



***FISCAL YEAR ENDED JUNE 30, 2003***



# **COMPREHENSIVE ANNUAL FINANCIAL REPORT**

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

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

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

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

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

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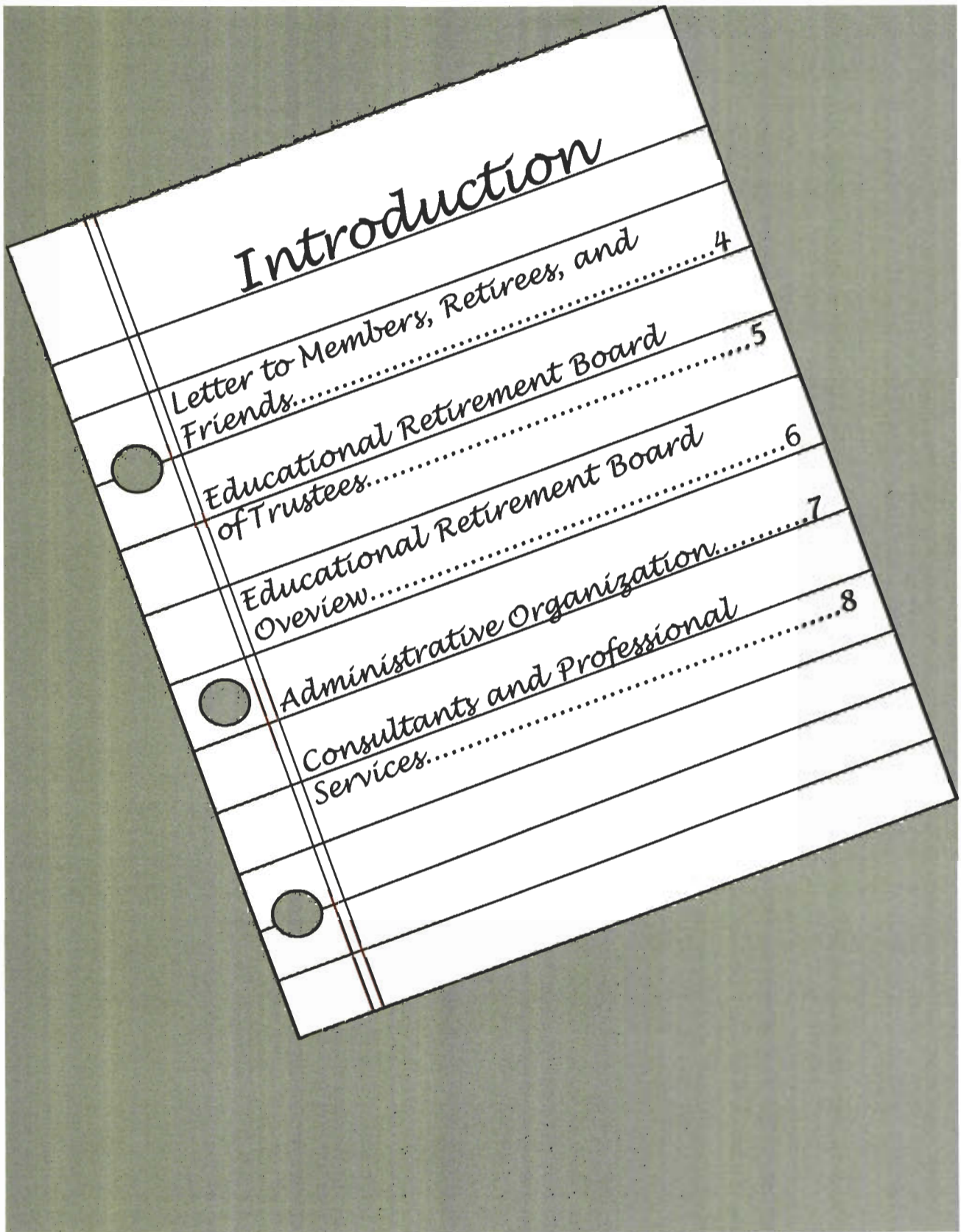
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## Letter to Members, Retirees, and Friends

Dear Members, Retirees, and Friends:

We are pleased to present the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003. This year marks the completion of our 46<sup>th</sup> year of service to the educators of New Mexico. We are proud of our accomplishments in providing excellent retirement benefits, sound financial management, and a high degree of service to our members.

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

This year's report reflects a brighter scenario than was present in 2002. The crisis of confidence among investors that drove the equity markets to record low levels in 2002 began to subside somewhat in 2003, although the difficult times the economic and stock market experienced in 2001 and 2002 continued through much of fiscal 2003. Fortunately, the market rebounded strongly in the June quarter and ended the year with a fractional gain.

It is critical to remember that the Educational Retirement Board's assets are invested for the long term. Our objective is to produce a very competitive long-term return that meets the system's funding requirements at an acceptable risk level.

The ultimate test of whether a retirement system such as ERA is financially sound is whether it can pay all of its promised benefits as they come due. The achievement of this goal can only be judged over a long period of time. The annual valuation of the system's assets and liabilities by the ERB actuary provides the best estimate of the current funding status, but even this has its limitations. Although ERB continues to be a well-funded retirement system, as reflected in its 81.1% funding ratio, (ratio of actuarial assets to actuarial liabilities), the increase in the funding period from 27.2 years to 78 years will necessitate some form of increased contributions to the fund.

During the past three years, the Educational Retirement Board and staff have made decisions, not only with a review of current situations, but also with an eye to the future. ERB has never failed to send its pension checks out on the first of the month, every month, to its retirees. This will not change.

Our goals remain to ensure the long-term stability of the plan, to continue to guarantee the safety and security of our member's retirement, and to work toward increasing the benefits provided by the ERA.

Sincerely,

Danny Joe Lyle  
Director

## Educational Retirement Board of Trustees

**Delman Shirley**, Chairperson

*Current term expires December 31, 2004*

Elected by New Mexican Association of Educational Retirees

**Dr. Pauline Turner**, Vice Chairperson

*Current term expires June 30, 2004*

Elected by American Association of  
University Professors

**Mary Lou Cameron**, Secretary

*Current term expires December 31, 2005*

Elected by New Mexico National  
Education Association

**Annadelle Sanchez**, Member

*Current term expires February 17, 2007*

Appointed by the Governor

**Michael Davis**, Member

Superintendent of Public Instruction

Ex-Officio Member

**Bruce Malott**, Member

*Current term expires June 10, 2007*

Appointed by the Governor

**Robert Vigil**, Member

New Mexico State Treasurer

Ex-Officio Member



*From left to right: Annadelle Sanchez, Robert Vigil, Mary Lou Cameron, Delman Shirley, and Pauline Turner. Missing is Bruce Malott and Michael Davis.*

## Educational Retirement Board Overview

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

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

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

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

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

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

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

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

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

**Significant Long Term Project: Integrated Retirement Information System (IRIS) -** ERB has retained Tier Technologies, Inc. as the system integrator to install a new pension administration computer system from Vitech Systems Group. KPMG Risk Advisory Services is acting as the independent auditor to ensure the system meets ERB's requirements. The project began in October, 2001, and is expected to be fully implemented by December, 2004. This replaces the system used by ERB for the past 23 years and is necessary to meet the growth in membership that ERB has had and expects as the state's population grows. Senior management has and will continue to closely supervise and monitor this critical project.

**Administrative Organization**

**OFFICE OF THE DIRECTOR**  
**Danny Joe Lyle**

**OFFICE OF THE  
DEPUTY DIRECTOR**  
**Dr. Evalynne Hunemuller**

**INVESTMENT DIVISION**  
**Frank C. Foy**

**LEGAL SERVICES DIVISION**  
**Robert Shulman**

**INFORMATION  
TECHNOLOGY DIVISION**  
**Jose F. Martinez**

**FINANCIAL SERVICES  
DIVISION**  
**David Barrett**

**MEMBER SERVICES  
DIVISION**  
**Steve Moreno**

**IRIS PROJECT**  
**Bruce Kingsolver**



## Consultants and Professional Services

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

The actuarial firm chosen by the Board is responsible for:

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

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

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

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

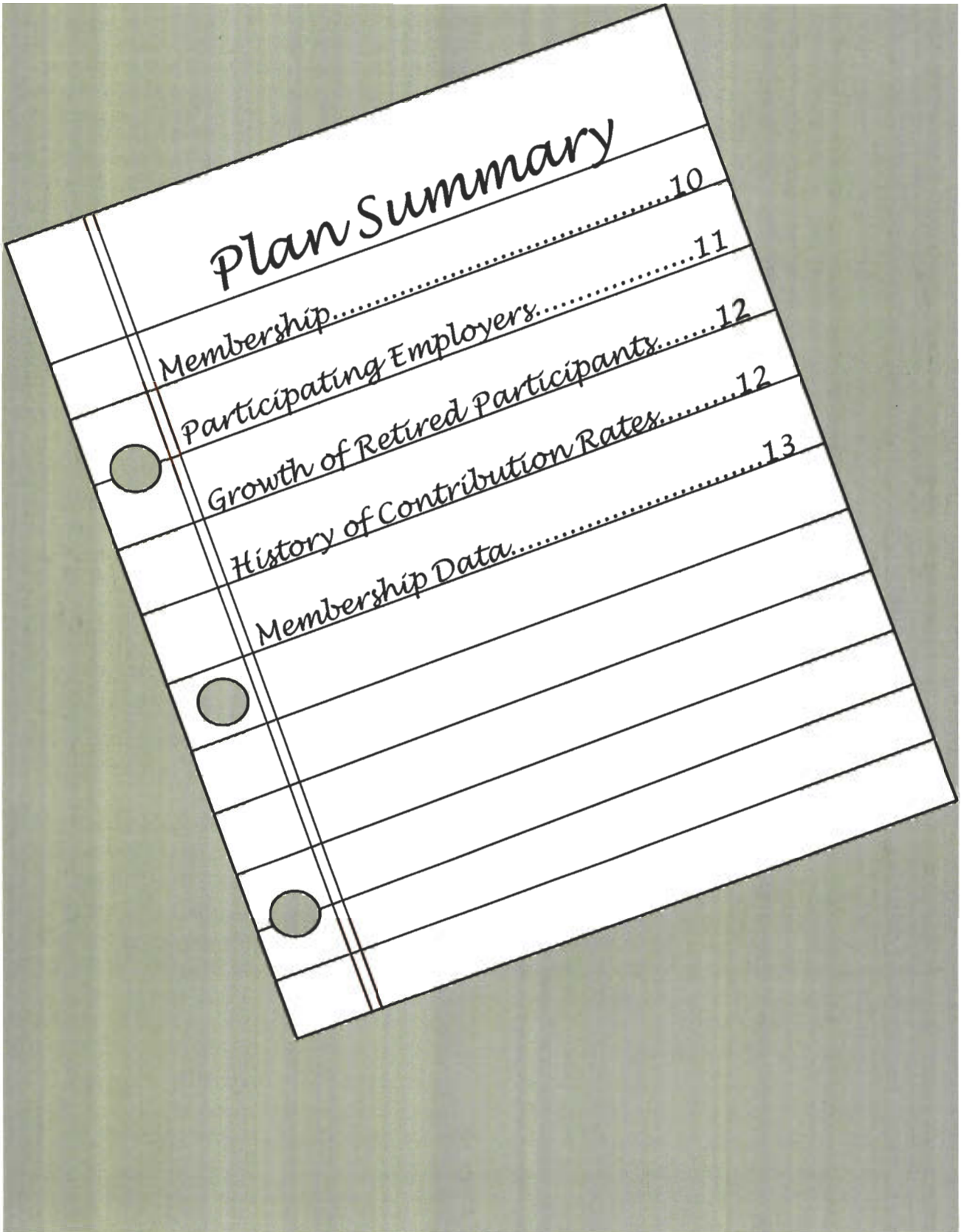
The Medical Review Board is responsible for:

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

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

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

An independent Certified Public Accountant firm conducts the financial audit of the ERB. Currently, that firm is Deloitte & Touche LLP.



The image shows a tilted graphic of a spiral-bound notebook page. The page contains a table of contents for a 'Plan Summary'. The text is written in a cursive font. The table lists five items with their corresponding page numbers: Membership (10), Participating Employers (11), Growth of Retired Participants (12), History of Contribution Rates (12), and Membership Data (13). There are three hole punches on the left side of the notebook page.

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## Membership

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

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

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

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

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

At June 30, 2003, there were 62,614 active members covered under the ERA by 149 contributing employers.

