

**STATE OF NEW
MEXICO
EDUCATIONAL
RETIREMENT BOARD**

**Financial Statements as of and for the
Years Ended June 30, 2008 and
2007, and Independent
Auditors' Report**

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STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

Financial Statements
and Other Supplementary Information
June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

Prepared By Board Staff

AUDITED BY:
MOSS ADAMS LLP

INTRODUCTORY SECTION

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STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD

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STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD

*Official Roster
As of June 30, 2008*

BOARD OF DIRECTORS

NAME	TITLE
Mr. Bruce Malott	Chairman
Ms. Mary Lou Cameron	Vice-Chairman
Mr. Gary Bland	Secretary
Dr. Pauline H. Turner	Member
Mr. H. Russell Goff	Member
Dr. Veronica Garcia	Ex-officio Member
Mr. James B. Lewis	Ex-officio Member

ADMINISTRATIVE STAFF

Ms. Jan Goodwin	Executive Director
Mr. Jeffrey M. Riggs	Deputy Director
Mr. Robert K. Westervelt	Chief Financial Officer
Mr. Bob Jacksha	Chief Investment Officer
Ms. Clara Mares	Administrative Services Manager
Mr. Greg Trujillo	Information Technology Manager
Mr. Chris Schatzman	General Counsel
Mr. Steve Moreno	Benefits
Mr. Paul Swanson	Outreach/Branch Offices

Independent Auditors' Report

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

We have audited the accompanying Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the State of New Mexico Educational Retirement Board (the "ERB"), as of and for the year ended June 30, 2008, as listed in the table of contents. We have also audited the Statement of Revenues and Expenses – Budget and Actual (Non-GAAP) shown as supplemental information for the year ended June 30, 2008, as listed in the table of contents. These financial statements and schedule are the responsibility of ERB's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit. The 2007 financial statements of ERB were audited by other auditors whose report, dated June 4, 2008, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and with 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 ERB's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of ERB are intended to present the net assets and changes in net assets of only that portion of the State of New Mexico which are attributable to the transactions of the Fund administered by ERB. They do not purport to, and do not present fairly, the financial position of the State of New Mexico as of June 30, 2008, and the changes in its financial position, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the plan net assets of ERB as of June 30, 2008, and the respective changes in financial position of its plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Statement of Revenues and Expenses - Budget and Actual, (Non-GAAP Basis) presents fairly the revenues and expenses on the basis of accounting as described in Note 2, for the year ended June 30, 2008.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2008, on our consideration of the ERB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audit was conducted for the purpose of forming opinions on the financial statements of ERB taken as a whole. The Schedules of Cash Accounts and Accountability in Government Act – Performance Measures, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Moss Adams LLP

Albuquerque, New Mexico
December 12, 2008

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended June 30, 2008 And 2007**

Agency management prepared this Management's Discussion and Analysis ("MD&A") of the financial position of the State of New Mexico Educational Retirement Board ("Board") for the fiscal year ended June 30, 2008 ("FY08"). For more detailed information of the Board's FY08 financial activities, the reader should review the financial statements, including the notes and required supplementary information.

FINANCIAL REPORTING REQUIREMENTS

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

FINANCIAL HIGHLIGHTS

- Net assets held in trust for pension benefits decreased \$686 million, or 7.25%, in FY08 compared to an increase of \$1.2 billion, or 15%, in FY07. The primary driver was a notable downward trend in both domestic and foreign stock markets beginning at the end of FY08.
- Investment advisor fees and custodial fees decreased \$0.5 million, or 2.1%, in FY08 compared to an increase of \$3.7 million, or 22%, in FY07. Higher fees incurred with an expanding portfolio in alternative investments were offset by the decrease in assets under management discussed above.
- Total cash and cash equivalents increased \$23 million in FY08 primarily due to the investment portfolios holding a higher balance of cash at fiscal year end. This compared to an \$88 million increase in FY07. Total cash and cash equivalents equaled \$351 million, or 3.7% of investments, in FY08 compared to \$327 million, or 3.2% of investments, in FY07, which is within the Board's investment policy that limits cash holdings to 5% or less.
- Receivables decreased by just over \$594 million in FY08 compared to an increase of \$876 million in FY07, with the majority of the decrease showing in investment broker sales proceeds, indicating that a smaller volume of investments were sold at or near fiscal year end and remained outstanding on June 30, 2008. Securities sales and purchases are usually based on "trade date + 3 days," meaning that the transaction will settle three business days after it is initiated.
- Investment holdings decreased \$723 million, or 7.0%, in FY08 compared to an increase of \$1.4 billion, or 15.2%, in FY07 primarily due to the weak performance at year end of domestic and foreign equity markets.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2008 And 2007**

- Capital assets increased by \$2.6 million, or 34.3%, in FY08 compared to an increase of \$100 thousand, or 1.3%, in FY07 due primarily to capitalization of development costs on the new pension administration system and the addition to the Santa Fe office building. There was also a moderate amount of asset purchases and some asset disposals in each year. The Board does not have any debt activity.
- The Board received total appropriations from the trust fund of \$9.8 million to implement the Integrated Retirement Information System (“IRIS”) Project. The Board successfully implemented the initial phase of the system in March 2006 and the Web-enablement phase of the project was completed in fiscal year 2008. There are currently no other significant capital commitments.
- Accounts payable increased \$537 thousand, or 10.8%, in FY08 compared to an increase of \$103 thousand, or 2.11%, in FY07 primarily due to an increase in the amount of investment advisor fees due at FY08 year-end.
- Investment purchases payable-brokers decreased by \$419 million in FY08 compared to a increase of \$636 million in FY07, indicating that a smaller number of investments were purchased at or near fiscal year end and remained outstanding on June 30, 2008. Securities sales and purchases are usually based on “trade date + 3 days,” meaning that the transaction will settle three business days after it is initiated.
- Securities lending collateral decreased \$199 million, or 15.1%, in FY08 compared to an increase of \$451 million, or 51.9%, in FY07, indicating that a smaller portion of the Board’s portfolio was being lent at fiscal year end. Securities lending net income increased \$3.5 million, or 152%, in FY08 compared to an increase of \$182 thousand, or 8.5%, in FY07, due to lower “borrower rebates” paid on the lent securities.
- Employer and member contributions increased \$47.5 million, or 10.7%, in FY08 compared to an increase of \$40.5 million, or 10.0%, in FY07 due to an increase in active membership contribution rates and salary increases. Benefit payments to retirees increased \$38.6 million, or 7.15%, in FY08 compared to an increase of \$46 million, or 9.3%, in FY07 due to the increase in the number of retirees, as well as the cost of living adjustments paid to retirees. Refunds and interest to terminated members increased \$1.9 million, or 7.1%, in FY08 compared to a decrease of \$0.8 million, or 2.8%, in FY07. The Board’s total membership increased by 2,274, or 1.8%, to 124,872 members in FY08 compared to an increase of 2,280, or 1.9%, to 122,598 members in FY07.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2008 And 2007

- During FY07 the Board began investing in the alternative investment categories of private equity and hedge funds, as provided for in the investment policy approved in February 2007. As of June 30, 2008, the Board's balance in private equity was \$94 million and \$723 million in hedge funds. For the year ended June 30, 2007, on the Statement of Plan Net Assets; Private Equity, Hedge Funds, and Private Real Estate are combined.
- The current volatility in the credit and other markets will affect the Board's investment returns. In the fiscal period through November 30, 2008 the Board is showing a decline in the fair value of investments of \$2.1billion or 24.6% compared with an increase of \$76.5 million or 0.8% in the same period in the prior year.

CONDENSED FINANCIAL INFORMATION

Statements of Plan Net Assets

	FY08	FY07	FY06
Cash and short-term investments	\$ 346,040,280	\$ 316,614,628	\$ 239,704,558
Receivables	384,628,705	978,651,452	102,640,807
Investment in State General Fund			
Investment Pool	4,990,356	11,124,535	-
Investments—at fair value	9,575,761,825	10,298,665,645	8,939,432,545
Capital assets (net of accumulated depreciation)	<u>10,121,468</u>	<u>7,528,949</u>	<u>7,428,225</u>
Total assets	<u>10,321,542,634</u>	<u>11,612,585,209</u>	<u>9,289,206,135</u>
Current liabilities	1,551,286,681	2,156,597,869	1,069,756,684
Long-term liabilities (compensated absences)	<u>211,914</u>	<u>191,487</u>	<u>159,477</u>
Total liabilities	<u>1,551,498,595</u>	<u>2,156,789,356</u>	<u>1,069,916,161</u>
Net assets held in trust for pension benefits	<u>\$8,770,044,039</u>	<u>\$9,455,795,853</u>	<u>\$8,219,289,974</u>

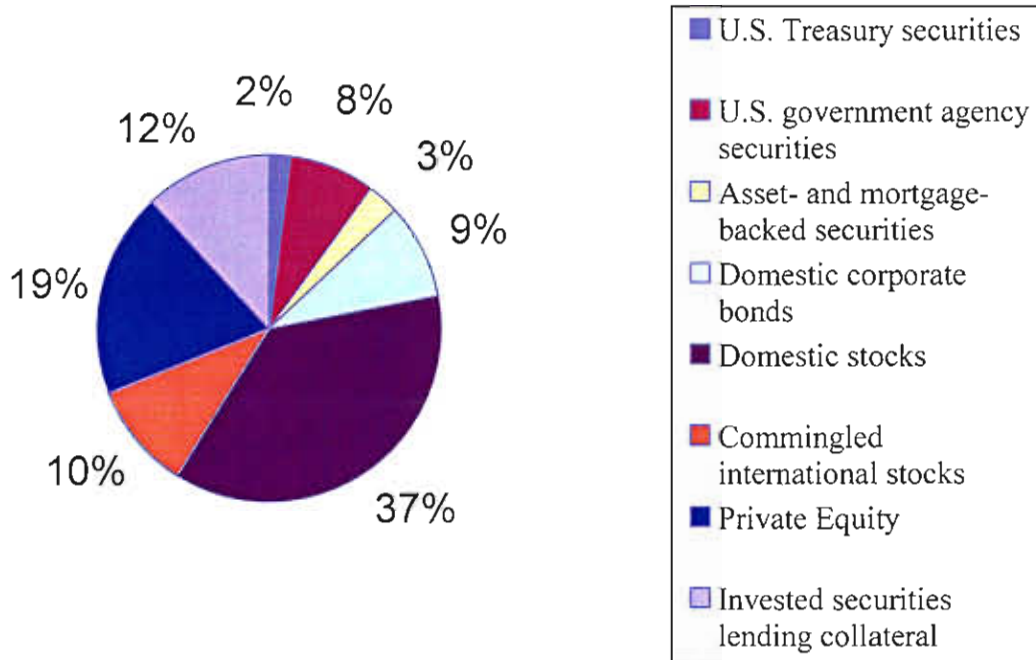
STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2008 And 2007

