	1,399,066	0.01%
Real Estate Investment Trust	Hong Kong dollar	1,102,977	0.01%
Real Estate Investment Trust	Singapore dollar	804,056	0.01%
Foreign Currency Investments and Cash and Cash Equivalents		<u>1,870,312,006</u>	<u>11.80%</u>
Non-Foreign Currency Investments and Cash and Cash Equivalents		<u>13,976,784,115</u>	<u>88.20%</u>
Total Investments and Cash and Cash Equivalents		<u>\$ 15,847,096,121</u>	<u>100.00%</u>

Securities Lending

In fiscal year 2012, the Office made the determination to terminate its securities lending program and accordingly, began and completed the liquidation process.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

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. The Office's contributions to PERA for the years ended June 30, 2012, 2011 and 2010 were \$316,464, \$371,435 and \$392,907, respectively, equal to 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 - 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 post-employment healthcare plan administered by the New Mexico Retiree Health Care Authority (RHCA). The RHCA provides health care insurance and prescription drug benefits to retired employees of participating New Mexico government agencies, their spouses, dependents, and surviving spouses and dependents. The RHCA Board was established by the Retiree Health Care Act (Chapter 10, Article 7C, NMSA 1978). The Board is responsible for establishing and amending benefit provisions of the healthcare plan and is also authorized to designate optional and/or voluntary benefits like dental, vision, supplemental life insurance, and long-term care policies.

Eligible retirees are: 1) retirees who make contributions to the fund for at least five years prior to retirement and whose eligible employer during that period of time made contributions as a participant in the RHCA plan on the person's behalf unless that person retires before the

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

**NOTE 6 - POST-EMPLOYMENT BENEFITS – STATE RETIREE HEALTH CARE PLAN
(CONTINUED)**

employer’s RHCA effective date, in which 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 post-employment healthcare plan. That report and further information can be obtained by writing to the Retiree Health Care Authority at 4308 Carlisle NE, Suite 104, Albuquerque, NM 87107.

Funding Policy

The Retiree Health Care Act (Section 10-7C-13 NMSA 1978) authorizes the RHCA Board to establish the monthly premium contributions that retirees are required to pay for healthcare benefits. Each participating retiree pays a monthly premium according to a service based subsidy rate schedule for the medical plus basic life plan plus an additional participation fee of five dollars if the eligible participant retired prior to the employer’s RHCA effective date or is a former legislator or 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. During the fiscal year ended June 30, 2012, the statute required each participating employer to contribute 1.834% of each participating employee’s annual salary; each participating employee was required to contribute .917% of their salary. In the fiscal year ending June 30, 2013, the contribution rates for employees and employers will rise as follows:

For employees who are not members of an enhanced retirement plan, the contribution rates will be:

<u>Fiscal Year</u>	<u>Employer Contribution Rate</u>	<u>Employee Contribution Rate</u>
FY13	2.000%	1.000%

Also, employers joining the program after January 1, 1998 are required to make a surplus-amount contribution to the RHCA based on one of two formulas at agreed-upon intervals.

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

The County’s contributions to the RHCA for the years ended June 30, 2012, 2011 and 2010 were \$43,288, \$40,658 and \$33,933, respectively, which equal the required contributions for each year.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 7 – CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets is as follows:

	<u>Balance June 30, 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2012</u>
Furniture and equipment	\$ 461,436	\$ -	\$ (136,503)	\$ 324,933
Accumulated depreciation	<u>(418,206)</u>	<u>(14,359)</u>	<u>136,503</u>	<u>(296,062)</u>
TOTAL CAPITAL ASSETS	<u>\$ 43,230</u>	<u>\$ (14,359)</u>	<u>\$ -</u>	<u>\$ 28,871</u>

Depreciation expense recorded by the Office in fiscal year 2012 was \$14,359. This amount was recognized as an expense in the general fund statement of activities.

NOTE 8 – CHANGES IN ACCRUED VACATION AND SICK PAY

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

Balance at June 30, 2011	\$ 158,413
Additions	152,063
Deletions	<u>(158,584)</u>
Balance at June 30, 2012	<u>\$ 151,892</u>

Of the balance outstanding at June 30, 2012, \$151,892 is estimated to be due within one year of the statement date.

NOTE 9 – COMMITMENTS

The Office has commitments for capital contributions to the various private equity partnerships and real estate / real asset investments. As of June 30, 2012, the Office was an investor in approximately 124 private equity limited partnerships 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, 2012, unfunded commitments to private equity partnerships were approximately \$829,029,456, and unfunded commitments to real estate and real asset investments were approximately \$755,791,214. Due to the nature of these investments, the Office cannot predict when these capital contributions will be called. Subsequent to June 30, 2012, the Office approved an additional \$150,000,000 of commitments to private equity partnerships, an additional \$100,000,000 of commitments to real estate partnerships, and an additional \$165,000,000 of commitments to real asset partnerships.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 9 – COMMITMENTS (CONTINUED)

In addition to the above investment commitments, the Office leases office space under a non-cancelable operating lease. Total rent expense for the year ended June 30, 2012 was \$278,640. Minimum annual lease payments under these leases for the years ended June 30 are as follows:

2013	\$ 282,657
2014	282,587
2015	286,808
2016	291,153
2017	295,627
2018 and thereafter	<u>24,667</u>
Total	<u>\$ 1,463,499</u>

NOTE 10 - 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.