**Participating Employers  
June 30, 2003**

**PUBLIC SCHOOLS**

Alamogordo	Las Cruces
Albuquerque	Las Vegas
Animas	Las Vegas West
Artesia	Logan
Aztec	Lordsburg
Belen	Los Alamos
Bernalillo	Los Lunas
Bloomfield	Loving
Capitan	Lovington
Carlsbad	Magdalena
Carrizozo	Maxwell
Central Consolidated	Melrose
Chama Valley	Mesa Vista
Cimarron	Mora
Clayton	Moriarty
Cloudcroft	Mosquero
Clovis	Mountainair
Cobre Consolidated	Pecos
Corona	Peñasco
Cuba	Pojoaque Valley
Deming	Portales
Des Moines	Quemado
Dexter	Questa
Dora	Raton
Dulce	Reserve
Elida	Rio Rancho
Española	Roswell
Estancia	Roy
Eunice	Ruidoso
Farmington	San Jon
Floyd	Santa Fe
Fort Sumner	Santa Rosa
Gadsden	Silver Consolidated
Gallup-McKinley Co.	Socorro
Grady	Springer
Grants-Cibola	Taos
Hagerman	Tatum
Hatch Valley	Texico
Hobbs	Truth or
Hondo Valley	Consequences
House	Tucumcari
Jal	Tularosa
Jemez Mountain	Vaughn
Jemez Valley	Wagon Mound
Lake Arthur	Zuni

**CHARTER SCHOOLS**

Academy for Technology  
and the Classics  
Amistad Elementary  
Amy Biehl High School  
Anansi  
Bridge Academy  
Cottonwood Valley  
East Mountain High School  
Horizon Academy  
Jefferson Montessori Academy  
Learning Community  
Los Puentes  
Monte del Sol  
Moreno Valley  
Nuestros Valores  
Public Academy for  
Performing Arts  
Red River Valley  
Robert F. Kennedy  
Roots and Wings  
San Diego Riverside  
Sidney Gutierrez  
South Valley Academy  
Southwest Secondary  
Learning Center  
Taos Municipal  
Turquoise Trail  
Twenty-First Century

**SPECIAL SCHOOLS**

NM Boys School  
NM Military Institute  
NM School for the Deaf  
NM School for the Visually  
Handicapped  
Youth Diagnostic Center  
University Hospital

**COLLEGES AND  
UNIVERSITIES**

Albuquerque TVI  
Clovis Community College  
Eastern NM University  
(Portales)  
Eastern NM University  
(Roswell)  
Luna Community College  
Mesalands Community College  
NM Highlands University  
NM Junior College  
NM State University  
NM Institute of Mining &  
Technology  
Northern NM Community  
College  
San Juan College  
Santa Fe Community College  
University of New Mexico  
Western NM University

**STATE AGENCIES**

Central Regional Education  
Coop  
High Plains Regional  
Education Coop  
Regional Education Coop #7  
Northeast Rec  
Pecos Valley Rec #8  
Regional Educational Center #6  
Region IX Educational Coop  
Southwest Rec #10  
NM Activities Association  
NM Department of  
Corrections  
NM Department of Education  
NM Department of Health  
NM Department of  
Vocational Rehab  
NM Educational Retirement  
Board

**PLAN SUMMARY**

**Growth of Retired Participants**

<u>Year Ending June 30</u> (1)	<u>Number of Retirees</u> (2)	<u>All Retirees Average Monthly Benefit</u> (3)
1984	8,462	\$ 430
1986	10,004	512
1988	11,375	663
1990	12,741	767
1992	14,107	846
1993	15,001	890
1994	15,814	966
1995	16,593	976
1996	17,381	1,011
1997	18,317	1,055
1998	19,244	1,104
1999	20,109	1,139
2000	21,186	1,228
2001	22,191	1,274
2002	23,052	1,315
2003	24,085	1,376

**History of Contribution Rates**

<u>Fiscal Year Beginning July 1</u> (1)	<u>Employee Rate</u> (2)	<u>Employer Rate</u> (3)	<u>Total Rate</u> (4)
1984	7.60%	7.60%	15.20%
1986	7.60	7.60	15.20
1988	7.60	7.60	15.20
1990	7.60	7.60	15.20
1992	7.60	7.60	15.20
1993	7.60	8.65	16.25
1994	7.60	8.65	16.25
1995	7.60	8.65	16.25
1996	7.60	8.65	16.25
1997	7.60	8.65	16.25
1998	7.60	8.65	16.25
1999	7.60	8.65	16.25
2000	7.60	8.65	16.25
2001	7.60	8.65	16.25
2002	7.60	8.65	16.25
2003	7.60	8.65	16.25

**PLAN SUMMARY**

**Membership Data**

	June 30, 2003 (1)	June 30, 2002 (2)
<b>1. Active members</b>		
a. Number	62,614	61,091
b. Total payroll supplied by System (annualized)	\$2,032,479,090	\$1,978,528,267
c. Average salary	\$32,460	\$32,387
d. Average age	45.3	45.2
e. Average service	9.3	9.3
<b>2. Vested inactive members (excluding pending refunds)</b>		
a. Number	5,391	5,217
b. Total annual deferred benefits	\$30,708,547	\$29,601,294
c. Average annual deferred benefit	\$5,696	\$5,674
<b>3. Nonvested inactive members and vested pending refunds</b>		
a. Number	15,686	14,714
b. Employee assessments with interest due	\$45,517,438	\$40,586,228
c. Average refund due	\$2,902	\$2,758
<b>4. Service retirees</b>		
a. Number	21,620	20,699
b. Total annual benefits	\$372,397,610	\$340,775,737
c. Average annual benefit	\$17,225	\$16,463
<b>5. Disabled retirees</b>		
a. Number	598	589
b. Total annual benefits	\$4,745,450	\$4,405,617
c. Average annual benefit	\$7,936	\$7,480
<b>6. Beneficiaries</b>		
a. Number	1,867	1,764
b. Total annual benefits	\$20,638,204	\$18,707,056
c. Average annual benefit	\$11,054	\$10,605

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

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## Management's Discussion and Analysis

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, 2003 (FY03). For more detailed information of the Board's FY03 financial activities, the reader should review the financial statements, including the notes and required supplementary information.

### Financial Reporting Requirements

The financial statements include the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets. The Statement of Plan Net Assets presents information on all of the assets and liabilities, with the difference between the two reported as net assets. Increases and decreases in net assets contrasted with budgetary decisions should serve as a useful indicator of whether the financial position of the Educational Retirement Fund is improving or deteriorating.

The Statement of Changes in Plan Net Assets presents information showing how net assets changed during the most recent fiscal year using full accrual basis of accounting. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

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

### Financial Highlights

- Net assets held in trust for pension benefits increased \$70.0 million or 1.2% in FY03. This relatively small increase stemmed from an initial period of continued downturn in the equities markets, followed by a gradual improvement to the market beginning late in the March 2003 quarter.
- Investment advisor fees and custodial fees increased \$2.3 million or 54.3% in FY03. The higher fees were a result of adding several new managers, costs to transition the equity portfolio, and an increase in the total market value of assets managed by external managers.
- The Board transitioned \$1.074 billion of its equity portfolio during August 2002 in an effort to maximize the long-term earnings of the Fund. The Board contracted with four additional money managers and terminated or did not renew contracts with two previous money managers. The new managers were hired to manage the small cap value, small cap growth, large cap value, and enhanced index fund portions of the Board's portfolio.
- Total cash and cash equivalents decreased \$81.3 million in FY03 primarily due to the investment portfolios holding a lower balance of cash at fiscal year end. Total cash and cash equivalents equaled \$108.1 million or 1.6% of investments, which is within the Board's investment policy that limits cash holdings to 5% or less.
- Receivables decreased almost \$43.5 million in FY03 or 37.9% with the decrease almost exclusively from investments receivable at fiscal year end.
- Investment holdings increased \$74.2 million or 1.1% primarily due to the recovery in the domestic and international equity markets that began late in the March 2003 quarter.



## FINANCIAL STATEMENTS

- Capital assets, assets costing \$1,000 and greater, increased only \$3.3 thousand or .1%, due to a moderate amount of asset purchases, some asset disposals, and, in comparison to last year, minimal software development costs on the new pension administration system.
- The Board received total appropriations from the trust fund of \$8 million in FY01, FY02 and FY03 to implement the IRIS Project. Phase 1 of IRIS, scheduled for completion in the summer of 2004, will be preceded by parallel testing in the spring of 2004. Phase 2 of IRIS, the web-enablement phase, will be completed in fall of 2004.
- Accounts payable increased \$227.1 thousand or 13.2% primarily due to an increase in the amount of investment advisor fees due at FY 03 year-end.
- Refunds payable decreased \$213.6 thousand or 8.5%, which correlates with the trend of a decrease in refunds paid during FY03. Lower rates of interest paid out on refunds after September 2002 resulted in fewer refund requests.
- Investment purchases payable-brokers increased \$17.9 million or 45.0% from the prior year, indicating that a greater number of investments were purchased at or near fiscal year end and remained outstanding on June 30, 2003. 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 \$138.5 million or 16.3%, indicating that a smaller portion of the Board's portfolio was being lent at fiscal year end. Securities lending net income decreased \$953.6 thousand or 36.8% due to the decreased amount of investments included in the securities lending portion of the Board's portfolio and the lower rate earned on the lent securities.
- Employer and member contributions increased \$8.2 million or 2.5% in FY03 due to an increase in active membership coupled with salary increases. Benefit payments to retirees increased \$28.6 million or 7.8% owing to the increase in the number of retirees and the amount of Cost-of-Living-Adjustments paid to retirees. Refunds and interest to terminated members decreased \$169.6 thousand or .6%. The Board's total membership increased 3.3% to 107,519 members in FY03.
- Administrative expenses increased by \$665.0 thousand or 18.4% in FY03. The changes in expenses, by category, were as follows: increase of \$213.3 thousand in personal services and employee benefits; increase of \$636.5 thousand in contractual services; decrease of \$183.8 thousand in other costs; and decrease of \$1.0 thousand in operating transfers.
- With the small recovery in the market during the latter part of the year, ERB saw an improvement in net assets from a decrease of \$653.6 million in FY02 to an increase of \$70.0 million in FY03.

## FINANCIAL STATEMENTS

### Condensed Financial Information

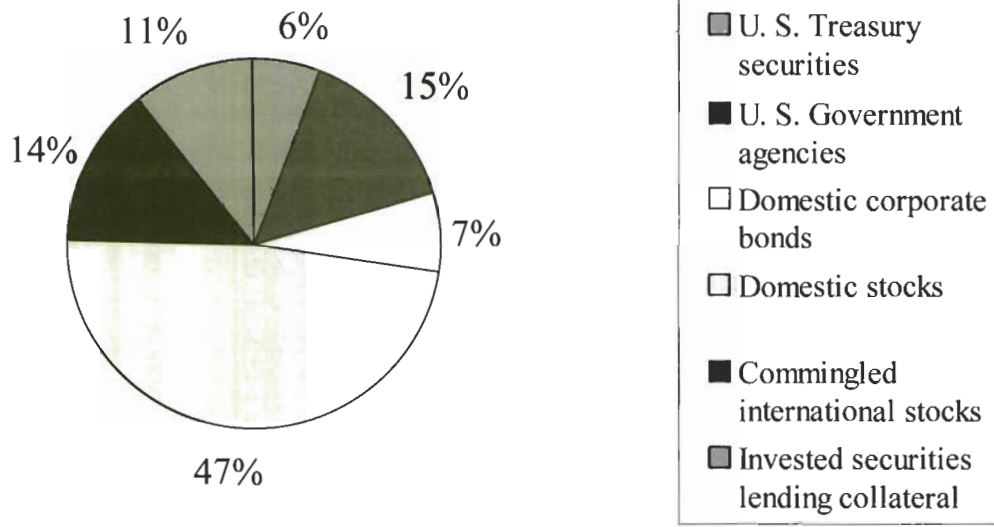
#### Statements of Plan Net Assets

	<u>FY03</u>	<u>FY02</u>
Cash and short-term investments	\$ 108,068,182	\$ 189,327,483
Receivables	71,199,484	114,719,798
Investments, at fair value	6,673,869,901	6,599,638,956
Capital assets (net of accum. depr.)	<u>3,633,927</u>	<u>3,630,586</u>
Total assets	<u>\$6,856,771,494</u>	<u>\$6,907,316,823</u>
Current liabilities	\$ 773,278,795	\$ 893,818,761
Long-term liabilities (comp. absences)	<u>133,915</u>	<u>142,134</u>
Total liabilities	<u>\$ 773,412,710</u>	<u>\$ 893,960,895</u>
Net assets held in trust for pension benefits	<u>\$6,083,358,784</u>	<u>\$6,013,355,928</u>

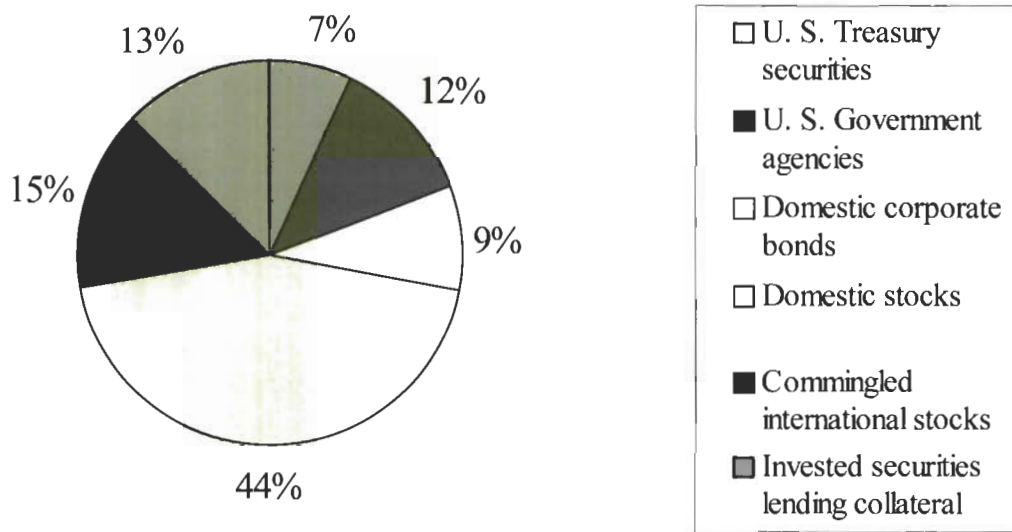
#### Statements of Changes in Plan Net Assets

	<u>FY03</u>	<u>FY02</u>
Contributions	\$ 333,437,104	\$ 325,241,818
Investment income less investment expenses	144,773,127	164,215,380
Net appreciation/(depreciation) in the fair value of investments	16,156,143	(746,928,008)
Other income	<u>4,344,038</u>	<u>3,450,064</u>
Total additions	<u>\$ 498,710,412</u>	<u>\$ (254,020,746)</u>
Benefit payments	\$ 396,081,755	\$ 367,494,870
Refunds	28,338,456	28,508,035
Administrative expenses	<u>4,287,345</u>	<u>3,622,362</u>
Total deductions	<u>\$ 428,707,556</u>	<u>\$ 399,625,267</u>
Increase/(decrease) in net assets	\$ 70,002,856	\$ (653,646,013)
Net assets held in trust for pension benefits		
Beginning of the year	<u>\$6,013,355,928</u>	<u>\$6,667,001,941</u>
End of the year	<u>\$6,083,358,784</u>	<u>\$6,013,355,928</u>

### FY03 Investments By Category



### FY02 Investments By Category



## FINANCIAL STATEMENTS

### Budgetary Highlights

There were no significant budgetary variations during the fiscal year ended June 30, 2003. The Board had savings over budgeted amounts totaling \$3.4 million in the four expense categories (non-GAAP budgetary basis) during the 2003 fiscal year.

