

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Financial Statements and Schedules

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)

KPMG LLP
New Jersey Headquarters
150 John F. Kennedy Parkway
Short Hills, NJ 07078

Independent Auditors' Report

Director, Division of Pension and Benefits
State of New Jersey
Alternate Benefit Program Fund
Pension Adjustment Fund:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Alternate Benefit Program Fund and Pension Adjustment Fund (the Funds) as of June 30, 2004 and 2003, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Funds' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 audit 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Pension Adjustment Fund and Alternate Benefit Program Fund as of June 30, 2004 and 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures to this information as prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

September 24, 2004

KPMG LLP

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Management's Discussion and Analysis

June 30, 2004 and 2003

Our discussion and analysis of the financial performance of the Alternate Benefit Program Fund and the Pension Adjustment Fund (the Funds) provides an overview of the Funds' financial activities for the fiscal year ended June 30, 2004 and 2003. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2004 - 2003

- The Funds' total additions were \$133.2 million mostly consisting of member and employer contributions of \$133.1 million and investment income of \$0.1 million.
- The Funds' total deductions were \$133.2 million consisting of pension and insurance benefit charges of \$132.2 million and other expenses of \$1.0 million.

2003 - 2002

- The Funds' total additions were \$130.4 million mostly consisting of member and employer contributions of \$130 million and investment income of \$0.4 million.
- The Funds' total deductions were \$130.4 million consisting of pension and insurance benefit charges of \$128.4 million and other expenses of \$2.0 million.

THE BALANCE SHEET AND THE STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

This annual report consists of two financial statements: *The Balance Sheet* and *The Statements of Changes in Fiduciary Net Assets*. These financial statements report information about the Funds and about their activities to help you assess whether the Funds, as a whole, have improved or declined as a result of the year's activities. The financial statements were prepared using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the period they are earned, and expenses are recorded in the year they are incurred, regardless of when cash is received or paid.

The Balance Sheet shows the balances in all of the assets and liabilities of the Funds at the end of the fiscal year. Liabilities include fiduciary net assets held for the State and the local participating employers to cover pension adjustment costs. *The Statements of Changes in Fiduciary Net Assets* show the results of financial operations for the year. The statements provide an explanation for the change in the Funds' fiduciary net assets since the prior year. These two financial statements should be reviewed along with the information contained in the financial statement footnotes to determine whether the Funds is able to meet its financial obligations.

FINANCIAL ANALYSIS

BALANCE SHEET

2004 - 2003

	2004	2003	Increase (Decrease)
Assets	\$27,295,305	\$27,433,384	\$(138,079)
Liabilities	27,295,305	27,433,384	(138,079)
Net Assets (Deficit)	\$0	\$0	\$0

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Management's Discussion and Analysis, Continued

The Funds' assets mainly consist of cash, investments and contributions due from the State and local employers. Between fiscal years 2003 and 2004, total assets decreased by 0.5%. This is mainly due to a decrease in fair value balances invested in Cash Management Fund (CMF).

Liabilities mainly consist of benefits payable to eligible recipients in the Pension Adjustment Fund (PAF); pension reimbursements owed by the State of New Jersey to state/county colleges and outstanding life and long-term disability insurance premium charges in the Alternate Benefit Program Fund (ABP). Between fiscal year 2003 and 2004, total liabilities decreased by 0.5%. The decrease in the liabilities is mainly related to a decrease in pension adjustment payroll payable to retirees and beneficiaries in the PAF.

2003 - 2002

	2003	2002	Increase (Decrease)
Assets	\$27,433,384	\$26,642,022	\$791,362
Liabilities	27,433,384	26,642,022	791,362
Net Assets (Deficit)	\$0	\$0	\$0

Between fiscal years 2002 and 2003, total assets increased by 3.0%. This is mainly due to an increase in contributions due from the State to cover pension and life insurance charges in the ABP.

Between fiscal year 2002 and 2003, total liabilities increased by 3.0%. The increase in the liabilities is mainly related to the increase in the State's reimbursement liability to state/county colleges for employer share in the ABP.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS

2004 - 2003

	2004	2003	Increase (Decrease)
Member Contributions	\$699,121	\$673,034	\$26,087
Employer Contributions	132,369,860	129,345,617	3,024,243
Investment & Other	174,436	409,218	(234,782)
Totals	\$133,243,417	\$130,427,869	\$2,815,548

For the ABP, additions primarily consist of member and employer contributions and earnings from investment activities. During the year, member contribution increased by 3.9% due to an increase in number of active members. Employer contributions increased by \$4.1 million or 3.5% due to higher base salaries. Investment earning decreased by 61.3% due to a low CMF interest rate.