NOTE 11 - JOINT POWERS AGREEMENTS

The Office manages investments for several governmental entities 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, 2012, these joint powers agreements with the following entities:

- (a) 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, 2012, the NMRHCA had total net assets held in trust of \$229,634,290.
- (b) 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, 2012, the NMIMT had total net assets held in trust of \$50,631,562.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 11 - JOINT POWERS AGREEMENTS (CONTINUED)

- (c) 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, 2012, the NMSBVI had total net assets held in trust of \$7,478,433.
- (d) 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, 2012, the Commissioner had total net assets held in trust of \$10,470,689.
- (e) 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, 2012, the Commission had total net assets held in trust of \$17,955,420.
- (f) 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, 2012, the NMMI had total net assets held in trust of \$22,851,070.
- (g) 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, 2012, the NMDGF had total net assets held in trust of \$989,362.
- (h) 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, 2012, the ENMU had total net assets held in trust of \$7,407,500.
- (i) 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, 2012, the SMSD had total net assets held in trust of \$145,272.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 11 - JOINT POWERS AGREEMENTS (CONTINUED)

- (j) 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, 2012, the Agency had total net assets held in trust of \$37,617,686.
- (k) 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, 2012, the County had total net assets held in trust of \$43,504,418.
- (l) 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, 2012, the NMPSIA had total net assets held in trust of \$38,116,650.
- (m) 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, 2012, the NMHU had total net assets held in trust of \$2,572,368.
- (n) 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, 2012, the CYFD had total net assets held in trust of \$2,562,368.
- (o) 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 NMMFA's investment policy. At June 30, 2012, the NMMFA had total net assets held in trust of \$31,556,811.
- (p) 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, 2012, the NMHED had total net assets held in trust of \$22,311,782.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 11 - JOINT POWERS AGREEMENTS (CONTINUED)

(q) 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, 2012, the Client had total net assets held in trust of \$13,355,052.

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 and the members of the State Investment Council;
2. Coverage to protect the State of New Mexico's property and assets; and
3. Fringe benefit coverage for State of New Mexico employees.

At June 30, 2012, 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 nor any outstanding balances 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 to the state legislature; therefore, the legislature annually appropriates funds for the SIC operating budget from the sources specified in this statute. Unexpended/unencumbered funds at fiscal year-end subsequently revert back to their original funding source.

This information is an integral part of the accompanying financial statements.

SUPPLEMENTAL INFORMATION

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
CHANGES IN LAND GRANT PERMANENT TRUST FUND HELD FOR BENEFICIARIES
Year Ended June 30, 2012**

Exhibit 1

Beneficiary	Balance June 30, 2011	State Land Office Transfers	Distributions to Beneficiaries	Other Increases in Capital Accounts, net	Balance June 30, 2012	Participation Percentage June 30, 2012
Carrie Tingley Hospital	\$ 188,666	\$ -	\$ (9,476)	\$ 894	\$ 180,084	0.001668%
Charitable, penal and reform	96,487,237	2,704,846	(4,912,713)	470,171	94,749,541	0.877658%
Public schools	8,971,618,707	466,545,278	(461,737,162)	44,765,392	9,021,192,215	83.562665%
Eastern New Mexico University	9,298,975	315,554	(475,747)	45,575	9,184,357	0.085074%
Improvements to the Rio Grande	28,637,674	459,336	(1,449,966)	137,876	27,784,920	0.257370%
Miners' Colfax Medical Center	109,488,699	2,341,218	(5,556,038)	529,987	106,803,866	0.989317%
New Mexico Boys School	707,416	9,225	(35,699)	3,396	684,338	0.006339%
New Mexico Highlands University	3,031,496	58,747	(153,472)	14,646	2,951,417	0.027339%
New Mexico Institute of Mining and Technology	22,289,286	803,234	(1,138,851)	109,483	22,063,152	0.204369%
New Mexico Military Institute	363,646,998	15,624,401	(18,638,576)	1,798,474	362,431,297	3.357175%
New Mexico School for the Deaf	221,787,411	8,189,178	(11,340,180)	1,090,339	219,726,748	2.035313%
New Mexico School for the Blind and Visually Impaired	221,243,870	8,189,205	(11,312,880)	1,087,764	219,207,959	2.030508%
New Mexico State Hospital	25,239,129	479,005	(1,278,267)	121,881	24,561,748	0.227514%
New Mexico State University	53,428,202	1,275,781	(2,715,549)	259,266	52,247,700	0.483967%
Northern New Mexico Community College	2,391,331	58,930	(121,322)	11,614	2,340,553	0.021680%
Penitentiary of New Mexico	218,064,407	9,677,599	(11,188,571)	1,079,951	217,633,386	2.015923%
Public Buildings - Capitol	123,932,890	3,411,592	(6,309,661)	603,600	121,638,421	1.126728%
The University of New Mexico	168,384,968	3,352,756	(8,544,465)	813,844	164,007,103	1.519186%
The University of New Mexico Saline Lands	602,527	2,083,154	(77,067)	13,009	2,621,623	0.024284%
Water reservoirs	123,011,743	3,399,940	(6,268,303)	599,154	120,742,534	1.118430%
Western New Mexico University	3,049,000	58,747	(154,351)	14,729	2,968,125	0.027494%
TOTAL	\$ 10,766,530,632	\$ 529,037,726	\$ (553,418,316)	\$ 53,571,045	\$ 10,795,721,087	100.00%

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
DETAIL OF INTERAGENCY TRANSFERS
Year Ended June 30, 2012**