The final budget contained \$2.4 million in rebudgeted cash balance related to carryover monies from the Building Addition/Remodel Project and the new Integrated Retirement Information System (IRIS) Project. The Building Addition/Remodel Project had a carryover balance of \$677,612 out of the initial \$750,000 appropriation, which occurred in FY01. The IRIS Project had \$1,703,170 in carryover monies available from appropriations in FY01 and in FY02 of \$3,000,000 each.

### Request for Information

This financial report is designed to provide various interested parties with a general overview of financial position and activities of the Board for the fiscal year ended June 30, 2003. If you have questions regarding this financial report or need additional information, please contact Margaret Phoenix, Accounting & IS Manager, at P.O. Box 26129, Santa Fe, NM 87502.

### Capital Assets

The Net Investment in Capital Assets at June 30, 2003 is as follows:

<u>Description</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Book Value</u>
<b>2003:</b>			
Land	\$ 248,172	—	248,172
Capital assets in progress	2,342,730	—	2,342,730
Depreciable Land Improvements	1,875	( 1,125)	750
Building & Building Improvements	1,156,369	(646,593)	509,776
Furniture & Equipment	<u>1,500,619</u>	<u>(968,120)</u>	<u>532,499</u>
Total	<u>\$5,249,765</u>	<u>(1,615,838)</u>	<u>3,633,927</u>
<b>2002:</b>			
Land	\$ 248,172	—	248,172
Capital assets in progress	2,205,176	—	2,205,176
Depreciable Land Improvements	1,875	( 937)	938
Building & Building Improvements	1,136,225	(600,074)	536,151
Furniture & Equipment	<u>1,445,456</u>	<u>(805,307)</u>	<u>640,149</u>
Total	<u>\$5,036,904</u>	<u>(1,406,318)</u>	<u>3,630,586</u>

# Deloitte

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of plan net assets and statements of changes in plan net assets of the State of New Mexico Educational Retirement Board (the ERB) as of and for the years ended June 30, 2003 and 2002, as listed in the foregoing table of contents. These financial statements are the responsibility of ERB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements of the ERB are intended to present the net assets and changes in net assets of only that portion of the funds of the State of New Mexico (the "State") which are attributable to the transactions of the ERB. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2003 or 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of ERB, as of June 30, 2003 and 2002, and respective changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis and the 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 the GASB. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The Introductory, Plan Summary, Actuarial and Investment Sections are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in our basic financial statements and, accordingly, we express no opinion or other form of assurance on them.

*Deloitte & Touche LLP*

December 8, 2003

Member of  
Deloitte Touche Tohmatsu

**FINANCIAL STATEMENTS**

**Statement of Plan Net Assets  
June 30, 2003 and 2002**

	<b>2003</b>	<b>2002</b>
<b>Assets</b>		
Cash and short-term investments	<u>\$108,068,182</u>	<u>\$189,327,483</u>
Receivables		
Contributions	42,951,929	42,979,199
Investment sales proceeds-brokers	7,090,361	44,555,672
Interest and dividends	21,154,666	27,183,401
Other	2,528	1,526
Total receivables	<u>71,199,484</u>	<u>114,719,798</u>
Investments, at fair value		
U. S. Treasury securities	383,767,250	455,999,937
U. S. Government agency securities	979,434,779	801,770,798
Domestic corporate bonds	470,180,574	601,700,740
Domestic stocks	3,199,553,289	2,898,146,632
Commingled international stocks	930,026,908	992,565,074
Invested securities lending collateral	10,907,101	849,455,775
Total investments	<u>6,673,869,901</u>	<u>6,599,638,956</u>
Capital assets, at cost, net of accumulated depreciation of \$1,615,838 and \$1,406,318 respectively	1,291,197	1,425,410
Capital assets in progress	<u>2,342,730</u>	<u>2,205,176</u>
Total capital assets	<u>3,633,927</u>	<u>3,630,586</u>
<b>Total assets</b>	<b><u>\$6,856,771,494</u></b>	<b><u>\$6,907,316,823</u></b>
<b>Liabilities</b>		
Accounts payable	\$1,943,065	\$1,715,936
Accrued payroll, employee benefits, and accrued compensated absences	192,768	194,359
Due to other state agencies	167,273	156,094
Refunds payable	2,308,415	2,522,051
Investment purchases payable-brokers	57,809,285	39,860,759
Funds held for others	84,803	55,921
Securities lending collateral	710,907,101	849,455,775
<b>Total liabilities</b>	<b><u>\$773,412,710</u></b>	<b><u>\$893,960,895</u></b>
<b>Net assets held in trust for pension benefits</b>	<b><u>\$6,083,358,784</u></b>	<b><u>\$6,013,355,928</u></b>

**FINANCIAL STATEMENTS**

**Statement of Changes in Plan Net Assets  
For the Years Ended June 30, 2003 and 2002**

	2003	2002
<b>ADDITIONS</b>		
<b><u>Contributions</u></b>		
Employer	\$179,010,098	\$173,863,363
Member	154,427,006	151,378,455
Total contributions	<u>333,437,104</u>	<u>325,241,818</u>
<b><u>Investment income</u></b>		
<i>From investing activities</i>		
Net appreciation/(depreciation) in fair value of investments	16,156,143	(746,928,008)
Interest	105,911,179	128,989,938
Dividends	43,844,090	36,924,516
Total investing activity gain/(loss)	<u>165,911,412</u>	<u>(581,013,554)</u>
Investing activity expenses:		
Investment advisor fees	(6,046,788)	(3,807,364)
Custody fees	(574,348)	(484,309)
Total investing activity expenses	<u>(6,621,136)</u>	<u>(4,291,673)</u>
Net gain/(loss) from investing activities	<u>159,290,276</u>	<u>(585,305,227)</u>
<i>From securities lending activities</i>		
Securities lending income	12,679,081	22,250,077
Securities lending expenses:		
Borrower rebates	(10,669,987)	(19,246,939)
Agent fees	(370,100)	(410,539)
Total securities lending expenses	<u>(11,040,087)</u>	<u>(19,657,478)</u>
Net income from securities lending activities	<u>1,638,994</u>	<u>2,592,599</u>
Total net investment gain/(loss)	<u>160,929,270</u>	<u>(582,712,628)</u>
<b><u>Miscellaneous Income</u></b>		
Penalties	681	5,412
Interest on restoration of service	4,343,174	3,351,634
Other	183	93,018
Total additions	<u>\$498,710,412</u>	<u>\$(254,020,746)</u>
<b>DEDUCTIONS</b>		
Refunds to terminated members	\$21,132,480	\$20,103,972
Interest on refunds	7,205,976	8,404,063
Administrative expenses	4,287,345	3,622,362
Age and service benefit payments	390,931,959	362,446,592
Disability benefit payments	5,149,796	5,048,278
Total deductions	<u>\$428,707,556</u>	<u>\$399,625,267</u>
Net increase/(decrease)	70,002,856	(653,646,013)
Net assets held in trust for pension benefits		
Beginning of the year	<u>6,013,355,928</u>	<u>6,667,001,941</u>
End of the year	<u>\$6,083,358,784</u>	<u>\$6,013,355,928</u>

**Statement of Revenues and Expenses -  
Budget and Actual (Non-GAAP Basis)  
for the Fiscal Year Ended June 30, 2003**

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Budgetary Basis</u>	Variance - Final Budget Favorable (Unfavorable)
Revenues:				
Other state funds	\$ 11,045,900	\$ 11,045,900	\$ 11,045,900	\$ ---
Total revenue	<u>11,045,900</u>	<u>11,045,900</u>	<u>11,045,900</u>	<u>---</u>
Rebudgeted cash balance		5,515,300	5,515,300	---
Total budgeted revenue	<u>\$ 11,045,900</u>	<u>\$ 16,561,200</u>	<u>\$ 16,561,200</u>	<u>\$ ---</u>
Expenses:				
Personal services and employee benefits	\$ 2,519,627	\$ 2,779,627	\$ 2,724,511	\$ 55,116
Contractual services	6,705,440	11,998,740	9,379,060	2,619,680
Other costs	1,820,833	1,782,833	1,036,103	746,730
Operating transfers	---	---	---	---
Total expenses	<u>\$ 11,045,900</u>	<u>\$ 16,561,200</u>	<u>\$ 13,139,674</u>	<u>\$ 3,421,526</u>



**NOTES TO THE FINANCIAL STATEMENTS**

**1. Educational Retirement Board**

**A. 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	89
• Universities and Colleges	12
• Charter Schools	25
• Special Schools	9
• State Agencies	<u>14</u>
	<u>149</u>

**B. Reporting Entity**

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

The Board has developed criteria to determine whether other state agencies, boards or commissions, which benefit the members of the Board, should be included within its financial reporting entity as component units. The criteria include, but

are not limited to, whether the Board exercises oversight responsibility on financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations and accountability for fiscal matters, scope of public service, and special financing relationships. Based on these criteria, management of the Board has determined that there are no component units that should be included in its financial reporting entity.

**C. 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 twenty-five percent of the time, are required to be members of the Plan.

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

The Board serves 149 employers in the State of New Mexico and has an active and inactive membership of 107,776 in 2003 and 104,074 in 2002.

Status and number of all participants at June 30 consisted of the following:

	<u>2003</u>	<u>2002</u>
(1) Retirees and beneficiaries of deceased retirees currently receiving benefits	24,085	23,052
(2) Inactive members	21,077	19,931
(3) Current active members	62,614	61,091

D. Benefit Provisions

The retirement benefit is determined by a formula. The formula 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; or
- 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 percent of the average salary of the last five years for each year of contributory employment needed plus three percent 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.

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.

*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 (COLA):** Retired members and surviving beneficiaries receiving benefits receive an automatic COLA in their benefit each July 1<sup>st</sup>, 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 four percent (4%), nor be less than two percent (2%) unless the change in CPI is less than two percent (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 three percent (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<sup>st</sup> of the third full year following disability retirement. A member on regular retirement that can prove retirement because of a disability may qualify for a COLA beginning July 1<sup>st</sup> in the third full year of retirement.

6. **Disability Retirement:**

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

*Monthly Benefit:* The monthly benefit is equal to two percent of FAS times years of service, but not less than the smaller of (a)

one-third of FAS or (b) two percent 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.

E. Refund of Contributions

Members may withdraw their contributions only when they terminate covered employment in the State of New Mexico 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 seventy-five percent (75%) of the average earnings rate of the Fund during the five fiscal years preceding the year of withdrawal. Interest is not earned on contributions credited to accounts prior to July 1, 1971, nor those on deposit for less than one year.

2. Summary of Significant Accounting Policies

A. Basis of Accounting

The Board’s financial statements are prepared using the accrual basis of accounting. Employer and member contributions are recognized as revenue in the period in which the member’s services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

B. GASB Statement No. 34

The Governmental Accounting Standards Board (GASB) issued Statement No. 34 entitled, “Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments” (GASB 34) in June 1999. GASB 34, adopted by the Board in FY02, minimally affects the Board because it is a qualified governmental defined benefit pension plan. GASB Statement No. 25 “Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans”, issued in 1995, governs the Board’s financial reporting. The main impact of GASB Statement No. 34 on the Board is the inclusion of the mandatory Management’s Discussion & Analysis (MD&A) as part of the financial statements of the Board. Other minor changes related to GASB 34 include changes in terminology and certain note disclosures.

C. Budgets and Budgetary Accounting

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

Only administrative expenses and a small portion of interest income are budgeted while significant revenues and non-

administrative expenses are not. The budget is prepared on a non-GAAP basis, which recognizes encumbrances and capital expenses as current expenses, excludes depreciation expense, and recognizes revenue when cash is received. Budgetary comparisons for the Educational Employees’ Retirement Fund are presented in the Statement 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 SBD and LFC on these performance measures.

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

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

The Board follows these procedures in establishing the annual budget:

- (1) By August 31<sup>st</sup>, the Board prepares a Budget Appropriation Request to be presented to the next Legislature. The Request includes proposed expenses and the means of financing them.

(2) On September 1<sup>st</sup>, the Budget Appropriation Request is submitted to the Department of Finance and Administration (DFA) and the Legislative Finance Committee (LFC).

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

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

(5) Both DFA's and LFC's recommended appropriation proposals are presented to the Legislature for approval of the final budget.

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

(7) Budgetary control is exercised at the appropriation unit level (revenue source and expenditure category) and any changes between budget categories must be approved by DFA and LFC.

D. Investments

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

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

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

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

E. 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 Department of Finance and Administration, is to include all assets costing \$1,000 and greater.