Statements of Changes in Plan Net Assets

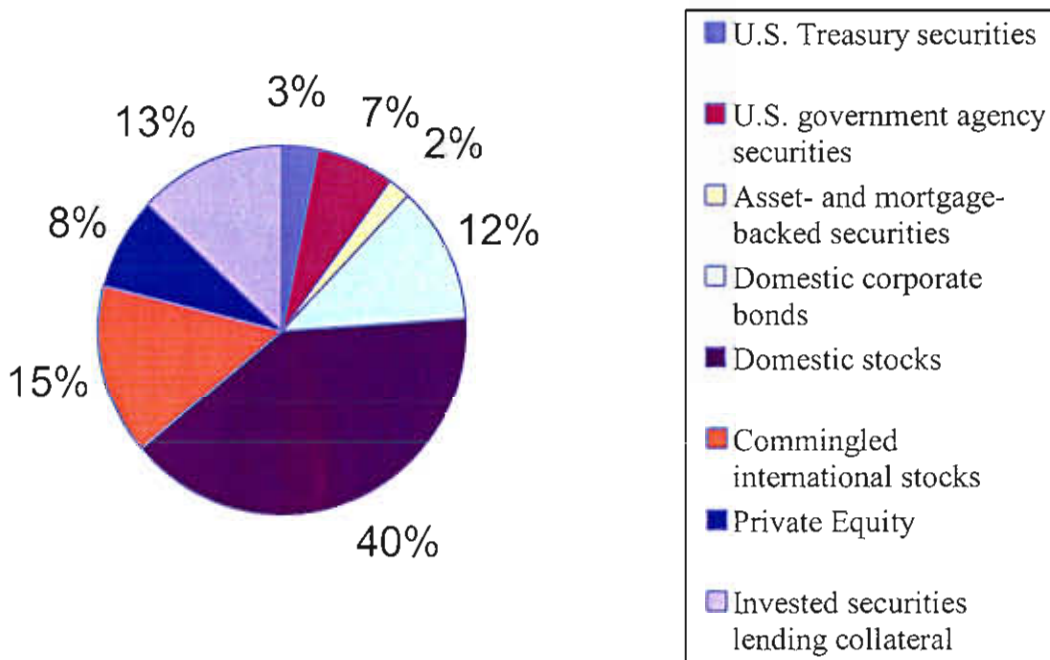
	FY08	FY07	FY06
Contributions	\$ 492,762,295	\$ 445,244,346	\$ 404,700,114
Investment income less investment expenses	217,647,920	182,784,302	171,139,469
Net (decrease) increase or in the fair value of investments	(785,485,191)	1,177,439,939	716,078,283
Other income	<u>3,662,453</u>	<u>4,331,489</u>	<u>3,866,927</u>
Total (decrease) additions	<u>(71,412,523)</u>	<u>1,809,800,076</u>	<u>1,295,784,793</u>
Benefit payments	578,775,611	540,143,723	494,096,614
Refunds	29,475,171	27,525,131	28,305,856
Administrative expenses	<u>6,088,509</u>	<u>5,625,343</u>	<u>5,230,635</u>
Total deductions	<u>614,339,291</u>	<u>573,294,197</u>	<u>527,633,105</u>
Decrease (increase) in net assets	(685,751,814)	1,236,505,879	768,151,688
Net assets held in trust for pension benefits:			
Beginning of year	<u>9,455,795,853</u>	<u>8,219,289,974</u>	<u>7,451,138,286</u>
End of year	<u>\$8,770,044,039</u>	<u>\$9,455,795,853</u>	<u>\$8,219,289,974</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Years Ended June 30, 2008 And 2007

FY08 Investments by Category

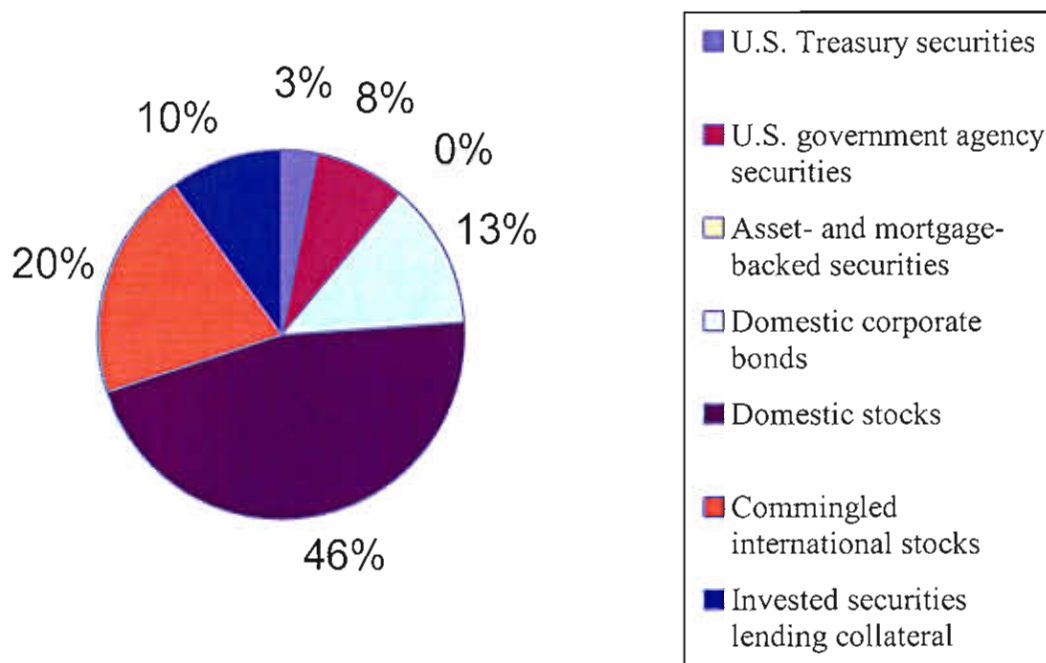


FY07 Investments by Category



STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Years Ended June 30, 2008 And 2007

FY06 Investments by Category



BUDGETARY HIGHLIGHTS

A major portion of the Board's contractual services are based on market performance, and the budget is established to absorb all expenses that may be incurred during the period. These initial budget estimates may be adjusted throughout the year, based on market performance, to arrive at a final budget. In 2008, the Board's initial budget was not changed from the original \$30.1 million, compared to an increase in 2007 of \$2.7 million from \$29.5 million to \$32.2 million. As the corpus of the fund increases, more assets are under management, which, combined with better performance, results in increased income and associated fees. The Board had savings over budgeted amounts totaling \$3.8 million in the three expense categories during the 2008 fiscal year compared to a savings of \$6.6 million in 2007. Savings generally result from less-than-expected income and expenses.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Years Ended June 30, 2008 And 2007

CAPITAL ASSETS

The Net Investment in Capital Assets at June 30, 2008, 2007 and 2006, is as follows:

Description	Cost	Accumulated Depreciation	Book Value
2008			
Land	\$ 248,172	\$ -	\$ 248,172
Depreciable land improvements	19,361	(2,412)	16,949
Capital assets in progress	1,176,211	-	1,176,211
Integrated Retirement Information System	9,156,963	(1,954,689)	7,202,274
Building and building improvements	2,151,067	(1,011,482)	1,139,585
Furniture and equipment	<u>1,078,738</u>	<u>(740,461)</u>	<u>338,277</u>
Total	<u>\$ 13,830,512</u>	<u>\$ (3,709,044)</u>	<u>\$ 10,121,468</u>
2007:			
Land	\$ 248,172	\$ -	\$ 248,172
Depreciable land improvements	1,875	(1,688)	187
Capital assets in progress	-	-	-
Integrated Retirement Information System	6,396,673	(629,350)	5,767,323
Building and building improvements	2,151,067	(846,467)	1,304,600
Furniture and equipment	<u>1,087,812</u>	<u>(879,145)</u>	<u>208,667</u>
Total	<u>\$ 9,885,599</u>	<u>\$ (2,356,650)</u>	<u>\$ 7,528,949</u>
2006:			
Land	\$ 248,172	\$ -	\$ 248,172
Depreciable land improvements	1,875	(1,688)	187
Capital assets in progress	5,507,158	-	5,507,158
Integrated Retirement Information System	-	-	-
Building and building improvements	2,151,067	(846,467)	1,304,600
Furniture and equipment	<u>1,369,735</u>	<u>(1,001,627)</u>	<u>368,108</u>
Total	<u>\$ 9,278,007</u>	<u>\$ (1,849,782)</u>	<u>\$ 7,428,225</u>

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENTS OF PLAN NET ASSETS
June 30, 2008

	2008	2007
Assets		
Cash and short-term investments	\$ 346,040,280	316,614,628
Receivables		
Contributions	66,582,666	61,056,485
Investment sales proceeds-brokers	286,904,399	887,335,140
Interest and dividends	31,018,123	30,243,773
Other	123,517	16,054
Total receivables	384,628,705	978,651,452
Investment in State General Fund Investment Pool	4,990,356	11,124,535
Investments, at fair value		
U. S. Treasury securities	166,650,949	303,532,895
Government agency securities	764,776,546	734,331,062
Asset and mortgage backed securities	280,538,993	195,679,860
Domestic corporate bonds	1,257,449,902	1,279,739,340
Domestic stocks	3,546,803,558	4,131,581,536
International stocks	1,583,681,765	478,391,144
Commingled international stocks	-	1,065,398,395
Private Equity	93,682,458	788,481,795
Hedge Funds	722,726,369	-
Private Real Estate	34,450,129	-
Other Investments	2,564,355	-
Invested securities lending collateral	1,122,436,801	1,321,529,618
Total investments	9,575,761,825	10,298,665,645
Capital assets, net of accumulated depreciation of \$3,709,044 and \$2,356,650, respectively	8,945,257	6,639,434
Capital assets in progress	1,176,211	889,515
Total capital assets	10,121,468	7,528,949
Total assets	\$ 10,321,542,634	11,612,585,209
Liabilities		
Accounts payable	\$ 5,490,449	4,953,293
Accounts payable school contributions	65,780	192,803
Accrued payroll and employee benefits	150,596	141,573
Accrued compensated absences	211,914	191,487
Due to other state agencies	-	894,778
Refunds payable	1,684,509	1,432,279
Investment purchases payable	407,395,504	826,760,776
Funds held for others	136,133	692,749
Securities lending collateral	1,136,363,710	1,321,529,618
Total liabilities	1,551,498,595	2,156,789,356
Net assets held in trust for pension benefits (A Schedule of Funding Progress is presented on page 41)	\$ 8,770,044,039	9,455,795,853

