STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

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, 2005 and 2004, 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 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Funds' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and 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, 2005 and 2004, and the changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

KPMG LLP

December 14, 2005

STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND

Management's Discussion and Analysis

June 30, 2005 and 2004

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, 2005 and 2004. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2005 - 2004

- The Funds' total additions were $141.0 million mostly consisting of member and employer contributions of $140.6 million and investment income of $0.4 million.
- The Funds' total deductions were $141.0 million consisting of pension and insurance benefit charges of $138.6 million and other expenses of $2.4 million.

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.

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 are able to meet their financial obligations.

FINANCIAL ANALYSIS

BALANCE SHEET

2005 - 2004

	2005	2004	Increase (Decrease)
Assets	$30,761,110	$27,295,305	$3,465,805
Liabilities	30,761,110	27,295,305	3,465,805
Net Assets	$0	$0	$0

The Funds' assets mainly consist of cash, investments and contributions due from the State and local employers. Between fiscal years 2004 and 2005, total assets increased by $3.5 million or 12.7%. This is mainly due to an increase in other receivables.

Liabilities mainly consist of 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 2004 and 2005, total liabilities increased by $3.5 million or 12.7%. The increase in the liabilities is mainly related to an increase in Due to State General Fund.

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	$0	$0	$0

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).

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.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS
2005 - 2004

	2005	2004	Increase (Decrease)
Member Contributions	$737,213	$699,121	$38,092
Employer Contributions	139,907,140	132,369,860	7,537,280
Investment & Other	353,072	174,436	178,636
Totals	$140,997,425	$133,243,417	$7,754,008

For the ABP, additions primarily consist of member and employer contributions and earnings from investment activities. During the year, member contribution increased by 5.5% due to higher base salaries. Employer contributions increased by $9.4 million or 7.8% due to higher base salaries. Investment earnings increased by 116.7% due to net appreciation in fair value of investments and a higher CMF interest rate.

For the PAF, additions consist of employer contributions and earnings from investment activities. Contributions recognized by the PAF decreased by $1.9 million or 16.3% over last year due to a decrease in number of retirees and beneficiaries receiving pension adjustment benefit. Investment earnings increased by 82.6% due to net appreciation in fair value of investments and a higher CMF interest rate.

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

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.

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.

DEDUCTIONS FROM FIDUCIARY NET ASSETS
2005 - 2004

	2005	2004	Increase (Decrease)
Benefits	$138,562,001	$132,187,587	$6,374,414
Refunds & Amounts Due the General Fund	2,435,424	1,055,830	1,379,594
Totals	$140,997,425	$133,243,417	$7,754,008

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. Benefit payments increased by $7.4 million or 6.1% 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 an increase in this expense by $1.4 million or 130.7% between 2005 and 2004.

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

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.

There was a decrease in this expense by 47.9% between 2004 and 2003.

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.

(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." 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.

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.

Investments:

The Funds' investments as of June 30, 2005 consist of an interest in the Cash Management Funds. The Cash Management Fund is not evidenced by securities that exist in physical or book entry form held by the Funds, and it is unrated.

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:

<u>Benefit Provisions - PAF</u>

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.

<u>Vesting and Benefit Provisions - ABP</u>

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.

(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. The Pension Adjustment Fund is a fund of the State of New Jersey and is tax-exempt.