All additions are capitalized at historical cost as of the date of acquisition and depreciation is calculated on a straight-line basis over the asset's estimated useful life with no salvage value.

Estimated useful lives are as follows:

Building and Building Improvements	25 years
Depreciable Land Improvements	10 years
Furniture and Equipment	10 years
Data Processing Equipment	5 years

F. 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)).

G. Refunds Payable

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

**3. Cash Deposits**

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

In addition to the overnight investment at the State Treasury, the Board invests in Short-term Investment Funds (STIF) at State Street. Each internal and external investment manager has a component in the STIF Fund. The STIF Fund 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 portfolios are swept into the STIF Fund at the end of each day. Overnight investments of \$95,394,999 and \$189,248,570 for 2003 and 2002 respectively, are considered cash equivalents and are reported as part of the cash balance in the Statement of Plan Net Assets.

The majority of the Board's cash deposits, \$105,754,544, is in repurchase agreements and therefore uncategorized. The remaining \$2,313,638 of cash deposits is classified as Category 1. (See Note 4. Investments for an explanation of risk categories.)

**4. Investments**

The Board is authorized by Statute to invest the assets of the Plan in the following instruments (Refer to Section 22-11-13, NMSA 1978, for additional limitations on authorized investments.):

- A. Obligations of the United States, United States government-sponsored enterprises or federal agency securities;
- B. Obligations of governments other than the United States or their political subdivisions, agencies or instrumentalities;
- C. Obligations of a municipality or political subdivision of the State that were issued pursuant to law;
- D. Contracts for the present purchase and resale at a specified time in the future, not to exceed one year, of specific securities;
- E. Obligations of any corporation, partnership or trust organized within the United States and preferred stock or common stock of any corporation, partnership or trust organized within the United States;
- F. Prime bankers' acceptances issued by money center banks;
- G. Obligations of any corporation, partnership or trust organized outside the United States; and preferred stock or common stock of any corporation, partnership or trust organized outside the United States;

## FINANCIAL STATEMENTS

- H. Currency transactions, including spot or cash basis currency transactions; forward currency contracts and buying or selling options or futures on foreign currencies;
- I. Stocks or shares of a diversified investment company registered under the Investment Company Act of 1940, as amended; or
- J. Industrial revenue bonds issued pursuant to the Industrial Revenue Bond Act [Sections 3-32-1 through 3-32-16, NMSA 1978].

held by the Board or its agent in the Board's name.

- (2) Category 2 – includes uninsured and unregistered investments for which the securities are held by the counter party's trust department or agent in the Board's name.
- (3) Category 3 – includes uninsured and unregistered investments for which the securities are held by the counter party or its trust department or agent, but not in the Board's name.

The Board's investments are categorized as follows to give an indication of the level of risk assumed by the entity at fiscal year end:

- (1) Category 1 – includes investments that are insured or registered for which the securities are

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

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

<u>Investment Description</u>	<u>2003</u>	<u>2002</u>
Investments – Category 1:		
(Held by Board's agent in Board's name)		
U.S. Government Agency Securities (not on securities loan)	\$ 838,772,289	\$ 638,012,613
Domestic Corporate Bonds (not on securities loan)	470,180,574	591,982,166
Domestic Stocks (not on securities loan)	<u>3,027,549,512</u>	<u>2,698,421,404</u>
Subtotal	4,336,502,375	3,928,416,183
Investments – Not Categorized:		
Commingled International Stocks	930,026,908	992,565,074
Investments Held by Broker-Dealers under Securities Loans with Cash Collateral:		
U.S. Government and Agencies Securities	524,429,740	619,758,122
Domestic Corporate Bonds	-	9,718,574
Domestic Stocks	172,003,777	199,725,228
Securities Lending Cash Collateral Investments	<u>710,907,101</u>	<u>849,455,775</u>
Total	<u>\$6,673,869,901</u>	<u>\$6,599,638,956</u>

**Derivatives:**

**Collateralized Mortgage Obligations** – In accordance with investment policy and fiduciary principles, the Plan invests in mortgage-backed securities, including certain agency collateralized mortgage obligations (CMO). CMO selections are chosen from a conservative segment 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. The Plan had \$801.6 million in CMO securities at June 30, 2003 and \$338.5 million at June 30, 2002.

**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. No such contract shall be entered into unless the contract is fully secured by a collateralized, irrevocable letter of credit running to the Board, cash or equivalent collateral of at least one hundred two percent (102%) of the market value of the securities plus accrued interest temporarily exchanged. This collateral shall be delivered to the state fiscal agent or its designee contemporaneously with the transfer of funds or delivery of the securities. Such contract may authorize the Board to invest cash collateral in instruments or securities that are authorized fund investments and may authorize payment of a fee from the Fund or from income generated by the investment of cash collateral to the borrower of securities providing cash as collateral. The Board may apportion income derived from the investment of cash collateral to pay its agent in securities lending transactions.

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

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

In FY 2003, the Board, through its agent, HSBC Bank, loaned portions of its U.S. Treasury Securities, equity securities, and domestic corporate bonds to approved broker-dealers in return for one hundred two percent (102%) of the market or fair value of the securities loaned. The collateral for these securities was generally cash, which was reinvested in short-term money market instruments having fixed coupons or floating rate instruments. The Board does not have the ability to pledge or sell the collateral without borrower default. HSBC has provided the Board one hundred percent (100%) loss indemnification in the event of borrower default.

The Board generally invests, through its lending agent, the cash collateral that matches the maturities of the securities loans. The maturities of both securities loans and collateral reinvestments are closely matched to avoid interest rate exposure. The weighted-average maturities for the loans and invested collateral outstanding at fiscal year end were as follows:

	<u>2003</u>	<u>2002</u>
Loans Outstanding	1 day	3 days
Collateral reinvestment	17 days	16 days

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

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

The Board experienced no losses in its securities lending program during FY 2003 or FY 2002 nor were there any accumulated losses from prior periods.



**FINANCIAL STATEMENTS**

The following represents the balances relating to the securities lending transactions at the financial statement date:

Securities Lent	Underlying Securities	Cash Collateral Received/ Securities Collateral Value*	Cash Collateral Investment Value*
<b><u>2003</u></b>			
<u>Lent for cash collateral:</u>			
U. S. Government & Agency Securities	\$524,429,740	\$533,543,750	\$ ---
U. S. Equities	172,003,777	177,857,000	---
U. S. Corporate Obligations with variable rates	---	---	270,294,985
Asset-backed Securities with variable rates	---	---	112,889,635
Commercial Paper	---	---	327,722,481
	<u>\$696,433,517</u>	<u>\$711,400,750</u>	<u>\$710,907,101</u>
<b><u>2002</u></b>			
<u>Lent for cash collateral:</u>			
U. S. Government & Agency Securities	\$619,758,122	\$635,350,000	\$ ---
U. S. Equities	199,725,227	205,095,300	---
U. S. Corporates	9,718,574	10,002,480	---
U. S. Corporate Obligations with variable rates	---	---	334,745,670
Asset-backed Securities with variable rates	---	---	160,185,536
Commercial Paper	---	---	354,524,569
* Reported at fair value	<u>\$829,201,923</u>	<u>\$850,447,780</u>	<u>\$849,455,775</u>

**FINANCIAL STATEMENTS**

**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. The Capital Assets in Progress represent costs associated with the Integrated Retirement Information System (IRIS) Project. Although these costs have been capitalized, depreciation expense will not be calculated until the project is completed during early FY 2005.

Depreciation expense for 2003 was \$274,242 and for 2002 was \$269,632.

**7. Due to Other State Agencies**

This account represents the amount due to various participating public employers for over-remittances of employer contributions during the fiscal years ended June 30, 2003 and 2002. Over-remittances can be applied to future reporting periods or refunded, at the option of the administrative unit.

**8. Accrued Compensated Absenses**

Qualified employees are entitled to accumulate vacation leave according to a graduated leave

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

When employees terminate employment with the State of New Mexico, they are compensated for accumulated vacation leave as of the termination date up to a maximum of 240 hours. All balances up to 240 hours for each employee have been recorded at their current pay rate as of June 30, 2003 and 2002.

Qualified employees are entitled to accumulate sick leave at the rate of one (1) day for each calendar month of service. There is no limit to the amount of sick leave an employee can accumulate. Once per fiscal year, in either January or July, employees may elect to be paid for accrued sick leave in excess of six hundred (600) hours but less than seven hundred twenty (720) hours at fifty percent (50%) of their current hourly rate.

Capital asset activity for the year ended June 30, 2003 was as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Land	\$ 248,172	\$ -----	\$ -----	\$ 248,172
Capital assets in progress	2,205,176	137,554	-----	2,342,730
Depreciable Land Improvements	1,875	-----	-----	1,875
Building & Building Improvements	1,136,225	20,144	-----	1,156,369
Furniture & Equipment	<u>1,445,456</u>	<u>123,887</u>	<u>(68,724)</u>	<u>1,500,619</u>
Total	<u>5,036,904</u>	<u>281,585</u>	<u>(68,724)</u>	<u>5,249,765</u>
Accumulated Depreciation				
Depreciable Land Improvements	937	188	-----	1,125
Building & Building Improvements	600,074	46,519	-----	646,593
Furniture & Equipment	<u>805,307</u>	<u>227,535</u>	<u>(64,722)</u>	<u>968,120</u>
Total	<u>1,406,318</u>	<u>274,242</u>	<u>(64,722)</u>	<u>1,615,838</u>
Capital Assets, Net	<u>\$3,630,586</u>	<u>\$ 7,343</u>	<u>\$ (4,002)</u>	<u>\$3,633,927</u>

## FINANCIAL STATEMENTS

In the case of retiring employees, they may be paid for accrued sick leave in excess of six hundred (600) hours but less than one thousand (1,000) hours at fifty percent (50%) of their current hourly rate. All sick leave balances in excess of six hundred (600) hours but less than seven hundred twenty (720) hours for each employee have been recorded at fifty percent (50%) of their current hourly rate.

The following table provides a summary of the change in accrued compensated absences for the fiscal year ended June 30, 2003:

Balances Payable at Beginning of the Fiscal Year	\$ 142,134
Additions	112,850
Deletions	<u>(121,069)</u>
Balances Payable at End of the Fiscal Year	<u>\$ 133,915</u>

It is estimated that approximately \$115,000 of this year-end liability will be payable within the next fiscal year. Funds used to liquidate this liability will come from the Board's Educational Retirement Fund.

### 9. Leases

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

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

<u>Fiscal Year</u> <u>Ended June 30</u>	<u>Future Minimum</u> <u>Lease Payments</u>
2004	\$ 35,858
2005	35,440
2006	<u>11,604</u>
Total	<u>\$ 82,902</u>

Lease expense was \$35,127 for the fiscal year ended June 30, 2003 and \$26,433 for the fiscal year ended June 30, 2002.

### 10. Retirement Plans

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

*Plan Description – ERA:* This Plan is a cost-sharing, multiple-employer defined benefit plan established and administered by the Board to provide retirement, disability benefits, survivor benefits and cost-of-living adjustments for all certified teachers and other employees of State public schools, higher education institutions, junior colleges, and technical-vocational institutions.

*Plan Description – PERA:* This Plan is a cost-sharing, multiple-employer defined benefit plan administered by the Public Employees Retirement Association (PERA). The Plan provides for retirement, disability benefits, survivor benefits and cost-of-living adjustments to Plan members and beneficiaries. PERA issues a separate, publicly available financial report that includes financial

statements and required supplementary information. That report may be obtained by writing to PERA, P. O. Box 2123, Santa Fe, NM 87504-2123.

*Funding Policy – ERA:* Educational Retirement Board Plan members are required to contribute 7.60% of their gross salary. The Board is required to contribute 8.65% of the gross covered salary. The contribution requirements of the Plan members and the Board are established in State statute at Chapter 22, Section 11, NMSA 1978. The requirements may be amended by acts of the Legislature. The Board’s contributions to ERA for the fiscal years ending June 30, 2003, 2002, and 2001 were \$48,760, \$53,970, and \$50,620, respectively, equal to the amount of the required contributions for each fiscal year.

*Funding Policy – PERA:* PERA Plan members are required to contribute 7.42% of their gross salary. The Board is required to contribute 16.59% of the gross covered salary. The contribution requirements of the Plan members and the Board are established in State statute at Chapter 10, Section 11, NMSA 1978. The requirements may be amended by acts of the Legislature. The Board’s contributions to PERA for the fiscal years ending June 30, 2003, 2002, and 2001 were \$384,519, \$346,424, and \$291,513, respectively, equal to the amount of the required contributions for each fiscal year.

**11. Post-Employment Benefits**

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

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

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

Each participating employer makes contributions to the Fund in the amount of one and three-tenths percent (1.3%) of each participating employee’s annual salary. Each participating employee contributes sixty-five hundredths of one percent (0.65%) of his or her annual salary to the Fund. These contribution rates were effective beginning July 1, 2002.

Each participating retiree pays a variable monthly premium based on coverage desired and years of service. The basic rate in FY 2003 was \$86.31. An additional premium of five dollars (\$5.00) per month is charged if the eligible participant retired prior to July 1, 1990 and made no contributions to the Plan.

Contributions from participating employers and employees become the property of the Retiree Health Care Fund and are not refundable under any circumstances, including termination of employment

or termination of the participating employers' operation or participation in the Retiree Health Care Act. The employer, employee, and retiree contributions are required to be remitted to the Retiree Health Care Authority on a monthly basis.

The Retiree Health Care Authority issues a separate, publicly available audited financial report that includes post-employment benefit expenditures of premiums and claims paid, participant contributions (employer, employee, and retiree), and net expenditures for the fiscal year. The report also includes the approximate number of retirees participating in the Plan. That report may be obtained by writing to the Retiree Health Care Authority, 810 West San Mateo Road, Santa Fe, NM 87505.