EDUCATIONAL RETIREMENT BOARD
STATEMENTS OF CHANGES IN PLAN NET ASSETS
Years Ended June 30, 2008 and 2007

	2008	2007
Additions		
Contributions		
Employer	\$ 290,846,065	255,853,194
Member	201,916,230	189,391,152
Total contributions	<u>492,762,295</u>	<u>445,244,346</u>
Investment income from investing activities		
Net (decrease) increase in fair value of investments	(785,485,191)	1,177,439,939
Interest income	158,600,235	116,890,199
Dividend income	73,576,472	84,403,825
Total investing activity (loss) gain	<u>(553,308,484)</u>	<u>1,378,733,963</u>
Investing activity expenses:		
Investment advisor fees	(19,700,796)	(20,430,023)
Custody fees	(692,531)	(406,448)
Total investing activity expenses	<u>(20,393,327)</u>	<u>(20,836,471)</u>
Net (loss) gain from investing activities	<u>(573,701,811)</u>	<u>1,357,897,492</u>
From securities lending activities		
Securities lending income	64,146,240	70,512,958
Securities lending expenses:		
Borrower rebates	(57,443,914)	(67,853,821)
Agent fees	(837,786)	(332,388)
Total securities lending expenses	<u>(58,281,700)</u>	<u>(68,186,209)</u>
Net income from securities lending activities	5,864,540	2,326,749
Total net investment (loss) gain	<u>(567,837,271)</u>	<u>1,360,224,241</u>
Miscellaneous Income		
Penalties	22,072	64,936
Interest on restoration of service	3,443,975	4,266,553
Other	196,406	-
Total Miscellaneous Income	<u>3,662,453</u>	<u>4,331,489</u>
Total (decrease) additions	(71,412,523)	1,809,800,076
Deductions		
Refunds to terminated members	23,729,865	23,335,088
Interest on refunds	5,745,306	4,190,043
Administrative expenses	6,088,509	5,625,343
Age and service benefit payments	572,191,714	533,923,520
Disability benefit payments	6,583,897	6,220,203
Total deductions	<u>614,339,291</u>	<u>573,294,197</u>
Net (decrease) increase	(685,751,814)	1,236,505,879
Net assets held in trust for pension benefits		
Beginning of the year	9,455,795,853	8,219,289,974
End of the year	<u>\$ 8,770,044,039</u>	<u>9,455,795,853</u>

See Accompanying Notes to Financial Statements

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 1. EDUCATIONAL RETIREMENT BOARD

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

Contributing employers to the Plan include the following:

Public schools	90
Universities and colleges	15
Charter schools	61
Special schools	4
State agencies	<u>10</u>
	<u>180</u>

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

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

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

The Board serves 180 employers in the State and has an active and inactive membership of 124,872 and 122,598 in 2008 and 2007, respectively.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 1. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

The status and number of all participants at June 30, 2008 and 2007, consisted of the following:

	2008	2007
(1) Retirees and beneficiaries of deceased retirees currently receiving benefits	31,192	29,969
(2) Inactive members	29,982	29,942
(3) Current active members	63,698	62,687

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

A brief summary of Plan coverage provisions follows:

A member is eligible to retire when one of the following events occurs:

- The member’s age and earned service credit add up to the sum of 75 or more.
- The member’s age is 65 or more with at least five years of earned service credit.
- The member has service credit totaling 25 years or more.

(1) A further requirement to be eligible to retire is that a member must have at least one year of employment after July 1, 1957, and at least five years of contributory employment. Eligible members who have one year of employment after July 1, 1957, but less than the required five years of contributory employment, may contribute to the fund for each year needed. The cost of such contributions is 15.2% of the average salary of the last five years for each year of contributory employment needed plus 3% compounded interest from July 1, 1957, to the date of payment.

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

(3) *Normal Benefit*—There are no reductions to the monthly benefit, and there is no continuing benefit due to a beneficiary or estate, except the balance, if any, of contributions less benefits paid.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 1. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

- (4) *Optional Forms of Payment*—There are two optional forms of payment available: Option B or Option C. The benefit reduction with an Option B or C form of payment depends on the age of the member and the age of the beneficiary at the time of retirement. The form of payment election and the beneficiary designated to receive a survivor's benefit are irrevocable. Details of Options B and C are as follows:

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

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

- (5) *Cost of Living Adjustment*—Retired members and surviving beneficiaries receiving benefits receive an automatic cost of living adjustment ("COLA") in their benefit each July 1, beginning in the year the member attains or would have attained age 65. The adjustment is equal to one-half the change in the Consumer Price Index ("CPI"), except that the COLA shall not exceed 4% or be less than 2%, unless the change in CPI is less than 2%, in which case, the COLA would equal the change in CPI. Members retired prior to July 1, 1984, are also entitled to an increase of the lesser of 3% or the increase in CPI for years prior to the attainment of age 65. Members on disability retirement are entitled to a COLA commencing on July 1 of the third full year following disability retirement. A member on regular retirement who can prove retirement because of a disability may qualify for a COLA beginning July 1 in the third full year of retirement.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 1. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

(6) *Disability Retirement:*

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

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

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

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

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

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

Alternative Retirement Plan - The New Mexico legislature established the Alternative Retirement Plan ("ARP") through the enactment of NMSA 1978, Sections 22-11- 47 through 52. In contrast to the regular defined benefit plan administered by the Educational Retirement Board ("ERB"), the ARP is a defined contribution plan. Beginning on July 1, 1991 at the State's six institutions of higher education, and July 1, 1999 at the State's eight community colleges (the colleges and universities are referred to as the "qualifying state educational institutions"), certain faculty and professional employees in eligible positions have the option of electing to participate in the ARP in lieu of participating in the regular defined benefit plan. Information about the ARP is provided to eligible employees by their employers. Employees must make the election to participate in the ARP within 90 days of employment; those who do not elect to participate in the plan become members of the regular defined benefit plan.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 1. EDUCATIONAL RETIREMENT BOARD (CONTINUED)

Pursuant to statute, ARP retirement benefits may be only in the form of a lifetime annuity, except in the case of death, when single sum cash payments are allowed. Two carriers have been approved to offer annuities to the participants: Teachers Insurance and Annuity Association/College Retirement Equities Fund ("TIAA-CREF"), and Variable Annuity Life Insurance Company ("VALIC" or "AIG VALIC," now known as "AIG Retirement"). Employees are allowed to transfer between carriers once each year.

For the year ended June 30, 2008, employees under the ARP contribute 7.825% of their gross salaries. The colleges and universities are required to contribute 7.9% to the carrier on behalf of the participant and 3% to the regular defined benefit plan to help fund the unfunded accrued actuarial liability. The 3% fee remitted to ERB for the years ended June 30, 2008, 2007 and 2006 was \$4,469,033, \$3,806,933, and \$3,612,499, respectively.

The 3% fee does not provide retirement benefits. The colleges and universities are responsible for submitting the employers' and the employees' contributions directly to the annuity carriers. Vesting is immediate for all contributions.

As noted above, the ARP is a defined contribution plan; benefits are determined strictly by contributions made and earnings on contributions. Participating employees are responsible for, and accept the risks of, selecting investments from those offered by the carriers and for managing their investments. Retirement benefits are computed and paid by the annuity carriers; the ERB does not compute or pay the retirement benefits. If a participant seeks to retire due to disability, the annuity carrier determines the disability and computes the lifetime annuity.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

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

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

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

The original budget was not amended during the fiscal year.

The Board follows these procedures in establishing the annual budget:

- (1) By August 31, the Board prepares a Budget Appropriation Request to be presented to the next legislature. The Request includes proposed expenses and the means of financing them.
- (2) On September 1, the Budget Appropriation Request is submitted to the Department of Finance and Administration (“DFA”) and the LFC.
- (3) The DFA makes recommendations and adjustments to the Board’s Budget Appropriation Request, which becomes the Governor’s proposal to the Legislature.
- (4) The LFC holds hearings on the Budget Appropriation Request. Recommendations and adjustments are made prior to presenting the Budget Appropriation Request to the Legislature.
- (5) Both the DFA’s and the LFC’s recommended appropriation proposals are presented to the Legislature for approval of the final budget.
- (6) On May 1, the Board submits its Annual Operating Budget to the DFA and the LFC based on the final appropriation from the Legislature.
- (7) Budgetary control is exercised at the appropriation unit level (revenue source and expenditure category), and any changes between budget categories must be approved by the DFA and the LFC.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Investments— Investments are recorded at fair value. The estimated fair value of investments is based on quoted market prices, except for certain alternative investments for which quoted market prices are not available. The estimated fair value of these alternative investments is based on the most recent valuations provided by the external investment managers, adjusted for cash receipts, cash disbursements, and securities distributions through June 30, 2008. The Board believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed.

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

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

The Board's investments in limited partnerships are valued at estimated fair value based on their proportionate share of the partnerships' fair value as recorded in the partnerships' audited financial statements. The limited partnerships allocate gains, losses and expenses to the partners based on the ownership percentage as described in the partnership agreements. At June 30, 2008, the Board had commitments for additional future contributions to the limited partnerships totaling \$361.9 million.