Exhibit 2

Agency Initiating Transfer/Fund	Transferring Cash Account	Agency Receiving Transfer/Fund	Receiving Cash Account
State Land Office	53900/26400/7770	State Investment Office/ Land Grant Permanent Fund	60100
A total of \$529,037,726 was received from the State Land Office for fiscal year 2012. Funds transferred are from royalties and principal from land sales generated by the State Land Office (see Note 1).			
State Treasurer's Office/ Severance Tax Bonding Fund	39400/41000	State Investment Office/ Severance Tax Permanent Fund	60200
A total of \$7,617,058 was transferred from the Severance Tax Bonding Fund during 2012. This balance was a receivable from fiscal year 2011. \$103,888,028 has been recorded as a receivable at June 30, 2012. Funds transferred are remaining severance tax revenues after paying Severance Tax Bonding debt service (see Note1).			
Department of Finance and Administration/ Tobacco Settlement Proceeds	39401	State Investment Office/ Tobacco Settlement Permanent Fund	95200
A total of \$39,320,878 was received in fiscal year 2012 for the Tobacco Settlement Permanent Fund's portion of the Tobacco Settlement Proceeds (see Note 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 receivables at June 30, 2012.			
State Investment Office/ Land Grant Permanent Fund	60100	Land Grant Permanent Fund beneficiaries	Various
A total of \$553,418,316 was distributed for fiscal year 2012 to the various beneficiaries of the Severance Tax Permanent Fund (see Note 1).			
State Investment Office/ Severance Tax Permanent Fund	60200	Department of Finance and Administration/ State General Fund	85300
A total of \$183,423,504 was distributed for fiscal year 2012 to the various beneficiaries of the Land Grant Permanent Fund (see Note 1).			
State Investment Office/ Tobacco Settlement Permanent Fund	95200	Department of Finance and Administration/ Tobacco Settlement Program Fund	69700
A total of \$39,320,878 was distributed for fiscal year 2012 to the Tobacco Settlement Program Fund (see Note 1). The difference between what was paid and what was recorded in the statement of changes in net assets is due to accrued amounts recorded as due to other state agencies at June 30, 2012.			

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS
 Year Ended June 30, 2012

Exhibit 3
 Page 1 of 9

For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Core Bonds Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 1,855,908	\$ -	\$ -	\$ -	\$ 140,553	\$ 1,996,461
Los Alamos County - Cemetery	147,769	-	-	(6,953)	10,960	151,776
Los Alamos County - General Fund	3,294,972	-	495,838	-	265,933	4,056,743
Los Alamos County - Permanent Fund	5,975,100	(938,508)	-	-	421,471	5,458,063
NM Children's, Youth & Family Department Next Generation Fund	984,692	-	-	-	74,574	1,059,266
NM Children's, Youth & Family Department Trust Fund	984,692	-	-	-	74,574	1,059,266
NM Commissioner of Public Lands - Oil and Gas	5,077,717	-	-	-	384,548	5,462,265
NM Department of Game and Fish	325,327	-	-	58,846	25,362	409,535
NM Highlands University - Endowment Fund	848,403	-	-	-	64,252	912,655
NM Higher Education Department	4,352,752	-	-	-	329,644	4,682,396
NM Institute of Mining and Technology - Employee Benefit Trust	246,852	-	-	-	18,695	265,547
NM Institute of Mining and Technology - Endowment Fund	10,092,380	-	-	-	764,321	10,856,701
NM Institute of Mining and Technology - Plant Debt Allocated Funds	12,092,851	-	-	-	915,822	13,008,673
NM Institute of Mining and Technology	4,633,434	(1,400,000)	-	-	290,525	3,523,959
NM Interstate Stream Comm. - Improvements on the Rio Grande	657,947	-	-	-	49,827	707,774
NM Interstate Stream Comm. - Irrigation Works Construction	6,886,239	-	-	-	521,510	7,407,749
NM Military Institute - Capital Outlay	460,857	-	-	(6,551)	34,445	488,751
NM Military Institute - Legislative Scholarship	3,072,888	-	-	(105,044)	225,434	3,193,278
NM Military Institute - LFC/VC Maintenance Endowment	1,666,308	-	-	(148,043)	115,885	1,634,150
NM Military Institute - Patterson Account	1,328,768	-	-	(5,597)	100,242	1,423,413
NM Military Institute - Trust Scholarship	1,675,561	(138,581)	-	74,658	124,629	1,736,267
NM Mortgage Finance Authority	17,301,646	-	-	-	1,310,294	18,611,940
NM Mortgage Finance Authority - IFT Housing Trust Fund	11,656,325	(3,442,593)	313,450	-	713,697	9,240,879
NM Public Regulation Commission - Patients' Comp. Fund	23,583,736	-	-	(381,226)	1,781,356	24,983,866
NM Public Schools Insurance Authority - Benefits	7,502,108	-	-	-	568,153	8,070,261
NM Public Schools Insurance Authority - Risk	5,001,496	-	-	-	378,774	5,380,270
NM Retiree Health Care Authority	73,501,169	-	7,371,000	-	5,883,452	86,755,621
NM School for the Blind and Visually Impaired	4,578,041	(246,117)	-	-	327,103	4,659,027
Springer Municipal School District	20,218	-	-	-	1,531	21,749
TOTAL	\$ 209,806,156	\$ (6,165,799)	\$ 8,180,288	\$ (519,910)	\$ 15,917,566	\$ 227,218,301