For the fiscal year ended June 30, 2003, \$24,830 in employer contributions and \$12,415 in employee contributions were remitted to the Retiree Health Care Authority by the Board.

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

## 12. Contingencies

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

For 2003, 34,228 terminated members with an aggregate balance of \$3,902,749 were eligible to receive refunds. For 2002, 32,338 terminated members were eligible to receive refunds in the aggregate amount of \$3,570,281. The aggregate

balances are exclusive of interest. There have been no adjustments made in the accompanying Statement of Plan Net Assets to reflect this contingent liability.

## 13. Risk Management

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

## 14. Statutory Disclosures

Section 2.2.2.12A(4) of the Audit Rule 2003, 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 (see next page).

ERB expects to complete the Pension Information Management System (IRIS) in the fall of 2004. It is anticipated that funding for IRIS will be carried over to FY 2005 and, therefore, be available for the completion of the project.

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

## 15. Preparation of Financial Statements, Exhibits, Schedules and Notes

Board staff prepared the Management's Discussion & Analysis (MD&A), financial statements, statements, schedules, and notes for the fiscal years ended June 30, 2003 and 2002.

## FINANCIAL STATEMENTS

### Building Remodel/Addition:

Laws of 2000-Second Session 2000/Section 29 (FY00-FY04)	\$ 750,000
Expended in FY01	(8,389)
Encumbered in FY01	<u>(63,999)</u>
Rebudgeted in FY02	\$ 677,612
Expended in FY02	---
Encumbered in FY02	<u>---</u>
Rebudgeted in FY03	\$ 677,612
Laws of 2002-Chapter 110, Section 58 (FY02-FY07)	<u>\$ 500,000</u>
Subtotal FY03 Budget with carryover from FY02	\$1,177,612
Expended in FY03	---
Encumbered in FY03	<u>(37,248)</u>
Unencumbered Balance at 6/30/03	<u><u>\$1,140,364</u></u>

### Pension Information Management System (IRIS):

Laws of 2000-Second Special Session/Chapter 5, Section 8 (FY00-02)	\$3,000,000
Expended in FY01	(38,007)
Encumbered in FY01	<u>(41,514)</u>
Rebudgeted in FY02	\$2,920,479
Laws of 2001-Second Session/Chapter 64, Section B (FY01-02)	<u>\$3,000,000</u>
Subtotal FY02 Budget with carryover from FY01	\$5,920,479
Expended in FY02	(2,157,222)
Encumbered in FY02	<u>(2,060,087)</u>
Rebudgeted in FY03	\$1,703,170
Laws of 2002-Second Session/Chapter 4, Section 7, Item 11 (FY03-04)	<u>\$2,000,000</u>
Subtotal FY03 Budget with carryover from FY02	\$3,703,170
Expended in FY03	(462,611)
Encumbered in FY03	<u>(345,807)</u>
Unencumbered Balance at 6/30/03	<u><u>\$2,894,752</u></u>

**Schedule of Funding Progress  
for the Fiscal Year Ended June 30, 2003**

**FINANCIAL STATEMENTS**

Valuation Date	(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 Actuarial Liability as a % of Covered Payroll (3)/(5)
1998	\$5,169.5	\$6,398.8	\$1,229.3	80.8%	\$1,542.8	79.7%
1999	\$5,988.5	\$6,971.6	\$983.1	85.9%	\$1,637.5	60.0%
2000	\$6,835.8	\$7,460.6	\$624.8	91.6%	\$1,795.7	34.8%
2001	\$7,418.3	\$8,070.3	\$652.0	91.9%	\$1,819.6	35.8%
2002	\$7,595.1	\$8,748.0	\$1,152.9	86.8%	\$1,978.5	58.3%
2003	\$7,518.2	\$9,266.6	\$1,748.4	81.1%	\$2,032.5	86.0%

**Notes:** 1. Dollar amounts are in millions.

2. Actuarial assumptions were changed as of June 30, 1998, June 30, 2001 and June 30, 2003.

**Schedule of Employer Contributions  
for the Fiscal Year Ended June 30, 2003**

Fiscal Year Ended <u>June 30</u>	Annual Required <u>Contribution</u>	Percentage <u>Contributed</u>
1998	\$136,190,862	100.0%
1999	\$145,521,527	100.0%
2000	\$153,260,317	100.0%
2001	\$161,524,340	100.0%
2002	\$173,863,363	100.0%
2003	\$179,010,098	100.0%

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION**

**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:

	<u>2003</u>	<u>2002</u>
Valuation date	June 30, 2003	June 30, 2002
Actuarial cost method	Entry Age Normal	Entry Age Normal
Amortization method	Level payment, open	Level payment, open
Remaining amortization period	78.0 years	27.2 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*	4.50% to 13.00%	4.50% to 13.00%
* Includes inflation calculated at	3.00%	3.00%
Cost of living adjustments	2.00%	2.00%

At June 30, 2003, the following changes were made to other actuarial assumptions:

- The profile of typical new hires was changed to one based on new members during the 1999 through 2002 actuarial valuations.
- The post-retirement mortality tables for non-disabled lives were changed to increase the setbacks for both males and females by one year.
- The male retirement rates were changed, generally lowering the retirement rates at 25 or more years of service.
- The payroll growth rate was increased from 3.00% to 3.75%.





December 12, 2003

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

Dear Members of the Board:

**Subject: Actuarial Valuation as of June 30, 2003**

We certify that the information contained in this report is accurate and fairly presents the actuarial position of the Educational Retirement Board of New Mexico (ERB) as of June 30, 2003.

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

To the best of our knowledge, this report is based on benefit provisions in effect as of June 30, 2003, audited financial information prepared as of that date, member data gathered as of that date, and actuarial assumptions and methods previously adopted by the Board.

**Actuarial Valuation**

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

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

**Financing Objectives**

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

**Progress Toward Realization of Financing Objectives**

As of June 30, 2003, the funding period is 78.0 years. This is an increase from last year's funding period of 27.2 years. Therefore, the current statutory rate is now inadequate. The contribution that would be required in order to

## ACTUARIAL REPORT

amortize the UAAL over 25 years, the Board's target period, is 10.43%. (Last year the 25-year funding rate was 8.81%.) To comply with the 30-year maximum amortization period set by GASB 25, the employer contribution rate would need to be 9.93%.

The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) decreased from last year. The funded ratio at June 30, 2002 was 86.8%, while it is now 81.1%. Five years ago the ratio stood at 80.8%. However, if the ratio were calculated using the market value rather than the actuarial value of assets, it would be 65.6% as of June 30, 2003. During the last fiscal year, the UAAL increased from \$1,152.8 million to \$1,748.5 million.

The increase in the funding period is almost entirely due to the lower than expected investment returns for the last three fiscal years.

### **Future Expected Changes**

All of the standard actuarial measurements, including the funded ratio and the funding period, are functions of the actuarial value of assets. The actuarial value of assets recognizes investment gains and losses – the positive or negative differences between the actual net investment return on market value and the expected 8.00% investment return – over a period of five years, at the rate of 20% per year. Therefore, 40% of the losses from FY 2001, 60% of the losses from FY 2002, and 80% of the losses in FY 2003 are not yet reflected in the actuarial measurements. As these losses are recognized over the next four valuations, we expect the funding period to continue increasing, in the absence of any changes in the benefit-and-contribution structure of ERB, and in the absence of offsetting experience gains.

### **Benefit Provisions**

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

### **Assumptions and Methods**

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan's actuary. The last review of these assumptions occurred following the 2002 actuarial valuation, and the Board adopted all of our recommendations. We believe the recommended assumptions are internally consistent and are reasonably based on the actual experience of ERB.

### **Member and Financial Data**

Member data for retired, active, and inactive participants was supplied as of June 30, 2003, by the ERB staff. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior year's data. Asset information was also supplied by the ERB staff and by the plan's auditors.

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

Sincerely,

Gabriel, Roeder, Smith & Company

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

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

**ACTUARIAL REPORT**

**Executive Summary**

<u>Item</u>	<u>2003</u>	<u>2002</u>
<b>Membership</b>		
•Number of		
- Active members	62,614	61,091
- Retirees and beneficiaries	24,085	23,052
- Inactive, vested	5,391	5,217
- Inactive, nonvested	<u>15,686</u>	<u>14,714</u>
- Total	107,776	104,074
•Payroll	\$2,032.5 million	\$1,978.5 million
<b>Statutory Contribution Rates</b>		
•Employer	8.65%	8.65%
•Member	7.60%	7.60%
<b>Assets</b>		
•Market value	\$6,083.4 million	\$6,011.2 million
•Actuarial value	\$7,518.2 million	\$7,595.1 million
•Return on market value	2.7%	-8.8%
•Return on actuarial value	0.1%	3.3%
•Employer contributions	\$179.1 million	\$173.9 million
•External cash flow %	-1.5%	-1.2%
•Ratio of actuarial to market value	123.6%	126.4%
<b>Actuarial Information</b>		
•Normal cost %	12.92%	12.72%
•Unfunded actuarial accrued liability (UAAL)	\$1,748.5 million	\$1,152.8 million
•Funded ratio	81.1%	86.8%
•Funding period (years)	78.0	27.2
<b>Gains/(losses)</b>		
•Asset experience	\$ (594.6) million	\$ (346.5) million
•Liability experience	81.8 million	(189.6) million
•Benefit changes	N/A	N/A
•Assumption/method changes	<u>(65.7) million</u>	<u>N/A</u>
•Total	\$ (578.5) million	\$ (536.1) million

### Introduction

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

### Actuarial Information

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

- The actuarial present value of future benefits is determined for the present members, including retired members, beneficiaries, inactive members and active members. This amounts to \$11,143.9 million, as shown on Table 3.
- The entry age normal funding method is used to allocate the actuarial present value of future benefits between the portion due for the current year (the normal cost), prior years (the actuarial accrued liability) and future years. The actuarial accrued liability is \$9,266.6 million, as shown in line 6d on Table 1.
- Under the entry age normal cost method the current and future normal costs are determined as a level percentage of payroll.

Table 4 shows an analysis of the normal cost rate. The amount needed to fund the current and future normal costs is 12.92% of payroll inclusive of member contributions. This is the total (member plus employer) contribution rate needed to pay for the average new member.

- A part of the normal cost is paid by the employee contributions of 7.60%, leaving 5.32% to be funded by the employers. I.e., the current year's employer normal cost is 5.32% of payroll. This is shown in Line 3 of Table 1.
- The unfunded actuarial accrued liability (UAAL) is determined by subtracting the actuarial value of assets from the actuarial accrued liability. (The actuarial value of assets is a smoothed market value, as discussed in more detail below.) The UAAL is \$1,748.5 million, as shown in line 8 on Table 1.
- Since the statutory employer contribution rate is 8.65%, and the employer normal cost rate is 5.32%, the difference of 3.33% is used to amortize the UAAL. The 3% contribution made on behalf of ARP members is also used to amortize the UAAL.
- Finally, the funding period is the anticipated period needed to reduce the UAAL to zero, assuming that plan experience exactly follows the assumptions, that no benefit changes are made, that payroll grows at 3.75% per year, and that the contributions are made as required. The funding period this year is 78.0 years.

### Analysis of Changes

Table 2 shows an analysis of the changes in the UAAL. Since the UAAL is an actuarial present value, with future anticipated benefits discounted using an 8.00% interest rate, the UAAL increases

each year by the imputed interest rate, less employer contributions made to amortize the UAAL. (Keep in mind that part of the employer contribution is used to pay the normal cost, so only part of each year's contribution is available to amortize the UAAL.)

As shown on Table 2, the UAAL increased by \$92.2 million for imputed interest and decreased by \$75.0 million because of payments made. This means that the UAAL was expected to increase \$17.3 million before recognizing plan experience. The UAAL as of June 30, 2002 was \$1,152.8 million, and the expected UAAL at June 30, 2003, recognizing actual contributions made, was \$1,169.9 million.

The plan experienced a liability gain of \$81.8 million. This gain represents 0.9% of the total actuarial accrued liability.

There was an actuarial loss on investments of \$594.6 million. The investment loss resulted from the fact that the return on the actuarial value of assets, 0.1%, was less than the 8.00% assumed investment return rate. This loss was the result of recognizing an additional 20% of the losses from FY 2001 and FY 2002, as well as recognizing 20% of the actuarial investment loss from FY 2003. The market rate of return in FY 2003 was 2.7%.

The Board has adopted several changes to the actuarial assumptions, including:

- Decreasing the mortality rates applied to current and future retirees, reflecting lower mortality and longer life expectancies
- Decreasing male retirement rates at most ages
- Increasing the payroll growth rate from 3.00% to 3.75%
- Revising the new entrant profile used to determine the normal cost to one based on

the age-sex-pay distribution of new members during FY 1999 through FY 2002

These assumptions changes, taken together, caused an increase of \$65.7 million in the UAAL.

As a result of all the experience, the UAAL increased from \$1,152.8 million to \$1,748.5 million, and the funding period increased from 27.2 years to 78.0 years.

### GASB 25 Disclosure

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

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

Tables 6a, 6b, and 6c show information required to be reported under GASB 25. Table 6a shows a history of funding progress—a comparison of the actuarial value of assets with the actuarial accrued liability and a comparison of the UAAL with covered payroll. This table shows steady progress over the last few years from 1992 to 2001, with the best funded ratio in 2001, 91.9%, then it decreased to 86.8% as of 2002 and 81.1% as of 2003.