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

Capital Assets—Capital assets represent the cost of assets, net of accumulated depreciation, used for the administration of the Plan. Capital assets include the Board's administration building located in Santa Fe, New Mexico. The Board's capitalization policy, based on the requirements from the DFA, is to include all assets with a useful life of more than one year and costing \$5,000 and greater. All additions are capitalized at historical cost as of the date of acquisition, and depreciation is calculated on a straight-line basis over the asset's estimated useful life with no salvage value.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

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

Estimated useful lives are as follows:

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

Funds Held for Others—Payments from members pursuant to agreements to purchase service credits are recorded as funds held for others until the purchase agreements have been completed. Upon receipt of all payments necessary to complete the purchase agreement, the funds held for others are transferred to the member's individual contribution account (for the contribution component) and income accounts (for the interest component(s)).

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

**NOTE 3. INTEREST IN STATE GENERAL FUND INVESTMENT POOL AND
CASH DEPOSITS**

Investment in State General Fund Investment Pool

The Board is required by statute to remit any money received for or on behalf of the Plan into its own account at the New Mexico State Treasury. Excess money at the end of the day in the Board's account at the New Mexico State Treasury is pooled and invested by the Office of the New Mexico State Treasurer in overnight repurchase agreements. Accordingly the investments of the Department consist of an interest in the investment pools managed by the New Mexico State Treasurer's Office. All repurchase agreements are collateralized by the U.S. Treasury securities held by the New Mexico State Treasurer's custodian bank. The amount deposited as of June 30, 2008 and 2007 with the New Mexico State Treasurer's Office was \$4,990,356 and \$11,124,535, respectively.

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

Credit risk - The New Mexico State Treasurer pools are not rated. For additional GASB 40 disclosure information regarding cash held by the State Treasurer, the reader should see the separate audit report for the State Treasurer's Office for the fiscal year ended June 30, 2008.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

**NOTE 3. INTEREST IN STATE GENERAL FUND INVESTMENT POOL AND
CASH DEPOSITS (CONTINUED)**

Cash Deposits

In addition to the overnight investment at the New Mexico State Treasury, the Board invests in the Short-Term Investment Fund ("STIF"), held by Northern Trust. The STIF is used to facilitate more efficient trade procedures with the Board's external money managers. Net cash balances in each internal and external investment manager's portfolio are swept into the STIF at the end of each day. STIF investments and cash of \$346,040,280 and \$316,614,628 as of June 30, 2008 and 2007, respectively, are considered cash equivalents and are reported as cash and short term investments balances in the statements of plan net assets.

Custodial Credit Risk - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Board will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Board does not have a deposit policy for custodial credit risk. As of June 30, 2008 and 2007, there were no cash balances exposed to custodial credit risk. All cash is invested in a mutual fund consisting of 100% U.S. Treasury securities.

NOTE 4. INVESTMENTS

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

The Uniform Prudent Investor Act does the following:

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

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

Investments of the Board as of June 30, 2008 and 2007 were as follows:

Investment Description	2008	2007
Investments held by the Board's agent in the name of the Board:		
U.S. Government and Agency Securities	\$ 502,464,238	445,039,338
Asset and Mortgage Backed Securities	280,538,993	195,679,860
Domestic Corporate Bonds	1,250,967,283	1,246,249,969
Domestic Stocks	2,885,840,099	3,310,096,751
International Stocks	1,580,072,169	478,391,144
Hedge Funds	722,726,369	-
Private Equity	93,682,458	-
Private Real Estate	34,450,129	-
Other Investments	2,564,355	788,481,795
Total	<u>7,353,306,092</u>	<u>6,463,938,857</u>
Commingled International Stocks	-	<u>1,065,398,395</u>
Investments Held by Broker/Dealers Under Securities Loaned with Cash Collateral:		
U.S. Governments and Agency Securities	428,963,257	592,824,619
Domestic Corporate Bonds	6,482,619	33,489,371
Domestic Stocks	660,963,459	821,484,785
International Equities	3,609,596	-
Securities Lending Collateral Investments	1,122,436,801	1,321,529,618
Total	<u>2,222,455,732</u>	<u>2,769,328,393</u>
Total Investments	<u>\$ 9,575,761,825</u>	<u>10,298,665,645</u>

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

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

Foreign Currency Risk—Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the investments. Foreign currency risk is present in the Board's investment in foreign equity securities. Managers of these assets are given discretion to hedge this risk. The maximum exposure to foreign currency risk as of June 30, 2008 was approximately \$1,984,666,000. The Board's investment exposure to foreign currency risk as June 30, 2007 was approximately \$2,273,286,000.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

Exposure to foreign currency risk as of June 30, 2008 is as follows:

Currency	Equity Securities	Cash (overdraft)
Argentina	\$ 3,598,292	1,140
Australia	67,369,716	-
Austria	1,799,884	-
Bahrain	548,118	-
Belgium	16,359,710	-
Brazil	57,755,377	145,574
Canada	5,218,173	93,031
Chile	2,032,964	22,699
China	34,147,326	162,404
Czech Republic	2,160,134	1,645
Denmark	14,133,430	-
Egypt	723,768	25,327
Finland	6,228,028	-
France	124,765,662	-
Germany	119,783,125	-
Greece	8,992,672	1,257,396
Hong Kong	11,999,226	114,938
Hungary	1	14,873
India	12,854,696	571,434
Indonesia	4,154,401	-
Ireland	1,799,884	-
Israel	11,794,390	43,314
Italy	34,904,900	-
Japan	227,673,807	2,164,023
Korea	12,887,198	-
Luxembourg	20,908,442	-
Malaysia	1,512,106	45
Mexico	12,680,087	47,306
Netherlands	52,846,486	-
Norway	26,668,209	(455,260)
Peru	2,777,227	-
Philippines	1,061,864	27,618
Poland	3,005,176	19,018
Portugal	4,799,690	-
Russia	34,278,810	-
Singapore	27,203,008	-
South Africa	23,069,808	99,087
South Korea	32,595,424	357,039
Spain	37,606,144	-
Sweden	10,936,111	-
Switzerland	83,538,453	294,974
Taiwan	26,400,950	306,218
Thailand	9,304,029	-
Turkey	2,401,575	105,210
United Kingdom	260,679,503	(1,168,490)
United Arab Emirates	939,230	-
Total Foreign Exposure	1,458,897,214	4,250,563
Investments Not Subject to Foreign Currency Risk	8,116,864,611	341,789,717
Total Investments	<u>\$ 9,575,761,825</u>	<u>346,040,280</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

Exposure to foreign currency risk as of June 30, 2007 is as follows:

Currency	Equity Securities	Cash (overdraft)
Argentinean Peso	\$ 2,136,068	-
Australian Dollar	74,668,905	6,321,801
Bahraini Dina	420,836	-
Brazilian Real	35,423,091	(20,478)
British Pound Sterling	404,756,040	-
Canadian Dollar	51,002,677	-
Chile	2,087,425	16,756
Chinese Renminbi	24,748,131	28,920
Czech Republic Koruna	697,386	-
Danish Krone	13,925,613	-
Egypt	1,471,056	19,907
Euro	727,343,272	15,037,860
Hong Kong Dollar	56,625,433	(16,854,288)
Hungarian Forint	2,577,600	-
Indian Rupee	20,294,862	149,203
Indonesian Rupiah	7,503,300	105,885
Israeli Shekels	6,684,166	25,883
Japanese Yen	433,428,404	8,889,662
Malaysian Ringgit	2,165,658	14,394
Mexican Nueva Peso	12,805,570	-
Norwegian Krone	29,804,758	-
Peru	1,594,154	-
Philippine Peso	3,740,950	-
Polish Zloty	468,932	-
Russia	15,592,871	-
Singapore Dollar	43,848,441	70,650
South African Rand	22,121,011	(147,331)
South Korean Won	48,063,137	(287,759)
Swedish Krona	33,154,654	-
Swiss Franc	137,237,501	(1,753)
Taiwan Dollar	33,357,475	862,262
Thailand Baht	6,235,470	-
Turkish Lira	3,040,533	29,469
Total Foreign Exposure	2,259,025,380	14,261,043
Investments Not Subject to Foreign Currency Risk	8,039,640,265	302,353,585
Total Investments	\$ 10,298,665,645	316,614,628

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policies of the Board require that noncash, interest-paying securities in the high-yield bond portfolios may not exceed 5% of the market value of the portfolio and that investments in cash may represent no more than 5% of each individual fund. Credit risk is managed through diversification and by operating within defined parameters versus a benchmark index.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

Excluding those investments issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk, the Board's credit quality distribution for investments with credit risk exposure at of June 30, 2008 and 2007, is summarized below. The investments were rated and categorized according to Standard & Poor's rating standards.

At June 30, 2008:

Investment Type	Rating	Fair Market Value
Asset Backed Securities	A	\$ 5,784,270
	AA	4,800,050
	AAA	43,707,030
	B	2,155,031
	BA	1,562,628
	BAA	1,445,684
	CAA	155,662
Commercial Mortgage-Backed	A	3,655,713
	AA	1,638,153
	AAA	148,236,089
	BAA	544,383
Non-Government Backed C.M.O.s	A	1,465,373
	AA	6,569,844
	AAA	54,866,967
	BAA	3,952,116
Total Asset and Mortgage Backed Securities		<u>280,538,993</u>
Corporate Bonds	A	144,532,066
	AA	116,309,441
	AAA	311,009,183
	B	260,563,455
	BA	89,723,987
	BAA	216,474,203
	BB	23,750,039
	BBB	6,242,770
	C	713,797
	CA	4,501,021
	CAA	59,109,930
	CC	2,533,239
	CCC	1,286,250
	Not Rated	20,837,683
Corporate Convertible Bonds	CAA	86,400
Fixed Income Derivatives - Options	Not Rated	<u>(223,562)</u>
Total Domestic Corporate Bonds		<u>1,257,449,902</u>
Government Agencies	AA	2,992,201
	AAA	66,282,629
Government Mortgage Backed Securities	AAA	618,227,050
Index Linked Government Bonds	AAA	70,058,253
Municipal/Provincial Bonds	AA	639,570
	AAA	1,188,668
Other investments classified as Government Agency Securities but not subject to credit risk		<u>5,388,175</u>
Total Government Agencies		<u>764,776,546</u>
Government Bonds	AAA	162,940,887
	BAA	<u>3,710,063</u>
Total U.S. Treasury Securities		<u>166,650,949</u>
Other Investments Not Subject To Credit Risk		<u>7,106,345,435</u>
TOTAL		<u>\$ 9,575,761,825</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