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Large Cap. Active Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Los Alamos County - Cemetery	\$ 148,966	\$ -	\$ -	\$ 7,324	\$ (2,964)	\$ 153,326
Los Alamos County - General Fund	3,321,655	-	814,231	-	(51,182)	4,084,704
Los Alamos County - Permanent Fund	6,028,676	(365,807)	-	-	(135,227)	5,527,642
City of Las Cruces	4,987,173	-	-	-	(104,916)	4,882,257
NM Commissioner of Public Lands - Oil and Gas	2,667,549	-	-	-	(56,117)	2,611,432
NM Children's, Youth & Family Department Next Generation Fund	174,505	-	-	-	(3,671)	170,834
NM Children's, Youth & Family Department Trust Fund	174,505	-	-	-	(3,671)	170,834
NM Higher Education Department	6,428,427	-	-	-	(135,235)	6,293,192
NM Interstate Stream Comm. - Improvements on the Rio Grande	617,503	-	-	-	(12,990)	604,513
NM Interstate Stream Comm. - Irrigation Works Construction	9,433,847	-	-	-	(198,461)	9,235,386
NM Military Institute - LFC/VC Maintenance Endowment	336	-	-	(331)	24	29
NM Retiree Health Care Authority	29,214,601	-	2,632,500	-	(516,092)	31,331,009
NM School for the Blind and Visually Impaired	782,341	(68,950)	-	-	(14,958)	698,433
TOTAL	\$ 63,980,084	\$ (434,757)	\$ 3,446,731	\$ 6,993	\$ (1,235,460)	\$ 65,763,591

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Large Cap. ETF Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 1,306,789	\$ -	\$ -	\$ (1,382,969)	\$ 76,180	\$ -
NM Commissioner of Public Lands - Oil and Gas	2,327,718	-	-	(2,463,416)	135,698	-
NM Department of Game and Fish	405,088	-	-	(428,704)	23,616	-
NM Institute of Mining and Technology - Employee Benefit Trust	191,388	-	-	(202,545)	11,157	-
NM Institute of Mining and Technology - Endowment Fund	11,176,684	-	-	(11,828,243)	651,559	-
NM Institute of Mining and Technology	10,539,806	-	-	(11,154,238)	614,432	-
NM Mortgage Finance Authority	3,596,867	-	-	(3,806,550)	209,683	-
NM Public Regulation Commission - Patients' Comp. Fund	5,794,006	-	-	(6,131,775)	337,769	-
Springer Municipal School District	13,499	-	-	(14,287)	788	-
NM Highlands University - Endowment Fund	546,337	-	-	(578,187)	31,850	-
TOTAL	\$ 35,898,182	\$ -	\$ -	\$ (37,990,914)	\$ 2,092,732	\$ -

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Large Cap. Index Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Los Alamos County - Cemetery	\$ 155,517	\$ -	\$ -	\$ (4,871)	\$ 5,416	\$ 156,062
City of Las Cruces	2,454,898	-	-	-	88,664	2,543,562
Los Alamos County - General Fund	3,467,704	-	542,300	-	147,581	4,157,585
Los Alamos County - Permanent Fund	6,288,520	(854,428)	-	-	191,933	5,626,025
Eastern New Mexico University	-	-	-	3,723,127	(100,391)	3,622,736
NM Higher Education Department	6,061,594	-	-	-	218,928	6,280,522
NM Commissioner of Public Lands - Oil and Gas	-	-	-	2,463,416	(66,424)	2,396,992
NM Department of Game and Fish	-	-	-	364,095	(9,818)	354,277
NM Highlands University - Endowment Fund	-	-	-	1,125,566	(30,350)	1,095,216
NM Institute of Mining and Technology - Employee Benefit Trust	-	-	-	462,053	(12,458)	449,595
NM Institute of Mining and Technology - Endowment Fund	-	-	-	11,828,243	(318,936)	11,509,307
NM Institute of Mining and Technology	-	-	-	11,154,238	(300,763)	10,853,475
NM Military Institute - Capital Outlay	494,262	-	-	3,339	18,287	515,888
NM Military Institute - Legislative Scholarship	3,190,563	-	-	59,811	123,054	3,373,428
NM Military Institute - LFC/VC Maintenance Endowment	1,667,960	-	-	(3,172)	59,827	1,724,615
NM Military Institute - Patterson Account	1,456,415	-	-	(6,860)	51,706	1,501,261
NM Military Institute - Trust Scholarship	1,965,338	(84,777)	-	(43,850)	57,677	1,894,388
NM Mortgage Finance Authority	-	-	-	3,806,550	(102,640)	3,703,910
NM Public Regulation Commission - Patients' Comp. Fund	-	-	-	6,834,382	(184,283)	6,650,099
NM Public Schools Insurance Authority - Benefits	-	-	-	9,945,756	(268,177)	9,677,579
NM Public Schools Insurance Authority - Risk	-	-	-	6,630,463	(178,783)	6,451,680
NM Retiree Health Care Authority	26,301,648	-	2,632,500	-	1,103,850	30,037,998
Springer Municipal School District	-	-	-	35,124	(947)	34,177
TOTAL	\$ 53,504,419	\$ (939,205)	\$ 3,174,800	\$ 58,377,410	\$ 492,953	\$ 114,610,377