Table 6b shows a six-year comparison of the employer contributions actually received with the GASB 25 ARC. Note that this shows that 100% of the ARC was contributed during FY 2003, since the 8.65% employer contribution rate is

larger than the 30-year contribution calculated in last year's valuation (8.49%). For FY 2004, however, the financial reports prepared for ERB will show that only 87.1% of the ARC was contributed for FY 2004. This is because the 8.65% statutory rate is less than the calculated 30-year contribution rate of 9.93%.

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

- Actuarial assumptions were changed at June 30, 1998, June 30, 2001 and June 30, 2003.

### Benefit Provisions

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

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

### Actuarial Assumptions and Methods

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

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

As noted above, following the completion of the June 30, 2002 actuarial valuation, we prepared an analysis of experience for ERB, generally over the five-year period ending June 30, 2002. As a result of that investigation, we recommended some changes to the actuarial assumptions, including adoption of revised post-retirement mortality rates and revised retirement rates for males. We also recommended increasing the payroll growth rate from 3.00% to 3.75%. The Board approved all of our recommendations.

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

### Assets

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

Table 8a presents a summary of the market value of assets held by the fund, and Table 8b shows the allocation of assets held for investment. About 68% of the assets are now held in equities, compared to 66% last year and 67% the year before. Table 9 shows a reconciliation of the assets from the beginning of the prior year to the valuation date. Note that after we prepared the June 30, 2002 actuarial valuation, the auditors made a decision to capitalize the purchase of certain software, which had been treated as an administrative expense. This resulted in an adjustment between the market value we used last year at June 30, 2002 and the value used this year.

Tables 10a and 10b show the development of the actuarial value of assets (AVA). The AVA is a smoothed market value. A smoothed value is used in order to dampen some of the year-to-year fluctuations

that would occur if the market value were used instead. The method used phases in differences between the actual and expected market returns over five years. The expected return is determined using the 8.00% assumption and the plan's market value, adjusted for contributions received and benefits and refunds paid. Both the actual and expected returns are computed net of administrative expenses.

Note that the actuarial value is 124% of the market value. Over time, we would expect the actuarial value to trend back towards the market value, so this disparity should shrink in the future.

Table 11a shows the investment return rate for the year on both market value (2.7%) and actuarial value (0.1%). Table 11b shows historical return rates since the current actuarial asset method was adopted.

Finally, Table 13 shows a history of cash flows to the trust, and the net cash flow measured as a percentage of the assets. The cash flow is slightly negative, 1.5% of market value, but this is not a sign of concern in a mature plan such as ERB.

### Member Data

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

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

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

The number of active members increased 2.5% since last year, from 61,091 to 62,614. Note that the actual number of active members during the year will be somewhat higher, since the June 30 count excludes May and June retirees, but does not include new teachers who will join the system for the 2003-2004 school year.

Total payroll increased 2.7% since last year. For all comparative purposes, payroll is the amount supplied by the ERB staff (i.e., the 2002-03 member pay). However, this figure is increased by one year's pay increase to determine the member's rate of pay at July 1, 2003. Pay is assumed to change only at the beginning of a school/fiscal year.

Average pay increased 0.2% since last year. Average pay for members active in both this valuation and the last year's valuation increased 3.0%. The difference between these two figures is due to the effect of retirements and terminations, and their replacement by new members who generally earn less.



**ACTUARIAL REPORT**

**Actuarial Information**

	<u>July 1, 2003</u>	<u>July 1, 2002</u>
	(1)	(2)
1. Payroll		
a. Supplied by System (annualized)	\$ 2,032,479,090	\$ 1,978,528,267
b. Adjusted for one-year's pay increase	2,144,882,038	2,088,571,200
2. Actuarial present value of future pay	\$ 14,530,195,684	\$ 14,132,519,737
3. Normal cost rate (payable monthly)		
a. Total normal cost rate	12.92%	12.72%
b. Less: member contribution rate	<u>(7.60%)</u>	<u>(7.60%)</u>
c. Employer normal cost rate	5.32%	5.12%
4. Employer normal cost (Item 3c * Item 1b)	\$ 114,107,724	\$ 106,934,845
5. Actuarial accrued liability for active members		
a. Actuarial present value of future benefits	\$ 6,729,619,109	\$ 6,497,787,700
b. Less: actuarial present value of future normal costs (Item 3a * Item 2)	<u>(1,877,301,282)</u>	<u>(1,797,656,511)</u>
c. Actuarial accrued liability	\$ 4,852,317,827	\$ 4,700,131,189
6. Total actuarial accrued liability for:		
a. Retirees and beneficiaries	\$ 4,220,117,566	\$ 3,860,531,900
b. Inactive members	194,191,579	187,308,311
c. Active members (Item 5c)	<u>4,852,317,827</u>	<u>4,700,131,189</u>
d. Total	\$ 9,266,626,972	\$ 8,747,971,400
7. Actuarial value of assets	\$ 7,518,163,450	\$ 7,595,149,744
8. Unfunded actuarial accrued liability (UAAL) (Item 6d - Item 7)	\$ 1,748,463,522	\$ 1,152,821,656
9. Amortization payment		
a. Employer contribution rate	8.65%	8.65%
b. Less: Employer normal cost rate (Item 3c)	<u>(5.32%)</u>	<u>(5.12%)</u>
c. Amortization rate	3.33%	3.53%
d. Amortization contribution (Item 9c * Item 1b)	\$ 71,424,572	\$ 73,726,563
e. Expected ARP contribution	3,563,732	3,007,898
d. Total	\$ 74,988,304	\$ 76,734,461
10. Funding period based on current 8.65% employer contribution requirement, with payments increasing at assumed payroll growth rate	78.0 years	27.2 years

**Table 1**

**ACTUARIAL REPORT**

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

<u>Basis</u> (1)	<u>June 30, 2003</u> (2)	<u>June 30, 2002</u> (3)
1. UAAL at prior valuation	\$ 1,152.8	\$ 652.0
2. Increases/(decreases) due to:		
a. Interest on UAAL	92.2	52.2
b. Amortization payments <sup>1</sup>	(75.0)	(87.5)
c. Liability experience	(81.8)	189.6
d. Asset experience	594.6	346.5
e. Changes in actuarial assumptions and methods	65.7	N/A
f. Benefit change	N/A	N/A
g. Total	\$ 595.7	\$ 500.8
3. Current UAAL (1+2g)	\$ 1,748.5	\$ 1,152.8

Note : Dollar amounts in millions

<sup>1</sup>Actual contributions reduced by normal cost, and adjusted for timing.

**Table 2**

Actuarial Present Value of Future Benefits

	<u>June 30, 2003</u> (1)	<u>June 30, 2002</u> (2)
1. Active members		
a. Service retirement benefits	\$ 6,052,112,822	\$ 5,863,072,600
b. Refunds and deferred termination benefits	538,887,830	519,150,600
c. Survivor benefits	62,588,330	44,452,900
d. Disability retirement benefits	<u>76,030,127</u>	<u>71,111,600</u>
e. Total	\$ 6,729,619,109	\$ 6,497,787,700
2. Retired members		
a. Service retirement	\$ 3,989,973,067	\$ 3,653,839,200
b. Disability retirement	45,439,515	42,614,300
c. Beneficiaries	<u>184,704,984</u>	<u>164,078,400</u>
d. Total	\$ 4,220,117,566	\$ 3,860,531,900
3. Inactive members		
a. Vested terminations	\$ 148,674,141	\$ 146,722,083
b. Nonvested terminations	<u>45,517,438</u>	<u>40,586,228</u>
c. Total	\$ 194,191,579	\$ 187,308,311
4. Total actuarial present value of future benefits	\$ 11,143,928,254	\$ 10,545,627,911

Table 3

ACTUARIAL REPORT

Analysis of Normal Cost

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
	(1)	(2)
1. Gross normal cost rate (payable monthly)		
a. Service retirement benefits	8.94%	8.92%
b. Refunds and deferred termination benefits	3.71%	3.57%
c. Disability retirement benefits	0.16%	0.16%
d. Survivor benefits	<u>0.11%</u>	<u>0.07%</u>
e. Total	12.92%	12.72%
2. Less: member contribution rate	<u>(7.60%)</u>	<u>(7.60%)</u>
3. Employer normal cost rate	5.32%	5.12%

Table 4

**ACTUARIAL REPORT**

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

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
	(1)	(2)
1. Long term GASB 25 funding period (years)	30	30
2. Amortization contribution percentage		
a. Amortization payment	\$ 102,525,361	\$ 73,308,849
b. Less: expected payment for ARP members	3,563,732	3,007,898
c. Net (a-b)	\$ 98,961,630	\$ 70,300,951
d. Expected payroll	2,144,882,038	2,088,571,200
e. Amortization contribution percentage (c/d)	4.61%	3.37%
3. GASB 25 Annual Required Contribution		
a. Employer normal cost rate	5.32%	5.12%
b. Amortization percentage	4.61%	3.37%
c. Total	<u>9.93%</u>	<u>8.49%</u>
d. Statutory rate	8.65%	8.65%
e. ARC ( max of (c,d) )	9.93%	8.65%

**Table 5a**

ACTUARIAL REPORT

Actual Contributions as Percentage of GASB 25 ARC  
For Year Ending 06/30/2003

1. Actual contributions		
a. On behalf of ERB members	\$ 175,697,304	
b. On behalf of ARP members	<u>3,434,922</u>	
c. Total	\$ 179,132,226	
2. Statutory employer contribution rate		8.65%
3. Imputed fiscal year payroll for ERB members (Item 1a / Item 2)	\$ 2,031,182,705	
4. GASB 25 Annual Required Contribution		
a. Required GASB 25 employer contribution for ERB members as percent of payroll		8.65%
b. Required GASB 25 employer contribution for ERB members (Item 4a * Item 3)	\$ 175,697,304	
c. GASB 25 ARC (Item 4b + Item 1b)	\$ 179,132,226	
5. Percentage of ARC contributed (Item 1c / Item 4c)		100.0%

Table 5b

ACTUARIAL REPORT

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

Valuation Date (1)	Actuarial Value of Assets (AVA) (2)	Actuarial Accrued Liability (AAL) (3)	Accrued Liability (UAAL) (3) - (2) (4)	Funded Ratio (2)/(3) (5)	Annual Covered Payroll (6)	UAAL as % of Payroll (4)/(6) (7)
June 30, 1992	\$2,549.8	\$3,912.7	\$1,362.9	65.2%	\$1,150.4	118.5%
June 30, 1993	2,798.2	4,207.7	1,409.5	66.5%	1,191.0	118.3%
June 30, 1994	3,180.1	4,657.7	1,477.6	68.3%	1,258.7	117.4%
June 30, 1995	3,561.8	5,079.6	1,517.8	70.1%	1,356.5	111.9%
June 30, 1996	3,993.6	5,542.3	1,548.7	72.1%	1,413.6	109.6%
June 30, 1997	4,516.4	5,854.4	1,338.0	77.1%	1,448.7	92.4%
June 30, 1998	5,169.5	6,398.8	1,229.3	80.8%	1,542.8	79.7%
June 30, 1999	5,988.5	6,971.7	983.1	85.9%	1,637.5	60.0%
June 30, 2000	6,835.8	7,460.6	624.8	91.6%	1,795.7	34.8%
June 30, 2001	7,418.3	8,070.3	652.0	91.9%	1,819.6	35.8%
June 30, 2002	7,595.1	8,748.0	1,152.8	86.8%	1,978.5	58.3%
June 30, 2003	7,518.2	9,266.6	1,748.5	81.1%	2,032.5	86.0%

Note: Dollar amounts in millions

Table 6a

ACTUARIAL REPORT

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

<u>Fiscal Year</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1997	\$131,535,477	98.9%
1998	\$136,190,862	100.0%
1999	\$145,521,527	100.0%
2000	\$153,260,317	100.0%
2001	\$161,524,340	100.0%
2002	\$173,863,363	100.0%
2003	\$179,132,226	100.0%

Table 6b



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

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

Valuation date	June 30, 2003
Actuarial cost method	Entry Age Normal
Amortization method	Level payment, open
Remaining amortization period (years)	78.0
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	8.00%
Projected salary increases*	4.50% to 13.00%
*Includes inflation at	3.00%
Cost-of-living adjustments	2.00%

Table 6c

**ACTUARIAL REPORT**

**Membership Data**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
	(1)	(2)
1. Active members		
a. Number	62,614	61,091
b. Total payroll supplied by System (annualized)	\$ 2,032,479,090	\$ 1,978,528,267
c. Average salary	\$ 32,460	\$ 32,387
d. Average age	45.3	45.2
e. Average service	9.3	9.3
2. Vested inactive members (excluding pending refunds)		
a. Number	5,391	5,217
b. Total annual deferred benefits	\$ 30,708,547	\$ 29,601,294
c. Average annual deferred benefit	\$ 5,696	\$ 5,674
3. Nonvested inactive members and vested pending refunds		
a. Number	15,686	14,714
b. Employee assessments with interest due	\$ 45,517,438	\$ 40,586,228
c. Average refund due	\$ 2,902	\$ 2,758
4. Service retirees		
a. Number	21,620	20,699
b. Total annual benefits	\$ 372,397,610	\$ 340,775,737
c. Average annual benefit	\$ 17,225	\$ 16,463
5. Disabled retirees		
a. Number	598	589
b. Total annual benefits	\$ 4,745,450	\$ 4,405,617
c. Average annual benefit	\$ 7,936	\$ 7,480
6. Beneficiaries		
a. Number	1,867	1,764
b. Total annual benefits	\$ 20,638,204	\$ 18,707,056
c. Average annual benefit	\$ 11,054	\$ 10,605