At June 30, 2007:

Investment Type	Rating	Fair Market Value
Asset Backed Securities	A	\$ 2,394,858
	AA	1,704,727
	AAA	71,448,328
	BBB	2,366,307
Cash & Cash Equivalent Derivative - Options	Not Rated	1,711
Commercial Mortgage-Backed	A	3,276,494
	AA	2,675,335
	AAA	117,438,884
Corporate Bonds	A	98,352,997
	AA	60,381,163
	AAA	321,870,358
	B	286,948,634
	Ba	7,512,675
	Baa	2,406,152
	BB	154,198,158
	BBB	196,026,110
	Caa	4,482,500
	CCC	69,378,065
Fixed Income Derivatives - Options	Not Rated	(215,627)
Government Agencies	Not Rated	7,809,135
	A	2,928,906
	AAA	93,491,962
Government Bonds	BBB	4,502,077
	Not Rated	299,030,818
Government Mortgage Backed Securities	Not Rated	544,069,222
Index Linked Government Bonds	Not Rated	86,675,037
Municipal/Provincial Bonds	A	1,625,107
Non-Government Backed C.M.O.s	A	1,212,001
	AA	1,816,164
	AAA	69,016,693
	BBB	244,290
Other Options		27,042
Other Payable		(1,031,549)
Pending Trade Purchases		(335,314,011)
Pending Trade Sales		59,171,525
Short Term Bills & Notes	Not Rated	1,019,301
	A	899,676
Short Term Investment Funds	Not Rated	217,219,645
Swaps	Not Rated	(388,534)
Other Investments not subject to credit risk		7,841,993,308
TOTAL		<u>\$ 10,298,665,645</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

The Board earns failed interest on monies held at the custodial agent bank overnight when a security purchase transaction fails to be completed due to the broker not delivering the purchase security on settlement date. When this occurs, the Board's money is invested overnight in a "STIF."

Concentration Risk—Concentration risk is identified by the amount of investment in any one issuer that represents 2% or more of plan net assets. The Board's investment policies stipulate that investments in the securities of any one corporation may not exceed 2% of the market value of the total fund. As of June 30, 2008 and 2007, the Board was not exposed to any concentration risk greater than 2%.

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

As of June 30, 2008 and 2007, the Board's exposure to interest rate risk is summarized as:

Investment Type	Amount		Duration (in Years)	
	2008	2007	2008	2007
U.S. Treasury securities	\$ 166,650,949	303,532,896	6.74	6.36
U.S. government and agency obligations	764,776,546	734,331,063	4.00	3.83
Corporate obligations	1,257,449,902	1,279,739,340	5.92	4.50
Asset- and mortgage-backed securities	280,538,993	195,679,860	3.45	4.16
Short-term investment	346,040,280	316,614,628	0.45	0.56
Overall	<u>\$2,815,456,670</u>	<u>2,829,897,787</u>	4.81	4.65

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

Derivative Investing—Derivatives are generally defined as contracts or securities whose value depends on, or derives from, the value of an underlying asset, reference rate, or index. In accordance with investment policy and fiduciary principles, the Plan invests in mortgage-backed securities, including certain agency Collateralized Mortgage Obligations ("CMO"). The plan holds CMOs that are based on cash flows from interest payments on underlying mortgages; therefore, they are sensitive to prepayments by mortgagees that may result from a decline in interest rates. CMO selections are chosen from a conservative segment that offers low volatility. CMO securities are included in aggregate with other U.S. government and agency securities in the disclosure of custodial risk above. In addition, the use of other derivatives is allowed under the Hedge Fund Investment Policy. The Plan had \$103 million and \$195 million in CMO government and non-government securities at June 30, 2008 and 2007, respectively.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

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

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

During 2008, the Board was a party to futures contracts held for trading purposes for U.S. Treasury bonds and 90 day Euro dollar fixed income futures. Upon entering into a futures contract, the Board is required to deposit either in cash or securities an amount (“initial margin”) equal to a certain percentage of the nominal value of the contract. Subsequent payments are then made or received by the Board, depending on the daily fluctuation in the value of the underlying contracts. FNMA Discount Notes owned and included in the investments of the Board, with a value of approximately \$1,940,744 and \$975,000 at June 30, 2008 and 2007, respectively, were held by the Plan’s brokers as performance security on futures contracts.

FY 08		
Summary of Outstanding Futures Contracts		
	<u>No. of Contracts</u>	<u>Notional Amount</u>
Futures Contracts - Long	944	\$ 123,256,836
Futures Contracts - Short	885	\$ 885,000,000
		<u>Fair Value</u>
Margin Deposit		\$ 1,940,744

FY 07		
Summary of Outstanding Futures Contracts		
	<u>No. of Contracts</u>	<u>Notional Amount</u>
Futures Contracts - Long	725	\$ 147,875,597
Futures Contracts - Short	320	\$ 33,724,252
		<u>Fair Value</u>
Margin Deposit		\$ 974,719

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 4. INVESTMENTS (CONTINUED)

Options – An option contract is a contract in which the writer of the option grants the buyer of the option the right to purchase from (“call option”), or sell to (“put option”), the writer a designated instrument at a specified price within a specified period of time. Both written and purchased options were used by the Board during 2008. When the Board purchases or writes an option, an amount equal to the premium paid or received by the plan is recorded as an asset or liability and is subsequently adjusted to the current market value of the option purchased or written. Gain or loss is recognized when the option contract expires or is closed. As of June 30, 2008, the value of open written and purchased options was approximately \$452,100 and \$457,300, respectively. As of June 30, 2007, the value of open written and purchased options was approximately \$268,000, and \$ 96,000, respectively.

Swap Contracts — Swap contracts are executed on a number of different bases. The two types employed by ERB on June 30, 2008, were interest rate swap contracts and credit default swap contract. An interest rate swap contract is an agreement between two parties to exchange periodic interest payments. One party agrees to make payments to the other based on a fixed rate of interest in exchange for payments based on a variable rate. ERB employs interest rate swap contracts to adjust fixed income portfolio durations.

A credit default swap contract is similar to an insurance policy, with the credit risk of an individual issuer or a basket of issuers (the “reference asset”) the insured factor. Under such a contract, two parties enter into an agreement whereby the first party pays the second party a fixed periodic payment for the specified life of the contract (analogous to an insurance premium). The other party makes no payment unless a credit event related to the reference asset occurs. If such an event takes place, the second party is obligated to make a payment to the first party. The size of the payment is linked to the decline in the reference asset’s market value following determination of the occurrence of a credit event.

NOTE 5. SECURITIES LENDING

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

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 5. SECURITIES LENDING (CONTINUED)

may authorize payment of a fee from the Plan or from income generated by the investment of cash collateral to the borrower of securities providing cash as collateral. The Board may apportion income derived from the investment of cash collateral to pay its agent in securities lending transactions.

At year-end, the Board has no net credit risk exposure to borrowers, because the amounts the Board owes the borrowers exceed the amount the borrowers owe the Board. The contract with the Board's agent requires it to indemnify the Board fully if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Board for income distributions by the securities' issuers while the securities are on loan. The Board has not experienced any losses due to credit or market risk on securities lending activities since the implementation of this program. The Board received net securities lending income totaling \$5,864,540 and \$2,326,749 for the fiscal years ended June 30, 2008 and 2007, respectively. The collateral information as of June 30, 2008 and 2007 is summarized as follows:

Securities On Loan	Underlying Securities	Collateral Received	Collateral Investment Value
2008:			
Lent for cash collateral:			
U.S. Government & Agency Sec.	\$ 428,963,257	439,746,944	3,361,287
U.S. Equities	660,963,459	684,465,920	-
Int'l Equities	3,609,596	3,654,604	-
U.S. Corporate Obligations with Variable Rates	6,482,619	6,689,320	438,875,515
Asset-Backed Sec. with Variable Rates	-	-	397,199,999
Repurchase Agreements	-	-	283,000,000
	<u>\$ 1,100,018,931</u>	<u>1,134,556,788</u>	<u>1,122,436,801</u>
2007:			
Lent for cash collateral:			
U.S. Government & Agency Sec.	\$ 592,824,619	604,143,893	-
U.S. Equities	821,484,786	850,584,826	-
Int'l Equities	-	-	-
U.S. Corporate Obligations with Variable Rates	33,489,371	34,240,250	570,748,618
Asset-Backed Sec. with Variable Rates	-	-	400,781,000
Repurchase Agreements	-	-	350,000,000
	<u>\$ 1,447,798,776</u>	<u>1,488,968,969</u>	<u>1,321,529,618</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 5. SECURITIES LENDING (CONTINUED)

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

NOTE 6. CAPITAL ASSETS

Capital assets relate to all assets of the Board that are used in operations and have useful lives extending beyond a single reporting period. Capital assets in progress in 2007 represent costs associated with the IRIS Project. With project completion in 2008, these costs were transferred to a separate asset classification. Capital assets in progress at June 30, 2008 represent costs to date on the second phase of the addition and modifications to the Santa Fe offices.

Depreciation expense was \$1,503,248 and \$822,041 for 2008 and 2007, respectively.