For the PAF, additions consist of employer contributions and earnings from investment activities. Contributions recognized by the PAF decreased by \$1 million or 8.5% over last year due to a decrease in number of retirees and beneficiaries receiving pension adjustment benefit. Investment earnings dropped by 50.4% due to a low CMF interest rate.

2003 - 2002

	2003	2002	Increase (Decrease)
Member Contributions	\$673,034	\$651,432	\$21,602
Employer Contributions	129,345,617	121,669,465	7,676,152
Investment & Other	409,218	2,378,235	(1,969,017)
Totals	\$130,427,869	\$124,699,132	\$5,728,737

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Management's Discussion and Analysis, Continued

During the year, employer contributions by the ABP increased by \$9.0 million or 8.3% due to higher base salaries. Investment earning decreased by \$1.8 million or 87.5% due to a low CMF interest rate.

Contributions recognized by the PAF decreased by \$1.3 million or 9.6% over last year due to decrease in number of retirees and beneficiaries. Investment earnings dropped by 46.6% due to a low CMF interest rate.

DEDUCTIONS FROM FIDUCIARY NET ASSETS
2004 - 2003

	2004	2003	Increase (Decrease)
Benefits	\$132,187,587	\$128,400,036	\$3,787,551
Refunds & Amounts Due the General Fund	1,055,830	2,027,833	(972,003)
Totals	\$133,243,417	\$130,427,869	\$2,815,548

The increase in benefit payments is mainly due to the increase in the State reimbursement expense to state/county colleges based on 8% of the base salaries of active participants in the ABP. Also, the increase is related to higher life insurance benefit payments in the ABP. Benefit payments increased by \$4.8 million or 4.1% in the ABP. The number of active and retired claims processed was higher as compared to the prior year.

Refunds and amounts due the general fund primarily represent contributions received from the State of New Jersey in excess of the amount required to cover benefit charges incurred by the Funds. There was a decrease in this expense by 47.9% between 2004 and 2003.

2003 - 2002

	2003	2002	Increase (Decrease)
Benefits	\$128,400,036	\$121,542,876	\$6,857,160
Refunds & Amounts Due the General Fund	2,027,833	3,156,256	(1,128,423)
Totals	\$130,427,869	\$124,699,132	\$5,728,737

The increase in benefit payments is mainly due to the increase in the State reimbursement expense to state/county colleges based on 8% of the base salaries of active participants. Also, the increase is related to higher life insurance benefit payments in the ABP. It increased by \$8.1 million or 7.5% in the ABP. The number of active and retired claims processed was higher as compared to the prior year.

Refunds and amounts due the general fund primarily represent contributions received from the State of New Jersey in excess of the amount required to cover benefit charges incurred by the Funds. There was a decrease in this expense between 2003 and 2002.

RETIREMENT SYSTEM AS A WHOLE

During the year, the Alternate Benefits Program Fund and the Pension Adjustment Fund received sufficient funding to meet their benefit obligations.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

The financial report is designed to provide our members, beneficiaries, investors and other interested parties with a general overview of the Funds' finances and to show the Funds' accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Division of Pensions and Benefits, P.O. Box 295, Trenton, NJ 08625-0295.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Balance Sheet
Fiduciary Funds - Agency Funds

June 30, 2004

	<u>ALTERNATE BENEFIT PROGRAM FUND</u>	<u>PENSION ADJUSTMENT FUND</u>	<u>TOTAL</u>
Assets:			
Cash and cash equivalents	\$ 261,287	688,111	949,398
Investments, at fair value:			
Cash Management Fund	<u>11,949,036</u>	<u>3,169,285</u>	<u>15,118,321</u>
Total investments	<u>11,949,036</u>	<u>3,169,285</u>	<u>15,118,321</u>
Receivables:			
State related employer contributions	—	2,484,014	2,484,014
Other	<u>8,734,029</u>	<u>9,543</u>	<u>8,743,572</u>
Total receivables	<u>8,734,029</u>	<u>2,493,557</u>	<u>11,227,586</u>
Total assets	<u>\$ 20,944,352</u>	<u>6,350,953</u>	<u>27,295,305</u>
Liabilities:			
Accounts payable and accrued expenses	\$ 20,036,372	—	20,036,372
Assets held for local contributing employers	—	3,808,277	3,808,277
Pension adjustment payroll payable	—	912,004	912,004
Due to State of New Jersey	907,980	121,423	1,029,403
Other	<u>—</u>	<u>1,509,249</u>	<u>1,509,249</u>
Total liabilities	<u>\$ 20,944,352</u>	<u>6,350,953</u>	<u>27,295,305</u>