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

**Table 7a**

Historical Summary of Active Member Data

Year Ending June 30, (1)	Active Members		Covered Payroll		Average Salary		Average Age (8)	Average Service Age (9)
	Number (2)	Percent Increase (3)	Amount in \$ Millions (4)	Percent Increase (5)	\$ Amount (6)	Percent Increase (7)		
1982	42,015	-----	\$ 622	-----	\$14,810	-----	40.9	10.7
1984	40,385	-3.9%	670	7.7%	16,600	12.1%	42.0	9.9
1986	45,311	12.2%	786	17.3%	17,353	4.5%	41.7	9.7
1988	45,492	0.4%	863	9.8%	18,968	9.3%	43.9	10.1
1990	48,858	7.4%	1,033	19.7%	21,146	11.5%	42.6	8.5
1992	51,161	4.7%	1,150	11.3%	22,486	6.3%	43.0	8.9
1993	52,296	2.2%	1,191	3.6%	22,774	1.3%	43.2	8.9
1994	53,744	2.8%	1,259	5.7%	23,420	2.8%	43.3	9.0
1995	54,840	2.0%	1,356	7.7%	24,735	5.6%	43.2	9.0
1996	55,782	1.7%	1,414	4.3%	25,341	2.4%	43.7	9.1
1997	56,685	1.6%	1,449	2.5%	25,556	0.8%	43.9	9.1
1998	58,097	2.5%	1,543	6.5%	26,555	3.9%	44.0	9.0
1999	58,615	0.9%	1,637	6.1%	27,936	5.2%	44.3	9.2
2000	60,090	2.5%	1,796	9.7%	29,884	7.0%	44.5	9.1
2001	60,155	0.1%	1,820	1.3%	30,248	1.2%	44.9	9.2
2002	61,091	1.6%	1,979	8.7%	32,387	7.1%	45.2	9.3
2003	62,614	2.5%	2,032	2.7%	32,460	0.2%	45.3	9.3

Table 7b

**ACTUARIAL REPORT**

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

<u>Item</u> (1)	Valuation as of	
	<u>June 30, 2003</u> (2)	<u>June 30, 2002</u> (3)
1. Cash and cash equivalents	\$ 108,068,182	\$ 189,327,483
2. Receivables:		
a. Contributions	\$ 42,951,929	\$ 42,979,199
b. Investment income	21,154,666	27,183,401
c. Investment sales proceeds - brokers	7,090,361	44,555,672
d. Other	2,528	1,526
e. Total receivables	\$ 71,199,484	\$ 114,719,798
3. Investments		
a. U.S. treasury securities	\$ 383,767,250	\$ 455,999,937
b. U.S. government agencies	979,434,779	801,770,798
c. Domestic corporate bonds	470,180,574	601,700,740
d. Domestic equities	3,199,553,289	2,898,146,632
e. International equities	930,026,908	992,565,074
f. Total investments	\$ 5,962,962,800	\$ 5,750,183,181
4. Invested securities lending collateral	\$ 710,907,101	\$ 849,455,775
5. Properties : land, building, furniture and equipment (at cost, less accumulated depreciation)	\$ 3,633,927	\$ 1,425,410
6. Total assets	\$ 6,856,771,494	\$ 6,905,111,647
7. Liabilities		
a. Accounts payable	\$ 1,943,065	\$ 1,715,936
b. Accrued expenses	192,768	194,359
c. Refunds payable	2,308,415	2,522,051
d. Investment purchases payable - brokers	57,809,285	39,860,759
e. Due to other funds	252,076	212,015
f. Securities lending collateral	710,907,101	849,455,775
g. Total liabilities	\$ 773,412,710	\$ 893,960,895
8. Total market value of assets available for benefits (Item 6 - Item 7)	\$ 6,083,358,784	\$ 6,011,150,752

**Table 8a**

Allocation of Cash and Investments

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
1. Cash and short-term equivalents	1.8%	3.2%
2. U.S. treasury securities	6.3%	7.7%
3. U.S. government agencies	16.1%	13.5%
4. Domestic corporate bonds	7.7%	10.1%
5. Domestic equities	52.8%	48.8%
6. International equities	<u>15.3%</u>	<u>16.7%</u>
7. Total investments	100.0%	100.0%

Table 8b

**ACTUARIAL REPORT**

**Reconciliation of Plan Net Assets**

	Year Ending	
	<u>June 30, 2003</u>	<u>June 30, 2002</u>
	(1)	(2)
1. Value of assets at beginning of year		
a. Value reported in prior valuation	\$ 6,011,150,752	\$ 6,667,001,941
b. Prior period adjustments	2,083,048 <sup>1</sup>	
c. Revised value	<u>\$ 6,013,233,800</u>	<u>\$ 6,667,001,941</u>
2. Revenue for the year		
a. Contributions		
i. Member contributions (including redeposits and service purchases)	\$ 158,770,180	\$ 154,730,089
ii. Employer contributions	175,697,304	170,943,074
iii. Employer contributions for ARP members	3,434,922	2,920,289
iv. Total	<u>\$ 337,902,406</u>	<u>\$ 328,593,452</u>
b. Income		
i. Interest, dividends, and other income	\$ 151,395,127	\$ 168,605,483
ii. Investment expenses	(6,621,136)	(4,291,673)
iii. Net	<u>\$ 144,773,991</u>	<u>\$ 164,313,810</u>
c. Net realized and unrealized gains	\$ 16,156,143	\$ (746,928,008)
d. Total revenue	<u>\$ 498,832,540</u>	<u>\$ (254,020,746)</u>
3. Expenditures for the year		
a. Refunds	\$ 28,338,456	\$ 28,508,035
b. Benefit payments	396,081,755	367,494,870
c. Administrative and miscellaneous expenses	4,287,345	5,827,538
d. Total expenditures	<u>\$ 428,707,556</u>	<u>\$ 401,830,443</u>
4. Increase in net assets (Item 2 - Item 3)	\$ 70,124,984	\$ (655,851,189)
5. Value of assets at end of year (Item 1 + Item 4)	\$ 6,083,358,784	\$ 6,011,150,752

<sup>1</sup> Sum of (i) \$2,205,176 in expenses capitalized after completion of June 30, 2002 actuarial valuation and (ii) (\$122,128) prior period adjustment made this year.

**Table 9**

**ACTUARIAL REPORT**

**Determination of Excess Earnings to be Deferred**

Year ended:	<u>June 30, 2000</u>	<u>June 30, 2001</u>	<u>June 30, 2002</u>	<u>June 30, 2003</u>
	(1)	(2)	(3)	(4)
1. MVA at beginning of year	\$ 6,740,382,211	\$ 7,567,525,248	\$ 6,667,001,941	\$ 6,011,150,752
2. Net new investments				
a. Contributions	\$ 295,885,902	\$ 315,244,141	\$ 328,593,452	\$ 337,902,406
b. Benefits and refunds paid	<u>(346,966,397)</u>	<u>(377,229,591)</u>	<u>(396,002,905)</u>	<u>(424,420,211)</u>
c. Subtotal	\$ (51,080,495)	\$ (61,985,450)	\$ (67,409,453)	\$ (86,517,805)
3. MVA at end of year	\$ 7,567,525,248	\$ 6,667,001,941	\$ 6,011,150,752	\$ 6,083,358,784
4. Net MVA earnings ( 3 - 1 - 2)	\$ 878,223,532	\$ (838,537,857)	\$ (588,441,736)	\$ 158,725,837
5. Assumed investment return rate	8.00%	8.00%	8.00%	8.00%
6. Expected return	\$ 537,187,357	\$ 602,922,602	\$ 530,663,777	\$ 477,431,348
7. Excess return ( 4 - 6)	\$ 341,036,175	\$ (1,441,460,459)	\$ (1,119,105,513)	\$ (318,705,511)
8. Excess return deferral percent	20%	40%	60%	80%
9. Amount deferred	\$ 68,207,235	\$ (576,584,184)	\$ (671,463,308)	\$ (254,964,409)

Note : MVA is market value of assets.

**Table 10a**

**ACTUARIAL REPORT**

**Development of Actuarial Value of Assets**

1. Market value of assets as of valuation	\$ 6,083,358,784
2. Deferred amounts for fiscal year ending June 30,	
a. 2003	\$ (254,964,409)
b. 2002	\$ (671,463,308)
c. 2001	\$ (576,584,184)
d. 2000	\$ <u>68,207,235</u>
e. Total	\$ (1,434,804,666)
3. Actuarial value of assets (1) - (2)	\$ 7,518,163,450
4. Actuarial value as percent of market value	123.6%

**Table 10b**



Estimation of Yields

	Year Ending	
	<u>June 30, 2003</u>	<u>June 30, 2002</u>
	(1)	(2)
A. Market value yield		
1. Beginning of year market assets	\$ 6,011,150,752	\$ 6,667,001,941
2. Investment income (including realized and unrealized gains and losses)	\$ 163,013,182	\$ (582,614,198)
3. End of year market assets	\$ 6,083,358,784	\$ 6,011,150,752
4. Estimated dollar weighted market value yield	2.7%	-8.8%
B. Actuarial value yield		
1. Beginning of year actuarial assets	\$ 7,595,149,744	\$ 7,418,311,093
2. Actuarial return	\$ 9,531,511	\$ 244,248,104
3. End of year actuarial assets	\$ 7,518,163,450	\$ 7,595,149,744
4. Estimated actuarial value yield	0.1%	3.3%

Table 11a

History of Investment Return Rates

<u>Plan Year Ending June 30 of</u> (1)	<u>Market</u> (2)	<u>Actuarial</u> (3)
1995	18.5%	11.5%
1996	12.2%	12.0%
1997	20.3%	13.4%
1998	19.6%	15.0%
1999	11.3%	16.4%
2000	13.1%	15.1%
2001	-11.1%	9.5%
2002	-8.8%	3.3%
2003	2.7%	0.1%

Table 11b

Investment Experience Gain or Loss

<u>Item</u> (1)	<u>June 30, 2003</u> (2)	<u>June 30, 2002</u> (3)
1. Actuarial assets, beginning of year	\$ 7,595,149,744	\$ 7,418,311,093
2. Total contributions during year	\$ 337,902,406	\$ 328,593,452
3. Benefits and refunds paid	\$ (424,420,211)	\$ (396,002,905)
4. Assumed net investment income at 8%		
a. Beginning of year assets	\$ 607,611,980	\$ 593,464,887
b. Contributions	13,516,096	13,143,738
c. Benefits and refunds paid	<u>(16,976,808)</u>	<u>(15,840,116)</u>
d. Total	\$ 604,151,268	\$ 590,768,509
5. Expected actuarial assets, end of year (Sum of items 1 through 4)	\$ 8,112,783,207	\$ 7,941,670,149
6. Actual actuarial assets, end of year	\$ 7,518,163,450	\$ 7,595,149,744
7. Asset gain (loss) for year (Item 6 - Item 5)	\$ (594,619,757)	\$ (346,520,405)

Table 12a

**ACTUARIAL REPORT**

**Total Experience Gain or Loss**

<u>Item</u> (1)	<u>June 30, 2003</u> (2)	<u>June 30, 2002</u> (3)
A. Calculation of total actuarial gain or loss		
1. Unfunded actuarial accrued liability (UAAL), previous year	\$ 1,152,821,656	\$ 652,024,201
2. Normal cost for the previous year	\$ 265,666,258	\$ 244,471,227
3. Less: contributions for the year	\$ (337,902,406)	\$ (328,593,452)
4. Interest at 8 %		
a. On UAAL	\$ 92,225,732	\$ 52,161,936
b. On normal cost	10,626,650	9,778,849
c. On contributions	(13,516,096)	(13,143,738)
d. Total	<u>\$ 89,336,286</u>	<u>\$ 48,797,047</u>
5. Expected UAAL (Sum of Items 1 - 4)	\$ 1,169,921,794	\$ 616,699,023
6. Actual UAAL	\$ 1,748,463,522	\$ 1,152,821,656
7. Total gain (loss) for the year (Item 5 - Item 6)	\$ (578,541,728)	\$ (536,122,633)
B. Source of gains and losses		
8. Asset gain (loss) for the year	\$ (594,619,757)	\$ (346,520,405)
9. Liability experience gain (loss) for the year	\$ 81,756,424	\$ (189,602,228)
10. Assumption change	\$ (65,678,395)	N/A
11. Benefit change	<u>N/A</u>	<u>N/A</u>
12. Total	\$ (578,541,728)	\$ (536,122,633)

**Table 12b**

## History of Cash Flow

Year Ending June 30, (1)	Expenditures					External Cash Flow for the Year <sup>3</sup> (8)	Market Value of Assets (9)	External Cash Flow as Percent of Market Value (10)
	Contributions <sup>1</sup> (2)	Benefit Payments (3)	Refunds (4)	Administrative Expenses <sup>2</sup> (5)	Other (6)			
1994	214.2	(175.3)	(19.8)	(1.7)	0.0	(196.8)	3,190.0	0.5%
1995	229.7	(193.1)	(22.3)	(2.0)	0.0	(217.4)	3,792.3	0.3%
1996	238.9	(210.6)	(23.9)	(2.3)	0.0	(236.8)	4,257.2	0.0%
1997	245.6	(231.6)	(24.7)	(1.9)	0.0	(258.2)	5,107.3	-0.2%
1998	260.9	(254.4)	(28.2)	(2.1)	0.0	(284.7)	6,082.1	-0.4%
1999	278.9	(274.8)	(30.0)	(2.7)	0.0	(307.5)	6,740.4	-0.4%
2000	295.9	(311.8)	(35.2)	(2.5)	0.0	(349.5)	7,567.5	-0.7%
2001	315.2	(340.6)	(36.6)	(3.5)	0.0	(380.7)	6,667.0	-1.0%
2002	328.6	(367.5)	(28.5)	(5.8)	0.0	(401.8)	6,011.2	-1.2%
2003	337.9	(396.1)	(28.3)	(4.3)	0.0	(428.7)	6,083.4	-1.5%