STATE OF NEW MEXICO INVESTMENT COUNCIL -
 INVESTMENT OFFICE
 EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
 Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Large Cap. Index ETF Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 2,220,374	\$ -	\$ -	\$ (2,340,157)	\$ 119,783	\$ -
NM Institute of Mining and Technology - Employee Benefit Trust	246,225	-	-	(259,509)	13,284	-
NM Public Regulation Commission - Patients' Comp. Fund	2,297,719	-	-	(2,421,674)	123,955	-
NM Public Schools Insurance Authority - Benefits	9,436,674	-	-	(9,945,756)	509,082	-
NM Public Schools Insurance Authority - Risk	6,291,078	-	-	(6,630,463)	339,385	-
Springer Municipal School District	19,770	-	-	(20,837)	1,067	-
NM Highlands University - Endowment Fund	519,361	-	-	(547,379)	28,018	-
TOTAL	\$ 21,031,201	\$ -	\$ -	\$ (22,165,775)	\$ 1,134,574	\$ -

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Mid/Small Cap. Index Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Los Alamos County - Cemetery	\$ 123,083	\$ -	\$ -	\$ (5,008)	\$ (6,135)	\$ 111,940
Los Alamos County - General Fund	2,429,004	-	684,436	-	(143,141)	2,970,299
Los Alamos County - Permanent Fund	4,973,460	(707,283)	-	-	(233,604)	4,032,573
City of Las Cruces	4,469,060	-	-	-	(227,839)	4,241,221
Eastern New Mexico University	-	-	-	1,116,674	(73,172)	1,043,502
NM Department of Game and Fish	-	-	-	121,365	(7,953)	113,412
NM Higher Education Department	3,450,636	-	-	-	(175,919)	3,274,717
NM Highlands University - Endowment Fund	-	-	-	322,151	(21,110)	301,041
NM Institute of Mining and Technology - Employee Benefit Trust	-	-	-	98,322	(6,443)	91,879
NM Military Institute - Capital Outlay	142,928	-	-	1,374	(7,213)	137,089
NM Military Institute - Legislative Scholarship	906,056	-	-	36,048	(44,227)	897,877
NM Military Institute - LFC/VC Maintenance Endowment	447,187	-	-	34,616	(20,912)	460,891
NM Military Institute - Patterson Account	417,349	-	-	2,916	(21,119)	399,146
NM Military Institute - Trust Scholarship	600,830	(13,642)	-	(41,963)	(33,357)	511,868
NM Retiree Health Care Authority	21,520,598	-	2,106,000	-	(1,094,191)	22,532,407
NM Public Regulation Commission - Patients' Comp. Fund	-	-	-	1,898,439	(124,399)	1,774,040
NM Public Schools Insurance Authority - Benefits	-	-	-	2,513,235	(164,685)	2,348,550
NM Public Schools Insurance Authority - Risk	-	-	-	1,675,475	(109,788)	1,565,687
NM School for the Blind and Visually Impaired	849,749	(74,873)	-	-	(39,168)	735,708
Springer Municipal School District	-	-	-	32,949	(2,160)	30,789
TOTAL	\$ 40,329,940	\$ (795,798)	\$ 2,790,436	\$ 7,806,593	\$ (2,556,535)	\$ 47,574,636

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Mid/Small Cap. ETF Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 984,334	\$ -	\$ -	\$ (1,116,674)	\$ 132,340	\$ -
NM Department of Game and Fish	110,268	-	-	(125,093)	14,825	-
NM Institute of Mining and Technology - Employee Benefit Trust	86,670	-	-	(98,322)	11,652	-
NM Public Regulation Commission - Patients' Comp. Fund	2,307,343	-	-	(2,617,560)	310,217	-
NM Public Schools Insurance Authority - Benefits	2,215,382	-	-	(2,513,235)	297,853	-
NM Public Schools Insurance Authority - Risk	1,476,909	-	-	(1,675,475)	198,566	-
Springer Municipal School District	34,576	(6,275)	-	(32,949)	4,648	-
NM Highlands University - Endowment Fund	283,971	-	-	(322,151)	38,180	-
TOTAL	\$ 7,499,453	\$ (6,275)	\$ -	\$ (8,501,459)	\$ 1,008,281	\$ -

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Non-U.S. Developed Markets Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 776,628	\$ -	\$ -	\$ -	\$ (102,711)	\$ 673,917
City of Las Cruces	1,945,280	-	-	-	(257,267)	1,688,013
Los Alamos County - Cemetery	87,964	-	-	2,461	(11,686)	78,739
Los Alamos County - General Fund	1,961,525	-	409,833	-	(268,271)	2,103,087
Los Alamos County - Permanent Fund	3,553,431	(256,110)	-	-	(464,416)	2,832,905
NM Children's, Youth & Family Department Next Generation Fund	46,826	-	-	-	(6,193)	40,633
NM Children's, Youth & Family Department Trust Fund	46,826	-	-	-	(6,193)	40,633
NM Department of Game and Fish	62,196	-	-	3,700	(8,420)	57,476
NM Institute of Mining and Technology - Employee Benefit Trust	83,445	-	-	-	(11,035)	72,410
NM Higher Education Department	1,339,081	-	-	-	(177,097)	1,161,984
NM Military Institute - Capital Outlay	154,343	-	-	1,511	(20,457)	135,397
NM Military Institute - Legislative Scholarship	1,016,016	-	-	2,499	(134,444)	884,071
NM Military Institute - LFC/VC Maintenance Endowment	414,443	-	-	105,028	(57,934)	461,537
NM Military Institute - Patterson Account	449,140	-	-	4,736	(59,541)	394,335
NM Military Institute - Trust Scholarship	604,048	-	-	5,717	(79,666)	530,099
NM Public Regulation Commission - Patients' Comp. Fund	1,119,957	-	-	1,252,066	(214,280)	2,157,743
NM Public Schools Insurance Authority - Benefits	1,168,329	-	-	-	(154,513)	1,013,816
NM Public Schools Insurance Authority - Risk	778,901	-	-	-	(103,012)	675,889
NM Retiree Health Care Authority	33,194,520	-	3,159,000	-	(4,443,958)	31,909,562
NM School for the Blind and Visually Impaired	775,900	(71,705)	-	-	(93,217)	610,978
Springer Municipal School District	31,764	-	-	-	(4,201)	27,563
NM Highlands University - Endowment Fund	182,759	-	-	-	(24,170)	158,589
TOTAL	\$ 49,793,322	\$ (327,815)	\$ 3,568,833	\$ 1,377,718	\$ (6,702,682)	\$ 47,709,376

**STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
EXTERNAL INVESTMENT TRUST FUNDS (CONTINUED)
Year Ended June 30, 2012**

Exhibit 3
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For fiscal year ended June 30, 2012, activity by participating agency was as follows:

Non U.S. Emerging Markets Pool	Beginning Balance June 30, 2011	Withdrawals	Contributions	Net Transfers In (Out)	Net Investment Income	Ending Balance June 30, 2012
Participant						
Eastern New Mexico University	\$ 87,628	\$ -	\$ -	\$ -	\$ (16,743)	\$ 70,885
Los Alamos County - Cemetery	30,609	-	-	7,046	(6,580)	31,075
Los Alamos County - General Fund	989,294	-	53,363	-	(194,586)	848,071
Los Alamos County - Permanent Fund	1,254,075	-	122,137	-	(252,349)	1,123,863
NM Children's, Youth & Family Department Next Generation Fund	12,920	-	-	-	(2,468)	10,452
NM Children's, Youth & Family Department Trust Fund	12,920	-	-	-	(2,468)	10,452
NM Department of Game and Fish	61,120	-	-	5,791	(12,255)	54,656
NM Higher Education Department	765,171	-	-	-	(146,201)	618,970
NM Military Institute - Capital Outlay	37,633	-	-	327	(7,222)	30,738
NM Military Institute - Legislative Scholarship	241,401	-	-	6,686	(46,818)	201,269
NM Military Institute - LFC/VC Maintenance Endowment	115,164	-	-	11,902	(23,244)	103,822
NM Military Institute - Patterson Account	105,780	-	-	4,805	(20,713)	89,872
NM Military Institute - Trust Scholarship	150,337	-	-	5,439	(28,160)	127,616
NM Public Regulation Commission - Patients' Comp. Fund	791,425	-	-	1,567,348	(306,838)	2,051,935
NM Public Schools Insurance Authority - Benefits	2,175,429	-	-	-	(415,658)	1,759,771
NM Public Schools Insurance Authority - Risk	1,450,251	-	-	-	(277,098)	1,173,153
NM Retiree Health Care Authority	29,826,817	-	3,159,000	-	(5,918,091)	27,067,726
NM School for the Blind and Visually Impaired	995,343	(38,355)	-	-	(182,701)	774,287
Springer Municipal School District	38,302	-	-	-	(7,318)	30,984
NM Highlands University - Endowment Fund	129,624	-	-	-	(24,769)	104,855
TOTAL	\$ 39,271,243	\$ (38,355)	\$ 3,334,500	\$ 1,609,344	\$ (7,892,280)	\$ 36,284,452

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS
June 30, 2012

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 State Treasurer's Office	Fund 173 - General Administrative Fund	Interest in SGFIP	\$ 13,629,911	\$ 13,629,911
Total Admin Fund			<u>\$ 13,629,911</u>	<u>\$ 13,629,911</u>
Fiduciary Funds				
<i>Cash and Cash Equivalents</i>				
NM State Treasurer's Office	Fund 601 - Land Grant Permanent Fund	Interest in SGFIP	\$ 49,083,955	\$ 49,083,955
NM State Treasurer's Office	Fund 602 - Severance Tax Permanent Fund	Interest in SGFIP	2,345	2,345
JP Morgan	Land Grant Permanent Fund	Money Market	211,523,519	211,523,519
JP Morgan	LG Permanent Stock	Cash	187,987	187,987
JP Morgan	Severance Tax Permanent Fund	Money Market	41,498,483	41,498,483
JP Morgan	ST UNM Equity	Money Market	17,760	17,760
JP Morgan	ST UNM Fixed Income	Money Market	16,506	16,506
JP Morgan	ST Stock	Cash	72,353	72,353
JP Morgan	Tobacco Settlement Permanent Fund	Money Market	86,699	86,699
JP Morgan	Water Trust Fund	Money Market	19,387	19,387
JP Morgan	Alliance Bernstein	Money Market	2,448,793	2,448,793
JP Morgan	Alliance Bernstein EM	Money Market	13,210,716	13,210,716
JP Morgan	Blackrock	Money Market	1,141,974	1,141,974
JP Morgan	Brown Brothers Harriman	Money Market	23,657,085	23,657,085
JP Morgan	Cortina Asset Management	Money Market	3,948,091	3,948,091
JP Morgan	Credit and Structured Finance Cash	Money Market	106,675,300	106,675,300
JP Morgan	Clearbridge	Money Market	173,803	173,803
JP Morgan	Denver	Money Market	641,927	641,927
JP Morgan	Donald Smith Co.	Money Market	19,067,608	19,067,608
JP Morgan	Fixed Income Pool	Money Market	3,309,470	3,309,470
JP Morgan	Global In-House	Money Market	3,679,844	3,679,844
JP Morgan	Hedge Fund Pooled Cash Account	Cash	6,340,987	6,340,987
JP Morgan	JP Morgan Asset Management	Money Market	4,968,726	4,968,726
JP Morgan	S&P 500 Active Pool	Money Market	14,615,654	14,615,654
JP Morgan	Lombardia	Money Market	622,510	622,510
JP Morgan	Loomis Sayles	Money Market	20,086,231	20,086,231
JP Morgan	Northern Trust	Money Market	1,780,640	1,780,640
JP Morgan	PanAgora	Money Market	1,811,393	1,811,393
JP Morgan	PIMCO	Money Market	1,684,372	1,684,372
JP Morgan	National Private Equity Pool	Cash	27,094,587	27,094,587
JP Morgan	Prudential	Money Market	39,813,231	39,813,231
JP Morgan	Real Asset Pool	Money Market	488,773	488,773
JP Morgan	Real Estate Pool	Money Market	483,635	483,635
JP Morgan	S&P Index 500 Pool	Money Market	1,565,223	1,565,223
JP Morgan	Seizert Capital	Money Market	8,200,174	8,200,174
JP Morgan	SIC Tax Reclaims	Money Market	68,827	68,827
JP Morgan	Simms	Money Market	5,614	5,614
JP Morgan	T. Rowe Price	Money Market	1,234,948	1,234,948
JP Morgan	Thornburg	Money Market	70,420	70,420
JP Morgan	Wellington	Money Market	9,657,804	9,657,804
Total Fiduciary Funds			<u>621,057,354</u>	<u>621,057,354</u>