See accompanying notes to the financial statements.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Balance Sheet
Fiduciary Funds - Agency Funds

June 30, 2003

	<u>ALTERNATE BENEFIT PROGRAM FUND</u>	<u>PENSION ADJUSTMENT FUND</u>	<u>TOTAL</u>
Assets:			
Cash and cash equivalents	\$ 344,780	132,124	476,904
Investments, at fair value:			
Cash Management Fund	<u>14,931,117</u>	<u>4,102,651</u>	<u>19,033,768</u>
Total investments	<u>14,931,117</u>	<u>4,102,651</u>	<u>19,033,768</u>
Receivables:			
State related employer contributions	—	2,779,531	2,779,531
Other	<u>5,119,718</u>	<u>23,463</u>	<u>5,143,181</u>
Total receivables	<u>5,119,718</u>	<u>2,802,994</u>	<u>7,922,712</u>
Total assets	<u>\$ 20,395,615</u>	<u>7,037,769</u>	<u>27,433,384</u>
Liabilities:			
Accounts payable and accrued expenses	\$ 18,598,669	—	18,598,669
Assets held for local contributing employers	—	3,807,568	3,807,568
Pension adjustment payroll payable	—	991,440	991,440
Due to State of New Jersey	1,796,946	267,427	2,064,373
Other	<u>—</u>	<u>1,971,334</u>	<u>1,971,334</u>
Total liabilities	<u>\$ 20,395,615</u>	<u>7,037,769</u>	<u>27,433,384</u>

See accompanying notes to the financial statements.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND**

Statements of Changes in Fiduciary Net Assets

Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Additions:		
Contributions:		
Members	\$ 699,121	673,034
Employers	<u>120,967,986</u>	<u>116,889,694</u>
Total contributions	<u>121,667,107</u>	<u>117,562,728</u>
Investment income:		
Net appreciation (depreciation) in fair value of investments	(11,074)	(10,150)
Interest	<u>112,434</u>	<u>272,151</u>
Total investment income	<u>101,360</u>	<u>262,001</u>
Total additions	<u><u>121,768,467</u></u>	<u><u>117,824,729</u></u>
Deductions:		
Benefits	120,827,308	116,036,015
Refunds of contributions and due General Fund	<u>941,159</u>	<u>1,788,714</u>
Total deductions	<u><u>\$ 121,768,467</u></u>	<u><u>117,824,729</u></u>

See accompanying notes to the financial statements.

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Statements of Changes in Fiduciary Net Assets

Years Ended June 30, 2004 and 2003

	2004	2003
Additions:		
Contributions:		
Employers	\$ 11,401,874	12,455,923
Total contributions	11,401,874	12,455,923
Investment income:		
Net appreciation (depreciation) in fair value of investments	(3,025)	(7,462)
Interest	76,101	154,679
Total investment income	73,076	147,217
Total additions	11,474,950	12,603,140
Deductions:		
Benefits	11,360,279	12,364,021
Refunds of contributions and due General Fund	114,671	239,119
Total deductions	\$ 11,474,950	12,603,140

See accompanying notes to the financial statements .

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements

June 30, 2004 and 2003

(1) DESCRIPTION OF THE FUNDS

Agency funds:

Pension Adjustment Fund
Alternate Benefit Program Fund

The State of New Jersey Pension Adjustment Fund (PAF) is a pay-as-you-go multiple-employer defined benefit plan which was established in 1958 under the provisions of N.J.S.A. 43:3B. The PAF provides cost-of-living increases in retirement allowances to certain retired public employees and beneficiaries of retired members in the State of New Jersey Consolidated Police and Firemen's Pension Fund, State of New Jersey Prison Officers' Pension Fund, and State of New Jersey Central Pension Fund.

The State of New Jersey Alternate Benefit Program Fund (ABP) was established by legislation in 1965 through 1968 for full-time faculty members of public institutions of higher education. It was later expanded to include certain administrative and professional titles.

The financial statements of the Funds are included along with other state-administered pension trust funds in the basic financial statements of the State of New Jersey.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus and Basis of Accounting:

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Agency funds do not have a measurement focus, but they employ the accrual basis of accounting, which recognizes increases and decreases in economic resources as soon as the underlying event or transaction occurs.

The accrual basis of accounting is used for measuring financial position and changes in fiduciary net assets of the Funds. Under this method, revenues are recorded in the accounting period in which they are earned, and deductions are recorded at the time the liabilities are incurred. The financial statements of the Funds conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans" and No. 26, "Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans." Employer contributions are recognized when payable to the Funds. Benefits and refunds are recognized when payable in accordance with the terms of the Funds.