Amounts in \$ millions

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

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

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

Table 13

**ACTUARIAL REPORT****Solvency Test**

	<u>June 30, 2003</u> (1)	<u>June 30, 2002</u> (2)
1. Actuarial accrued liability (AAL)		
a. Active member contributions	\$ 1,144,836,500	\$ 1,084,611,241
b. Retirees and beneficiaries	4,220,117,566	3,860,531,900
c. Active and inactive members (employer financed)	<u>3,901,672,906</u>	<u>3,802,828,259</u>
d. Total	\$ 9,266,626,972	\$ 8,747,971,400
2. Actuarial value of assets	\$ 7,518,163,450	\$ 7,595,149,744
3. Cumulative portion of AAL covered		
a. Active member contributions	100%	100%
b. Retirees and beneficiaries	100%	100%
c. Active and inactive members (employer financed)	55%	70%

**Table 14**

**Historical Retired Participants' Data**

<u>Year Ending June 30,</u> (1)	<u>Number</u> (2)	<u>Average Monthly Benefit</u> (3)
1984	8,462	\$ 430
1986	10,004	512
1988	11,375	663
1990	12,741	767
1992	14,107	846
1993	15,001	890
1994	15,814	966
1995	16,593	976
1996	17,381	1,011
1997	18,317	1,055
1998	19,244	1,104
1999	20,109	1,139
2000	21,186	1,228
2001	22,191	1,274
2002	23,052	1,315
2003	24,085	1,376

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

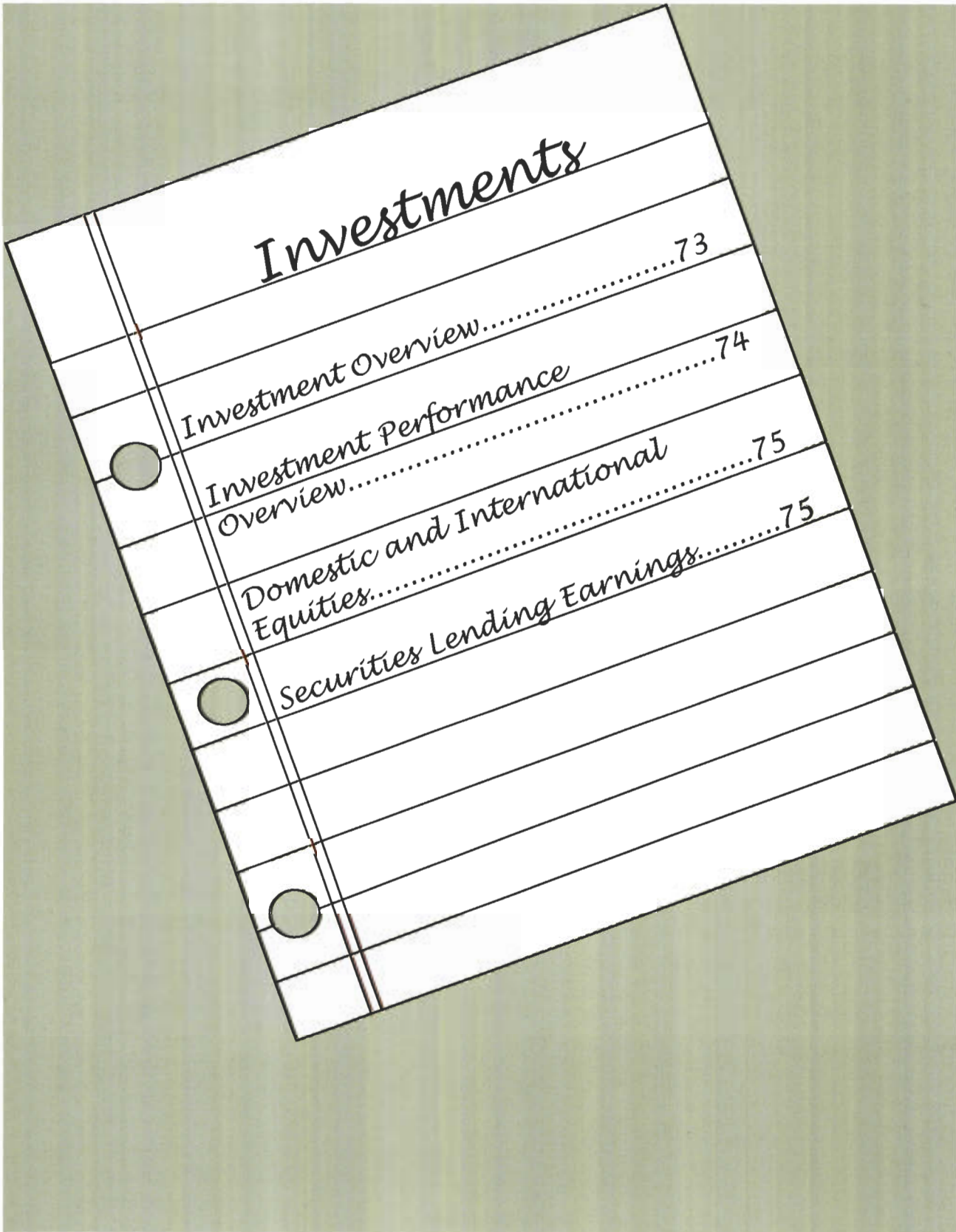
**Table 15**

**Distribution of Active Members by Age and by Years of Service  
As of 06/30/2003**

Attained Age	Years of Credited Service													Total Count
	0	1	2	3	4	5-9	10-14	15-19	20-24	25-29	30-34	35/Over		
	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	Count & Avg. Comp.	
Under 25	598 \$14,661	505 \$18,901	218 \$15,564	71 \$14,977	36 \$16,748	10 \$20,948	0 \$0	0 \$0	0 \$0	0 \$0	0 \$0	0 \$0	0 \$0	1,438 \$16,398
25-29	568	1,111	840	621	436	456	6	0	0	0	0	0	0	4,038
30-34	\$21,912	\$25,348	\$25,644	\$26,539	\$28,033	\$27,580	\$26,139	\$0	\$0	\$0	\$0	\$0	\$0	\$25,652
	539	906	789	667	558	1,926	266	7	0	0	0	0	0	5,658
35-39	\$23,835	\$23,838	\$24,931	\$27,471	\$27,933	\$31,079	\$30,955	\$26,234	\$0	\$0	\$0	\$0	\$0	\$27,624
	1,075	1,143	772	670	538	2,022	1,207	243	9	0	0	0	0	7,679
40-44	\$21,317	\$24,573	\$24,883	\$25,485	\$26,659	\$29,956	\$34,275	\$35,824	\$30,308	\$0	\$0	\$0	\$0	\$27,679
	513	855	801	739	656	2,487	1,561	1,138	305	14	0	0	0	9,069
45-49	\$25,250	\$23,588	\$23,447	\$24,127	\$26,140	\$29,083	\$34,464	\$39,219	\$38,195	\$29,016	\$0	\$0	\$0	\$29,738
	419	802	710	710	593	2,557	1,972	1,383	1,223	427	10	0	0	10,806
50-54	\$26,759	\$23,913	\$24,950	\$25,861	\$27,391	\$29,982	\$36,010	\$41,331	\$45,704	\$44,763	\$38,960	\$0	\$0	\$33,587
	330	617	593	502	509	2,164	2,137	1,665	1,332	1,106	230	1	1	11,186
55-59	\$27,624	\$27,740	\$27,790	\$28,200	\$29,803	\$32,378	\$35,737	\$41,251	\$48,059	\$51,080	\$52,221	\$26,058	\$37,520	\$37,520
	209	428	387	364	322	1,293	1,376	1,314	978	735	380	29	29	7,815
60-64	\$32,645	\$28,912	\$28,939	\$29,380	\$30,502	\$32,537	\$37,149	\$40,421	\$46,725	\$51,836	\$57,492	\$60,083	\$38,976	\$38,976
	93	149	172	148	156	661	643	592	404	341	176	68	68	3,603
65 & Over	\$32,660	\$28,856	\$30,115	\$26,230	\$28,987	\$30,672	\$33,618	\$39,127	\$43,120	\$51,535	\$62,935	\$63,036	\$37,838	\$37,838
	49	73	83	66	57	288	228	163	113	90	58	54	54	1,322
Total	\$28,307	\$16,391	\$19,515	\$27,690	\$21,272	\$26,278	\$28,880	\$36,055	\$42,068	\$41,671	\$65,612	\$66,924	\$32,675	\$32,675
	4,393	6,589	5,365	4,558	3,861	13,864	9,396	6,505	4,364	2,713	854	152	152	62,614
	\$23,180	\$24,544	\$25,124	\$26,260	\$27,680	\$30,452	\$35,149	\$40,202	\$45,762	\$49,922	\$57,529	\$63,611	\$32,460	\$32,460

Table 16





<b>Investments</b>	
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## Investment Overview

### I. INVESTMENT OVERVIEW

Recognizing the important and perpetual nature of the fund and the fiduciary responsibilities of the Board, the primary goal in investing the assets shall be to provide significant real returns adjusted for inflation with acceptable risk (volatility). In light of these dual goals, the Investment Division continues to diversify the fund's assets for purposes of both controlling risk and enhancing return.

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

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

### II. INVESTMENT PROCESS

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

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

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

### III. ASSET ALLOCATION

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

## Investment Performance Overview

### I. ERB FUND STRATEGY

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

### II. ECONOMIC OVERVIEW

The crisis of confidence among investors that drove the equity markets to record low levels began to abate somewhat in the spring of 2003. Investors in search of yield returned to the markets with an appetite for risk that had not been present in the market for the last two years. The financial markets had to contend with increasing jobless claims, a higher unemployment rate, fears of deflation, lower industrial production, the SARS epidemic in the Far East and Canada, and the war in Iraq. These fears led to lower consumer confidence and kept investors nervous about an economic recovery in the U.S. Monetary authorities in the U.S. and abroad have provided record amounts of monetary stimulus to the global economy. In the U.S., the Federal Reserve cut the

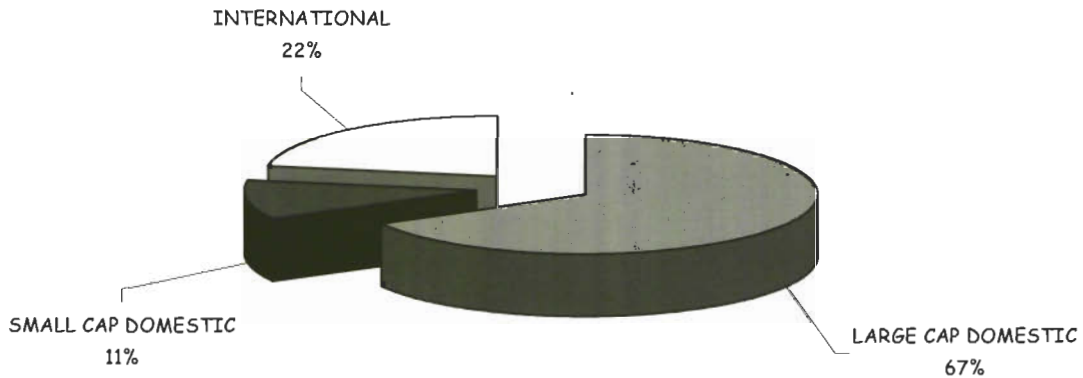
Federal Funds rate twice during FY 2003, lowering rates from 1.75% to 1.00%. As a result, the fixed income market realized its third consecutive year of strong positive returns. In addition, a massive fiscal stimulus package was passed during the latter half of the fiscal year. All of this monetary and fiscal-policy stimulation drove economic growth expectations up and fueled a significant rally in the stock markets worldwide during the quarter ended June 30, 2003.

### III. ERB PORTFOLIO PERFORMANCE

The domestic equity portfolio gained 2.92%, outperforming the S&P 500's 0.22% return. This was largely attributable to our two new small cap managers, Franklin Advisors and Rothschild Asset Management, who had a combined return of 11.7% versus the benchmark return of -1.6%. The three international managers returned -6.17% versus the benchmark return of -4.92%. The fixed income portfolio returned 11%, slightly above the 10.4% return of its benchmark, the Lehman Brothers Aggregate Bond Index. The total fund returned 2.8%, compared to the 3.87% return earned by the Composite Index Benchmark. This poor relative performance was entirely due to the under-performance of one international investment manager who was terminated when the four-year contract expired and was subsequently replaced by two new international managers, Fidelity Management Trust Company and J.P. Morgan Fleming.

**INVESTMENTS**

**Domestic and International Equities as of June 30, 2003**



**Securities Lending Earnings**

**Fiscal Year 2003**

**Earned July 2002 through June 2003**

**Paid August 2002 through July 2003**

<b>PAY MONTH</b>	<b>INCOME</b>
AUGUST	\$ 116,386.57
SEPTEMBER	\$ 102,821.32
OCTOBER	\$ 96,568.37
NOVEMBER	\$ 128,791.66
DECEMBER	\$ 202,935.79
JANUARY	\$ 191,962.78
FEBRUARY	\$ 160,532.54
MARCH	\$ 189,972.88
APRIL	\$ 105,618.08
MAY	\$ 132,504.64
JUNE	\$ 98,884.63
JULY	\$ 112,014.94
<b>TOTAL</b>	<b>\$1,638,994.20</b>

**NOTES**



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