STATE OF NEW MEXICO INVESTMENT COUNCIL -
INVESTMENT OFFICE
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS (CONTINUED)
June 30, 2012

Exhibit 4
Page 2 of 2

Depository Institution	Account Name	Deposit Type	Balance per Books	Balance per Statement
Fiduciary Funds				
<i>Investments on Deposit</i>				
JP Morgan	Alliance Bernstein	Equity	1,157,774,757	1,157,774,757
JP Morgan	Alliance Bernstein EM	Equity	719,888,955	719,888,955
JP Morgan	Blackrock	Equity	154,015,314	154,015,314
JP Morgan	Brown Brothers Harriman	Equity	426,669,118	426,669,118
JP Morgan	Cortina Asset Management	Equity	225,183,241	225,183,241
JP Morgan	Denver	Equity	114,895,379	114,895,379
JP Morgan	Donald Smith Co.	Equity	192,983,664	192,983,664
JP Morgan	Emerging Markets Pool	Equity	145,003,000	145,003,000
JP Morgan	JP Morgan Asset Management	Equity	413,068,705	413,068,705
JP Morgan	S&P 500 Active Pool	Equity	432,564,641	432,564,641
JP Morgan	Loomis Sayles	Core Bonds	653,141,001	653,141,001
JP Morgan	Northern Trust	Equity	2,719,488,290	2,719,488,290
JP Morgan	PIMCO	Core Bonds	1,700,284,912	1,700,284,912
JP Morgan	Prudential	Core Bonds	640,710,447	640,710,447
JP Morgan	S&P Index 500 Pool	Equity	264,861	264,861
JP Morgan	Seizert Capital	Equity	186,785,988	186,785,988
JP Morgan	SIC Tax Reclaims	Equity	46	46
JP Morgan	T. Rowe Price	Equity	204,951,344	204,951,344
JP Morgan	Wellington	Equity	651,826,368	651,826,368
JP Morgan	Fixed Income Pool	Core Bonds	97	97
	<i>Total Investments on Deposit</i>		<u>10,739,500,128</u>	<u>10,739,500,128</u>
<i>Other Investments</i>				
JP Morgan	Structured Credit Finance	Structured Credit	597,688,205	597,688,205
JP Morgan	PanAgora	Enhanced Index	435,632,742	435,632,742
JP Morgan	AAM High Desert	Hedge Investments	264,179,266	264,179,266
JP Morgan	Altair Stars	Hedge Investments	169,648	169,648
JP Morgan	Austin	Hedge Investments	15,520,376	15,520,376
JP Morgan	Crestline Enchantment	Hedge Investments	319,920,511	319,920,511
JP Morgan	Crestline Offshore	Hedge Investments	18,443,397	18,443,397
JP Morgan	CT Preferred Investors	Hedge Investments	6,923,866	6,923,866
JP Morgan	EIM Fund of Fund	Hedge Investments	213,184	213,184
JP Morgan	Mariner Select	Hedge Investments	258,725,397	258,725,397
N/A	Various	UNM Fixed Income	2,091,270	2,091,270
N/A	Various	UNM Equity	2,973,622	2,973,622
N/A	Various	Govt. Sponsored Entities	39,061,910	39,061,910
N/A	Various	Direct Equity Investment	3,666,160	3,666,160
N/A	Various	Mortgages and Mort. Certifs.	38,302	38,302
N/A	Various	Private Equity Investments	1,744,831,442	1,744,831,442
N/A	Various	Real Estate Holding	732,829,430	732,829,430
N/A	Various	Film Loans	30,000,000	30,000,000
	<i>Total Other Investments</i>		<u>4,472,908,728</u>	<u>4,472,908,728</u>
	Total Fiduciary Fund Investments		<u>15,212,408,856</u>	<u>15,212,408,856</u>
	Total Fiduciary Fund Cash and Investments		<u>\$15,833,466,210</u>	<u>\$15,833,466,210</u>

**Independent Auditor's 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 Susana Martinez, Chair
and Members of the State Investment Council
and Mr. Hector H. Balderas, State Auditor

We have audited the financial statements of the governmental activities, the general fund, the general fund budget comparison and each fiduciary fund of the State of New Mexico Investment Council – Investment Office (the Office) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 19, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Office is responsible for establishing and maintaining effective 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 our opinions 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 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 described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or 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 noted no findings that we considered to be material weaknesses.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency indexed at 2012-01 and described in the accompanying schedule of findings and responses to be a significant deficiency.