Capital asset activity for the years ended June 30, 2008 and 2007 is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
2008:				
Land	\$ 248,172	-	-	248,172
Capital assets in progress	6,396,673	1,176,211	6,396,673	1,176,211
Depreciable land improvements	1,875	17,486	-	19,361
Building and building improvements	2,151,067	-	-	2,151,067
Furniture and equipment	1,087,812	141,779	150,853	1,078,738
Integrated Retirement Information System (IRIS)	-	9,156,963	-	9,156,963
	<u>9,885,599</u>	<u>10,492,439</u>	<u>6,547,526</u>	<u>13,830,512</u>
Accumulated depreciation:				
Capital Assets In Progress	629,350	-	(629,350)	-
Depreciable land improvements	1,688	724	-	2,412
Building and building improvements	846,467	165,015	-	1,011,482
Furniture and equipment	879,145	12,170	150,854	740,461
Integrated Retirement Information System (IRIS)	-	1,325,339	629,350	1,954,689
	<u>2,356,650</u>	<u>1,503,248</u>	<u>150,854</u>	<u>3,709,044</u>
Capital assets—net	<u>\$ 7,528,949</u>	<u>8,989,191</u>	<u>6,396,672</u>	<u>10,121,468</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 6. CAPITAL ASSETS (CONTINUED)

	Beginning Balance	Additions	Deletions	Ending Balance
2007				
Land	\$ 248,172	\$ -	\$ -	\$ 248,172
Capital assets in progress	5,507,158	889,515	-	6,396,673
Depreciable land improvements	1,875	-	-	1,875
Building and building improvements	2,151,067	-	-	2,151,067
Furniture and equipment	1,369,735	34,446	316,369	1,087,812
Total	<u>9,278,007</u>	<u>923,961</u>	<u>316,369</u>	<u>9,885,599</u>
Accumulated depreciation:				
Capital Assets In Progress	-	629,350	-	629,350
Depreciable land improvements	1,688	-	-	1,688
Building and building improvements	846,467	-	-	846,467
Furniture and equipment	1,001,627	192,691	315,173	879,145
Total	<u>1,849,782</u>	<u>822,041</u>	<u>315,173</u>	<u>2,356,650</u>
Capital assets—net	<u>\$ 7,428,225</u>	<u>\$ 101,920</u>	<u>\$ 1,196</u>	<u>\$ 7,528,949</u>

NOTE 7. DUE TO EMPLOYERS AND OTHER STATE AGENCIES

This account represents the amount due to various participating public employers for over remittances of employer contributions during the fiscal years ended June 30, 2008 and 2007. Over remittances can be applied to future reporting periods or refunded, at the option of the administrative unit, in the next fiscal year. Also included in this amount as of June 30, 2007 is \$11,852 due to the Department of Cultural Affairs/Art in Public Places. There were no amounts due to other state agencies as of June 30, 2008.

NOTE 8. ACCRUED COMPENSATED ABSENCES

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

When employees terminate employment with the State, they are compensated for accumulated vacation leave as of the termination date, up to a maximum of 240 hours. All balances up to 240 hours for each employee have been recorded at their current pay rate as of June 30, 2008 and 2007.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 8. ACCRUED COMPENSATED ABSENCES (CONTINUED)

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

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

The following table provides a summary for the fiscal years ended June 30, 2008 and 2007, of the change in accrued compensated absences:

	2008	2007
Balance payable—beginning of fiscal year	\$ 191,487	\$ 159,477
Additions	393,557	140,098
Deletions	<u>(373,130)</u>	<u>(108,088)</u>
Balance payable—end of fiscal year	<u>\$ 211,914</u>	<u>\$ 191,487</u>
Amount due within one year, estimated at 97%	<u>\$ 205,557</u>	<u>\$ 185,742</u>

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

NOTE 9. LEASES

The Board leases mailing and copier equipment, office space, and storage space under operating leases. Operating leases do not give rise to property rights or leases obligations; therefore, the amounts of the Board's lease agreements are not reflected on the statements of plan net assets.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 9. LEASES (CONTINUED)

Leases are subject to future appropriations and are cancelable by the Board at the end of each fiscal year with 30 days' written notice to the lessor. The following table as of June 30, 2008, summarizes the Board's future minimum lease payments:

Years Ending June 30	
2009	\$ 78,183
2010	65,584
2011	<u>8,029</u>
Total	<u>\$151,796</u>

Lease expense was \$77,189 and \$71,111 for the fiscal years ended June 30, 2008 and 2007, respectively.

NOTE 10. RETIREMENT PLANS

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

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

Funding Policy. Plan members are required to contribute 7.42% of their gross salary. The Board is required to contribute 16.59% of the gross covered salary. The contribution requirements of plan members and the Board are established in State statute under Chapter 10, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The plan members and Board's contributions to PERA for the fiscal years ending June 30, 2008, 2007 and 2006 were \$606,265, \$515,435, and \$431,566, respectively, which equal the amount of the required contributions for each fiscal year.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

NOTE 10. RETIREMENT PLANS (CONTINUED)

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

Funding Policy. Plan members are required to contribute 7.825% of their gross salary. The Board is required to contribute 10.9% of the gross covered salary. Effective July 1, 2008, plan members are required to contribute 7.9% of their gross salary. The employer contribution will increase .75% each year until July 1, 2011 when the employer contribution will be 13.9%. The contribution requirements of plan members and the Board are established in State statute under Chapter 22, Article 11, NMSA 1978. The requirements may be amended by acts of the legislature. The plan member's and Board's contributions to ERB for the fiscal years ending June 30, 2008, 2007, and 2006, were \$2,590, \$13,134, and \$35,859, respectively, which equal the amount of the required contributions for each fiscal year.

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

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

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

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008 and 2007

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

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

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

The Retiree Health Care Act (Section 10-7C-15, NMSA 1978) is the statutory authority that establishes the required contributions of participating employers and their employees. The statute requires each participating employer to contribute 1.3% of each participating employee's annual salary; each participating employee is required to contribute .65% of their salary. Employers joining the program after 1/1/1998 are also required to make a surplus-amount contribution to the RHCA based on one of two formulas at agreed-upon intervals.

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

The Board's contributions to the RHCA for the years ending June 30, 2008, 2007 and 2006 were \$31,255, \$27,267, and \$25,022 for employer contributions and \$15,268, \$13,634, \$12,515 in employee contributions, respectively, which equal the required contributions for each year.

NOTE 12. RISK MANAGEMENT

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

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 13. STATUTORY DISCLOSURES

Section 2.2.2.10P(2) of the Audit Rule 2008, 2.2.2 NMAC entitled, "Requirements for Contracting and Conducting Audits of Agencies" requires that state agencies disclose all special, deficiency, and specific appropriations. The Board received the following specific appropriations:

Building Remodel/Addition

Laws of 2000, 2nd S.S., Chapter 23, Section 29	\$ 750,000
Expended in FY 2001	(8,389)
Encumbered in FY 2001	<u>(63,999)</u>
Rebudgeted in FY 2002	677,612
Outstanding encumbrance from 2001	63,999
Expended in FY 2002	(8,624)
Encumbered in FY 2002	(46,986)
Rebudgeted in FY 2003	686,001
Outstanding encumbrance from 2002	46,986
Expended in FY 2003	(9,490)
Encumbered in FY 2003	(74,744)
Rebudgeted in FY 2004	648,753
Outstanding encumbrance from 2003	74,744
Expended in FY 2004	(13,871)
Encumbered in FY 2004	<u>(60,873)</u>
Rebudgeted in FY 2005	648,753
Outstanding encumbrance from 2004	60,873
Laws of 2002, Chapter 110, Section 58	500,000
Expended in FY 2005	(913,525)
Encumbered in FY 2005	<u>(50,769)</u>
Rebudgeted in FY 2006	245,332
Outstanding encumbrance from 2005	50,769
Expended in FY 2006	(71,885)
Encumbered in FY 2006, but then unencumbered and restored to ERB	(1,055)
Rebudgeted in FY 2007	223,161
Laws of 2006, Chapter 111, Section 71	500,000
Laws of 2007, Chapter 42, Section 90	1,185,188
Expended in FY 2007	(125,024)
Encumbered in FY 2007	(702,262)
Rebudgeted in FY 2008	1,081,063
Outstanding encumbrance from 2007	702,262
Expended in FY 2008	(883,174)
Encumbered in FY 2008	<u>(3,112)</u>
Unencumbered Balance June 30, 2008	<u>\$ 897,039</u>

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 13. STATUTORY DISCLOSURES

Pension Information Management System (IRIS)

Laws of 2000, Second Special Session/Chapter 5, Section 8	\$ 3,000,000
Expended in FY 2001	(38,007)
Encumbered in FY 2001	<u>(41,514)</u>
Rebudgeted in FY 2002	2,920,479
Outstanding encumbrance from 2001	41,514
Expended in FY 2002	(2,166,943)
Encumbered in FY 2002	<u>(795,050)</u>
Rebudgeted in FY 2003	-
Outstanding encumbrance from 2002	795,050
Expended in FY 2003	(795,050)
Encumbered in FY 2003	<u>-</u>
Funding fully used	-
Laws of 2001 Second Session/Chapter 64, Section B	3,000,000
Expended in FY 2002	-
Encumbered in FY 2002	<u>(1,281,812)</u>
Rebudgeted in FY 2003	1,718,188
Outstanding encumbrance from 2002	1,281,812
Expended in FY 2003	(871,639)
Encumbered in FY 2003	<u>(1,206,353)</u>
Rebudgeted in FY 2004	922,008
Outstanding encumbrance from 2003	1,206,353
Expended in FY 2004	(539,007)
Encumbered in FY 2004	<u>(1,589,354)</u>
Rebudgeted in FY 2005	-
Outstanding encumbrance from 2004	1,589,354
Expended in FY 2005	(784,481)
Expended in FY 2006	(804,873)
Encumbered in FY 2006	<u>-</u>
Funding fully used	-
Laws of 2002 Second Session/Chapter 4, Section 7, Item 11	2,000,000
Expended in FY 2004	-
Encumbered in FY 2004	<u>(1,607,110)</u>
Rebudgeted in FY 2005	392,890
Outstanding encumbrance from 2004	1,607,110
Expended in FY 2005	(769,168)
Encumbered in FY 2005	<u>(286,848)</u>
Rebudgeted in FY 2006	943,984

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2008 and 2007

NOTE 13. STATUTORY DISCLOSURES (CONTINUED)

Pension Information Management System (IRIS) (Continued)

Outstanding encumbrance from 2005	\$ 286,848
Expended in FY 2006	<u>(37,973)</u>
Rebudgeted in FY 2007	1,192,859
Rebudgeted from FY 2006	1,192,859
Expended in FY 2007	(889,515)
Encumbered in FY 2007	<u>(50,255)</u>
Unused funding restored to ERB	253,089
Laws of 2004, Second Session/Chapter 114, Section 8, Item 16	750,000
Encumbered in FY 2007	<u>(750,000)</u>
Unencumbered balance – June 30, 2007	-
Outstanding Encumbrance from FY 2007	750,000
Laws of 2005, Second Session/Chapter 33, Section 7, Item 5	300,000
Encumbered in FY 2007	<u>(28,072)</u>
Unencumbered balance – June 30, 2007	1,021,928
Outstanding Encumbrance from FY 2007	28,072
Laws of 2007, Second Session/Chapter 28, Section 7, Item 12	<u>750,000</u>
Unencumbered balance – June 30, 2007	1,800,000
Expended in FY 2008	<u>(1,461,412)</u>
Unused funding restored to ERB	<u>\$ 338,588</u>

The final phase of the IRIS Project implementation was completed in FY 2008. Any unspent amounts of the above specific appropriations revert to the Educational Employees' Retirement Fund, the source of the funding, and not to the State General Fund.