Investment Valuation:

State of New Jersey Cash Management Fund units are stated at fair value.

The State of New Jersey, Department of the Treasury, Division of Investment, issues publicly available financial reports that include the financial statements of the State of New Jersey Cash Management Funds. The financial reports may be obtained by writing to the State of New Jersey, Department of the Treasury, Division of Investment, P.O. Box 290, Trenton, New Jersey 08625-0290.

The State of New Jersey Division of Investment, under the jurisdiction of the State Investment Council, has the investment responsibility for all funds administered by the State of New Jersey Division of Pensions and Benefits. All investments must conform to standards set by state law.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements, Continued

The purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the Funds, through the State Treasurer, and custodian banks as agents for the Funds. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institutions, amount of the portfolio to be covered by the agreements, and other pertinent matters.

No investments held by the PAF are subject to GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, which requires that investments be categorized to indicate the level of custodial risk assumed by the Funds.

Administrative Expenses:

The Funds are administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the State of New Jersey, who is responsible for such costs.

Benefit Provisions:

Benefit Provisions - PAF

The pension adjustment program covers eligible retirees and survivors of the Consolidated Police and Firemen's Pension Fund, Prison Officers' Pension Fund, and Central Pension Fund. Eligible retirees and/or survivors are those who have been retired at least 24 months.

Those eligible for benefits are entitled to cost-of-living increases equal to 60% of the change in the average consumer price index for the calendar year in which the pensioner retired as compared to the average consumer price index for a 12-month period ending with each August 31st immediately preceding the year in which the adjustment becomes payable. The regular retirement allowance is multiplied by the 60% factor as developed and results in a dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits after 24 months of retirement.

Chapter 4, P.L. 2001, provided increased benefits to certain members of the Consolidated Police and Firemen's Pension Fund who retired prior to December 29, 1989 with at least 25 years of creditable service. The benefit increase was effective November 1, 2001. The maximum amount of the increase was 5% of the retiree's final compensation. For those with 30 or more years of service, the total pension benefit increased from 65% to 70% of final compensation.

As a result of this legislation, cost-of-living benefits payable to eligible retirees also increased. The State, not the local municipalities, is responsible for these costs.

Vesting and Benefit Provisions - ABP

The Alternate Benefit Program provides retirement benefits, disability benefits, and group life insurance benefits to eligible participants. Retirement benefits are payable upon separation from service with no age or service requirements. However, distributions under age 55 are limited to employee contributions and accumulations. The remaining employer's contributions and earnings are available for distribution upon attaining age 55. Participants are immediately vested if the participant has an existing retirement account containing employer and employee contributions based on employment in public education, or is an active or vested member of a federal or state retirement system.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements, Continued

Cash and Cash Equivalents

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, also requires that deposits held in financial institutions be categorized to indicate the level of custodial risk assumed by the entity. Category 1 consists of deposits that are insured or collateralized with securities held by the entity or by its agent in the entity's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name. Category 3 consists of deposits which are uninsured and uncollateralized.

Based upon aggregate collateral levels maintained for all State bank accounts as a whole, substantially all cash balances maintained in financial institutions as of June 30, 2004 and 2003, which include funding for the July 1, 2004 and 2003 retirement payroll, are designated Category 3.

The categorization of cash and cash equivalents for all state funds, including the pension trust funds, can be found in the notes to the general purpose financial statements of the State of New Jersey.

(3) CONTRIBUTIONS

Contribution Requirements - PAF

The contribution requirements were established by N.J.S.A. 43:3B-4 and are not actuarially determined. An actuarial valuation is not performed to determine the actuarial implications of the contribution requirements. The State of New Jersey and state-related employers' contributions required to provide the cost-of-living benefits under this program are determined and requested by the Division of Pensions and Benefits annually. The benefits are contributed only if the State of New Jersey appropriates the amount necessary to meet the cost of the increases to eligible retirees. If the State of New Jersey does not appropriate funds, then the cost-of-living portion of benefits to all retirees and beneficiaries of applicable state-administered retirement systems will cease.

Contribution Requirements - ABP

Members contribute a mandatory 5% of base or contractual salary that is tax deferred under the 414(h) provisions of the Internal Revenue code. Members are also permitted to make voluntary federal tax-deferred contributions under Internal Revenue Code Section 403(b). The State of New Jersey pays the employer contribution for all State and county employees participating in the plan. The employer contribution is based on 8% of base or contractual salary. The State of New Jersey is also responsible for the cost of noncontributory life insurance coverage and long term disability coverage for its plan members.

(4) INCOME TAX STATUS

The Alternate Benefit Program Fund is a qualified plan as described in Section 403(b) of the Internal Revenue Code.