Compliance and Other Matters

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 statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are indexed at 2012-02 and described in the accompanying schedule of findings and responses.

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

This report is intended solely for the information and use of management, the State Investment Council, others within the entity, the Department of Finance and Administration, the State Auditor, the New Mexico Legislature, and applicable federal grantors, and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Albuquerque, New Mexico
November 19, 2012

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2012**

Section II - Financial Statement Findings

Finding 2012-01 Recording of Management Fees (Significant Deficiency)

Condition: During fiscal year 2012, the agency did not timely accrue management fees to the investment pools on a quarterly basis for the first 2 quarters of the fiscal year, resulting in the net asset value (NAV) calculation being overstated. . In May 2012, the management fees for the first two quarters plus the third quarter, totaling \$8.8 million, were properly charged to the agency's clients. The portion allocable to client funds was \$486,000. In addition, management fees were over-accrued at the end of fiscal year 2011. The over-accrual was impacted by a larger estimated expense allocation base figure being used in the calculation, which was at that time done on a monthly basis. The over-accrued amount of \$5.7 million was credited back to the pools and to the fund participants in April, 2012. The portion allocable to clients was approximately \$280,000.

Criteria: Controls should be in place to ensure management fees are recorded on a timely basis and any effect on NAV is properly adjusted.

Cause: The error was caused by staff turnover in fiscal year 2012.

Effects: The NAVs of the investment pools were overstated due to the lack of timely recording of management fees.

The net effect of the difference on any fund participant was negligible as the net assets for SIC approximated \$14.9 billion and the client assets under management were approximately \$540 million at June 30, 2012.

Recommendation: We recommend that a formal policy be documented regarding how management fees are calculated and assessed, including procedures for performing allocations to the external trust funds and assigning responsibility for completion of the process.

Management's Response: At the time that this problem occurred, there was not a permanent CFO on staff. Procedures in this area will be enhanced. The challenge with allocating management fees to clients on a timely basis is that external investment management fees are billed to SIC by investment managers quarterly in arrears, thus, the recent change in methodology, which includes assessing clients for those fees quarterly, in arrears, based upon actual invoices received. There is a lag to quarter-end in making the assessments due to required time for receipt of actual invoices. The over-accrual resulted from a change in methodologies which benefited our clients. In the past the billings included numerous estimates and a larger expense base, including internal allocations. This is no longer the case. Management fees are now billed based upon actual external expense activity.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2012**

Section II - Financial Statement Findings (continued)

Finding 2012-02 Failure to Perform Annual Fixed Asset Inventory Count (Compliance)

Condition: The agency did not perform an annual fixed asset inventory count.

Criteria: Section 12-6-10(A) NMSA 1978 requires each agency to conduct an annual physical inventory of movable chattels and equipment on the inventory list at the end of each fiscal year.

The agency shall certify the correctness of the inventory after the physical inventory. This certification should be provided to the agency's auditors.

Cause: Noncompliance caused by lack of procedure to communicate this compliance requirement and to assign responsibility for its completion.

Effects: The agency is not in compliance with State statute.

Recommendation: We recommend that the agency formalize this process by documenting procedures for performing it and assigning responsibility for completion.

Management's Response: Going forward, an annual fixed asset inventory will be performed. It is not clear when the last inventory was completed. Subsequent to year-end, the Office's net fixed assets of \$28,871 were further reviewed and additional deletions of fully depreciated assets were recorded as of June 30, 2012.

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
June 30, 2012**

Section I – Financial Statement Findings

Finding 07-1 Use of General Ledger Software – Cleared

Finding 11-1 Financial Close and Reporting (Material Weakness) – Cleared

Finding 11-2 Late Audit Report (State Compliance) – Cleared

**STATE OF NEW MEXICO INVESTMENT COUNCIL –
INVESTMENT OFFICE
EXIT CONFERENCE
June 30, 2012**

An exit conference was held with the Office on November 19, 2012. In attendance were:

NEW MEXICO STATE INVESTMENT COUNCIL

Peter Frank, Audit Committee Chairman
Jim Goodwin, Audit Committee Member
Tom Clifford, DFA Secretary and Audit Committee Member (by phone)
Leonard Lee Rawson, Audit Committee Member (by phone)
Steven K. Moise, State Investment Officer
Vince Smith, Deputy State Investment Officer
Evan Land, General Counsel
Brent Shipp, CFO
Kerri Segell, Executive Assistant

CLIFTONLARSONALLEN LLP

Bill Petri, CPA, Partner
Joel Blackman, CPA, Manager

PREPARATION OF FINANCIAL STATEMENTS

The financial statements presented in this report have been prepared by the independent auditor, reviewed and approved by the management of the Office. The responsibility of the financial statements is the management's, as addressed in the Independent Auditors' Report.