NOTE 14. SUBSEQUENT EVENTS

During 2008, financial markets as a whole have incurred significant declines in values. ERB's investment portfolio has also incurred a significant decline in the values reported in the accompanying financial statements. However, because the values of individual investments fluctuate with market conditions, the amount of losses that ERB will recognize in future financial statements, if any, cannot be determined. ERB has invested the cash collateral from securities. With the financial markets being extremely volatile and significant declines in values that are occurring, ERB could have a potential loss on these collateral investments resulting in ERB liquidating assets to offset the loss.

As part of ERB's overall investment plan, ERB allocated approximately 10% of its assets to hedge funds. One of ERB's hedge fund managers invested in a fund managed by Bernard Madoff. As the press has widely reported, Mr. Madoff is alleged to have committed fraud in the management of several hedge funds. While the ultimate outcome of this investment is unclear at this time, ERB's estimated maximum possible exposure is approximately \$9.75 million (0.11% of ERB's net assets held in trust for pension benefits at June 30, 2008).

REQUIRED SUPPLEMENTARY INFORMATION

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
STATEMENT OF REVENUES AND EXPENSES—BUDGET AND
ACTUAL (NON-GAAP BASIS)
For the Year Ended 30, 2008

	Original Budget	Final Budget	Actual Budgetary Basis	Variance— Final Budget Favorable (Unfavorable)
REVENUES:				
Other state funds	\$ 30,051,200	30,051,200	30,051,200	-
TOTAL BUDGETED REVENUE	<u>\$ 30,051,200</u>	<u>30,051,200</u>	<u>30,051,200</u>	<u>-</u>
EXPENSES:				
Personal services and employee benefits	\$ 3,787,100	3,787,100	3,612,412	174,688
Contractual services	25,485,700	25,485,700	21,879,759	3,605,941
Other costs	778,400	778,400	734,807	43,593
TOTAL EXPENSES	<u>\$ 30,051,200</u>	<u>30,051,200</u>	<u>26,226,978</u>	<u>3,824,222</u>

RECONCILIATION OF GAAP BASIS TO BUDGETARY BASIS:

Revenue GAAP basis	\$ (71,412,523)
Net depreciation in investment value	785,485,191
Investment advisor and custody fees	20,393,327
Current-year revenue not needed for budgeted expenses	<u>(704,414,795)</u>
Revenue (non-GAAP) budgetary basis	<u>\$ 30,051,200</u>
Expenses GAAP basis—administrative*	\$ 6,088,509
Capital outlay	4,095,767
Depreciation expense	(1,503,248)
Investment advisor and custody fees	20,393,327
Miscellaneous GAAP adjustments and accruals	<u>(2,847,377)</u>
Expenses (non-GAAP) budgetary basis	<u>\$ 26,226,978</u>

* Significant revenues and non-administrative expenses are not budgeted (see note 2).

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FUNDING PROGRESS
FOR THE YEAR ENDED JUNE 30, 2008
(Unaudited)

Valuation Date June 30	(1) Actuarial Value of Assets (AVA)	(2) Actuarial Accrued Liability (AAL)	(3) Unfunded Actuarial Accrued Liability (2) - (1)	(4) Funded Ratio (1)/(2)	(5) Annual Covered Payroll	(6) Unfunded Liability Actuarial as a Percentage of Covered Payroll (3)/(5)
2003	7,518.2	9,266.6	1,748.5	81.1%	2,032.5	86.0
2004	7,488.0	9,927.1	2,439.1	75.4%	2,142.4	113.8
2005	7,457.5	10,591.8	3,134.3	70.4%	2,209.1	141.9
2006	7,813.9	11,436.3	3,622.4	68.3%	2,219.4	163.2
2007	8,591.4	12,190.1	3,598.7	70.5%	2,341.1	153.7
2008	9,272.8	12,967.0	3,694.2	71.5%	2,491.7	148.3

Note: Dollar amounts are in millions.

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF EMPLOYER CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2008
(Unaudited)

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2003	\$ 179,132,226	100.0
2004	203,937,432	92.8
2005	243,237,303	81.3
2006	299,967,996	75.5
2007	364,128,448	70.3
2008	368,196,682	79.0

STATE OF NEW MEXICO
 EDUCATIONAL RETIREMENT BOARD
 NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
 For the Years Ended June 30, 2008 and 2007
 (Unaudited)

ACTUARIAL METHODS AND SIGNIFICANT ASSUMPTIONS

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

	2008	2007
Valuation date	June 30, 2008	June 30, 2007
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level payment, open	Level payment, open
Amortization period for GASB 25 ARC**	30 years	30 years
Asset valuation method	5-year smoothed market	5-year smoothed market
Actuarial assumptions:		
Investment rate of return*	8.00%	8.00%
Projected salary increases*	5.00% to 13.50%	5.00% to 13.50%
* Includes inflation calculated at	3.00%	3.00%
Cost of living adjustments	2.00%	2.00%

**The Governmental Accounting Standards Board (“GASB”) Annual Required Contribution (“ARC”) for this Plan is defined as the larger of (a) the employer normal cost plus a 30-year amortization of the Unfunded Actuarial Accrued Liability (“UAAL”), and (b) the statutory employer contribution rate, plus the 3.00% contribution on behalf of ARP members. Under GASB 25, the maximum allowable amortization period is 30 years. GASB 25 had allowed the use of a 40-year amortization during a transitional period that ended with FY 2006.

OTHER SUPPLEMENTAL INFORMATION

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF CASH ACCOUNTS
As of June 30, 2008 and 2007

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

	2008	2007
Petty cash	\$ 100	\$ 100
Qualified Excess Benefit Arrangement Trust Checking Account at Wells Fargo Bank	4,650	23,514
Short-term investment accounts:		
Overnight repurchase agreement pool—State Treasurer	4,990,356	11,124,535
Short-term Investment Fund—STIF	346,035,530	316,591,014
	<hr/>	<hr/>
Balance per financial statements	<u>\$ 351,030,636</u>	<u>\$ 327,739,163</u>
Pledged collateral for Wells Fargo demand deposit account:		
Total amount on deposit at June 30	\$ 4,650	\$ 23,514
Less Federal Deposit Insurance Corporation coverage	(4,650)	(23,514)
	<hr/>	<hr/>
Total uninsured public funds	<u>\$ -</u>	<u>\$ -</u>

STATE OF NEW MEXICO
EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF ACCOUNTABILITY IN GOVERNMENT ACT—
PERFORMANCE MEASURES
As of June 30, 2008
(Unaudited)

Type	Description	Target	Actual
Outcome	Average number of days to process refund requests	15	15
Output	Average number of days to respond to requests for benefits estimates and purchase of service requests	20	18
Outcome	Percentage of member satisfaction with seminars and trainings	95%	95%
Outcome	Average rate of return over a cumulative five-year period	8.00 %	9.50 %
Output	Percent of retirement applications processed within 60 days	95%	98%
Output	Number of benefit estimates and purchase of service requests computed annually	6,250	6,250
Output	Number of member workshops conducted	27	27
Quality	Percent of accurately computed retirements	99.5%	99.5%
Output	Percent completion of the new pension system	n/a	N/A
Outcome	Funding period of UAAL in years	≤ 30	Infinite

ADDITIONAL INFORMATION

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

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

We have audited the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the State of New Mexico Educational Retirement Board (ERB) as of and for the year ended June 30, 2008, and have issued our report thereon dated December 12, 2008. We have also audited the Statement of Revenues and Expenses – Budget and Actual (Non-GAAP) for ERB presented as supplemental information for the year ended June 30, 2008, as listed in the table of contents. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by ERB's internal control.

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

We consider the deficiencies described in the accompanying schedule of findings and responses as items 06-8, 07-4, and 08-1 to 08-5 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by ERB's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and accordingly would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 08-1 and 08-4 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ERB's basic 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

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

Moss Adams LLP

Albuquerque, New Mexico
December 12, 2008

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS
Year Ended June 30, 2008

03-2	Actuarial Liability	Resolved
06-8	Fraud Risk Assessment Process	Repeated
06-10	Business Continuity Planning	Resolved
06-12	Financial Statements Submission Deadline	Resolved
07-1	Financial Reporting and Monitoring	Resolved
07-2	Information Security	Resolved
07-3	Change Management Procedures	Resolved
07-4	Monitoring of Journal Entries	Repeated, modified
07-5	Employer Reporting	Resolved
07-6	Information System Operations	Resolved
07-7	Posting of Board and Committee Minutes	Resolved

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2008

06-8 Fraud Risk Assessment

CONDITION

There is no formal program or process to document the results or the mitigating controls that should be put into place as a result of the risks identified during the fraud risk assessment. In addition, the investment function has not been specifically identified in the risk assessment.

CRITERIA

Best practices over entity risk assessments suggest the current fraud risk assessment process should be modified to address the following items:

- Consider prior frauds, both those within the entity and at other entities with similar fraud risk profiles (e.g., in the same industry, with similar financial characteristics, operating in the same geographies)
- Be conducted based upon the assessment of inherent risk of material misstatement of the financial statements (i.e., without considering the existence and effectiveness of mitigating controls)
- Consider internal and external environmental factors, including the three categories of fraud risk factorings in the “fraud triangle” (i.e., incentives and pressures, attitudes and rationalizations, and opportunities)
- Evaluate each fraud risk factor to determine whether it represents an identified fraud risk for the entity (i.e., based on an evaluation of likelihood and significance, considering all applicable facts and circumstances relative to the particular entity)
- Classify each identified fraud risk appropriately as either pervasive or specific to particular account balances or disclosure
- For each identified fraud risk, consider related fraud schemes and identify possible perpetrators
- Include investment operations in overall risk analysis

CAUSE

Lack of formal risk assessment process.

EFFECT

Improving the fraud risk assessment process enables the agency to develop programs for mitigating all risks identified.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

06-8 Fraud Risk Assessment (Continued)

RECOMMENDATION

ERB should have a formal process in place for identifying any fraud risks and developing and establishing programs and controls mitigating all such risks.

MANAGEMENT RESPONSE

ERB Management concurs with this recommendation. Management recognizes the importance of a formal fraud risk assessment and has assigned responsibility for developing and implementing an internal audit program to the Internal Audit position. This position was filled in October 2008.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

07-4 Monitoring of Journal Entries

CONDITION

The State Treasurer's Office and the Department of Finance and Administration can make entries directly into the ERB SHARE general ledger. There was no process in place in fiscal year 2008 to review all journal entries posted to the general ledger on a timely basis and to identify unusual transactions or adjustments posted by other State of New Mexico agencies.

CRITERIA

Section 12-6-5, NMSA 1978, states that any violation of good accounting practices be included in the annual audit report. Good accounting practice requires that all journal entries posted to the general ledger be reviewed for appropriateness and accuracy.

CAUSE

As a result of turnover, posting of journal entries by the NM State Treasurer's Office and DFA were not reviewed until after year-end.

EFFECT

There is an increased potential for error due to lack of ERB review.

RECOMMENDATION

ERB should review all activity including journal entries posted by other agencies on a timely and regular basis. This review should be performed in conjunction with regular account reconciliations.

MANAGEMENT RESPONSE

ERB Management concurs with this recommendation. Management has implemented a procedure for monthly reviews, reconciliations, and closings and now has adequate staffing in place to ensure timely monitoring of journal entries made by other agencies.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

08-1 Lack of Reconciliations over General Ledger Accounts

CONDITION

Reconciliations were not performed over cash, investment in state general investment pool, investments held at custodian balances, securities lending activity and fixed asset balances until after the June 30, 2008 fiscal year end.

CRITERIA

Section 12-6-5, NMSA 1978, states that any violation of good accounting practices be included in the annual audit report. Good accounting practice requires that reconciliations be performed between the general ledger balances and supporting detail on a regular and timely basis.

CAUSE

As a result of turnover, reconciliations over certain significant areas were not performed during the fiscal year.

EFFECT

ERB's general ledger throughout fiscal year 2008 did not reflect the true and accurate balances for significant accounts.

RECOMMENDATION

Management should implement a process to ensure that all balances in the general ledger are reconciled at least monthly. The reconciliations should be in a standard format that includes general ledger balances, supporting detail balances and reconciling items for any differences. Additionally, reconciliations should include detail information for any adjusting entries required. Reconciliations should be performed timely and should be reviewed and approved by an individual independent of the data entry or reconciliation process.

MANAGEMENT RESPONSE

ERB management concurs with this recommendation. ERB plans to implement regular monthly or quarterly reconciliations, as appropriate, and to prepare quarterly financial reports for management review.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

08-2 Review of Internal Payroll Disbursements

CONDITION

During our internal payroll testwork, we noted that none of the internal employee payroll disbursements were reviewed and approved by management during the entire fiscal year.

CRITERIA

Section 12-6-5, NMSA 1978, states that any violation of good accounting practices be included in the annual audit report. Good accounting practices include management review and approval of payroll on a regular basis.

CAUSE

As a result of turnover in the accounting position, the review and approval of internal payroll by management did not occur during the fiscal year.

EFFECT

There is an increased likelihood that errors or irregularities in payroll may occur.

RECOMMENDATION

Payroll should be reviewed and approved by management on a regular basis with documentation of such review indicated on the payroll registers.

MANAGEMENT RESPONSE

ERB concurs with this recommendation. Management will be implementing this procedure very soon and will review year to date activity. The procedure will include, but not be limited to, designated personnel reviewing and comparing the biweekly payroll to an approved personnel roster, which includes documentation of rates paid, hours worked, and leave taken.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

08-3 Employee and Vendor Background Checks

CONDITION

ERB does not currently conduct criminal background checks for new employees or new vendors for those employees or vendors that handle confidential information.

CRITERIA

Section 12-6-5, NMSA 1978, states that any violation of good accounting practices be included in the annual audit report. Proper internal controls and good accounting practice require adequate safeguarding a member's personal information. A key component to ensuring the safety of this information contained in the IRIS membership database and related paper files is to restrict the access to such information to individuals who pass a background check.

CAUSE

ERB has not implemented a system for background checks.

EFFECT

ERB exposes itself to the increased likelihood of member information abuse as a result of not performing background checks. Due to the level of sensitive information, the possibility of identity theft is increased.

RECOMMENDATION

We recommend that ERB perform background checks on all potential employees that may potentially be handling confidential information once they have passed the initial phase of approval but prior to hiring. In addition, we recommend that ERB perform background checks on all vendors that may be handling confidential information.

MANAGEMENT RESPONSE

The ERB concurs that, when combined with effective internal controls, performing background checks on prospective employees and vendors may provide an additional level of security for members' records and financial information. The ERB, however, does not have clear statutory authority to perform such checks. In addition, other state and federal laws and regulations may affect ERB's ability to perform background checks. ERB will research what measures must be taken in order to perform background checks and to comply with any other applicable laws and regulations, including determining whether statutory authority is required.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

08-4 Material Adjustments to the General Ledger after Year-End

CONDITION

There were several material adjustments made to the post-closing balances within the general ledger.

CRITERIA

Per Statement on Auditing Standards (SAS) 112, Communicating Internal Control Related Matters Identified in an Audit, the auditors are required to examine deficiencies in controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements and report on any deficiencies in the period end financial reporting process.

In addition, ERB should follow the NM Department of Finance and Administration (DFA) closing process which required the agency to submit its journal entries by September 19, 2008 (DFA Alert 08-058).

CAUSE

ERB did not allocate resources to ensure that all general ledger accounts were reconciled on a timely basis.

EFFECT

The balances within the general ledger for several significant transaction cycles were not correct during the year. Additionally, the agency did not comply with the DFA closing requirements for the SHARE general ledger system.

RECOMMENDATION

We recommend that management follow the suggested general ledger closing timeframes and procedures posted on the DFA website.

MANAGEMENT RESPONSE

ERB management concurs in part with this finding. Working with DFA to complete postings ERB met DFA's deadlines in FY 2008. Staff has been directed to insure that general ledger accounts are reconciled on a timely basis and SHARE closing requirements are satisfied.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

08-5 Alternative Retirement Plan Documentation

CONDITION

The current documents governing the Alternative Retirement Plan (ARP) are inconsistent and unclear. The *ARP Operations Manual* dictates that the ARP should be operated under provisions of Section 404(a) of the Internal Revenue Code and that the ARP Document is pending IRS approval. Section 9.2 of the current plan document indicates that the Board will be named “fiduciary” as that term is defined in “Section 401(a)(2).” Based on review of this IRS code, the reference appears to be in error as this code does not seem to apply to the document.

The Plan Document has not been filed for approval with the IRS nor does it appear that the Board approved a final version of the Plan Document.

Additionally, ERB does not have evidence of current contracts in place with the carriers for the ARP.

CRITERIA

Best practices require that legal documents governing the ARP and ERB’s responsibilities under the plan should be current, consistent, clear, and properly approved.

CAUSE

Management has not followed up on the plan requirements or obtained proper approval for the governing documents.

EFFECT

The ARP is currently operating under certain terms that are may not have been approved by the Board and which appear contradictory.

RECOMMENDATION

We recommend that management clarify the terms of the plan within the ARP Document, including the responsibilities of ERB, and obtain proper approval for the ARP Document.

STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended June 30, 2008

MANAGEMENT RESPONSE

ERB concurs in part, but as discussed below, believes that the auditor's proposed finding does not reflect all facts material to this matter.

1. The ERB's Board of Trustees approved the ARP Operations Manual in 1999; that document has served as the ARP plan document. The provisions of the Operations Manual were taken from a 1991 document entitled "ARP Plan Document." No evidence has been located that the 1991 document was formally adopted by the Board of Trustees. The reference to the Board being named as a "fiduciary" appears in the 1991 ARP Plan Document, and apparently is an erroneous reference to Section 402(a)(2) of ERISA, which does not govern public retirement plans such as the ARP. That reference was not repeated in the 1999 Operations Manual and in any event, the reference is not legally material.
2. The ERB did not request formal approval of the ARP from the IRS. This is similar to the course of action taken by many, if not most, other public retirement plans. As a result of changes in IRS procedure, the ERB has been working with outside tax counsel on requesting approval, however on the advice of such counsel, has delayed filing the request pending resolution by the IRS of several issues. Significant among those is whether the IRS is going to postpone the deadline for public plans to request formal approval. The ERB intends to request formal approval within applicable IRS deadlines.
3. Amendments to the statutes governing the ARP will be proposed in the 2009 legislative session. The ERB had been in the process of revising ARP plan documents and drafting proposed regulations for the plan. As that process would not have been completed until late 2008 or early 2009 at the earliest, and those documents might then have to be again revised based on legislative action, the ERB decided to suspend that process pending final action by the Legislature in the 2009 session. If the Legislature has not completed action on proposed amendments by the deadline for requesting formal approval from the IRS, the ERB will file the existing documents with the IRS. Any necessary amendments would then be filed when completed.
4. The ERB has attempted to locate contracts between the ERB and the ARP carriers. These efforts included searching ERB records and repeatedly contacting the carriers. These efforts were unsuccessful. After the 2009 legislative session, the ERB will begin the process of developing contractual documents to replace missing documents. The process will not begin until after the session so that any new documents developed will reflect legislative changes.

**STATE OF NEW MEXICO EDUCATIONAL RETIREMENT BOARD
EXIT CONFERENCE
Year Ended June 30, 2008**

Board staff prepared the Management's Discussion & Analysis ("MD&A"), financial statements, schedules, and notes for the fiscal years ended June 30, 2008 and 2007. The contents of this report were discussed during an exit conference with the Audit Committee of the Board of Directors and management of ERB on December 10, 2008. The following individuals attended this exit conference:

Educational Retirement Board

Members of the Audit Committee –
Bruce Malott, Audit Committee Chairman
Mary Lou Cameron, Audit Committee Member

Agency Management –
Jan Goodwin, Executive Director
Jeffrey M. Riggs, Deputy Director
Bob Westervelt, Chief Financial Officer
Greg Trujillo, Information Technology Manager

Moss Adams LLP

Scott Eliason, Partner
Julie Alliman, Supervisor

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