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The Honorable Richard J. Codey
Acting Governor of New Jersey

The Honorable Richard J. Codey
President of the Senate

The Honorable Albio Sires
Speaker of the General Assembly

Mr. Albert Porroni
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Office of Legislative Services

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of New Jersey as of and for the year ended June 30, 2004, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of New Jersey's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units, is based on the reports of the other auditors.

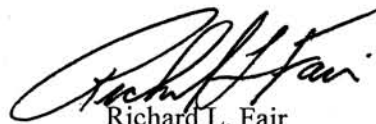
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of New Jersey as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2004 on our consideration of the State of New Jersey's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, the budgetary comparison schedules, and the funding progress schedule for all pension trust funds are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of New Jersey's basic financial statements. The introductory section, Combining Fund Statements - Non-Major Funds section, other information section and the statistical section, listed in the table of contents, are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The Combining Fund Statements - Non-Major Funds section and the other information section have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements. The introductory section and the statistical section have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.



Richard L. Fair
State Auditor
December 1, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following narrative provides an overview and analysis concerning New Jersey State Government's financial performance of its activities for the fiscal year ended June 30, 2004. Readers should consider this information in conjunction with the transmittal letter, which precedes Management's Discussion and Analysis, and the State's financial statements, which follow.

The State is in its third year of accounting and reporting under the standards outlined in the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Therefore, a majority of the information provided is not easily comparable to reporting periods prior to the fiscal year ended June 30, 2002. Year-to-year comparisons are provided in this year's Management's Discussion and Analysis. It is the intent of GASB Statement No. 34 to provide meaningful comparisons that will further explain the State's financial position and results of its operations.

FINANCIAL HIGHLIGHTS

Government-wide

- The primary government's assets total \$27.5 billion, a decrease of \$2.5 billion from the prior fiscal year. This decrease was the result of lower unemployment contributions and the liquidation of a \$1.5 billion receivable from the Fiscal Year 2003 sale of tobacco rights under the master settlement agreement. As of June 30, 2004, liabilities exceeded assets by \$2.3 billion. The State's unrestricted net assets, which represent net assets that have no statutory commitments and are available for discretionary use, totaled a negative \$13.0 billion. The negative balance is primarily a result of financing unfunded actuarial liabilities in the State's pension fund systems and uninsured motorist funds, financing local elementary and high school construction, and securitizing tobacco master settlement agreement receipts.
- June 30, 2004 component unit assets exceeded component unit liabilities by \$12.7 billion. Total component unit assets grew to \$34.4 billion, a \$3.9 billion increase in net assets from the prior fiscal year. The reclassification of Tobacco Settlement Financing Corporation, Inc. to the primary government of New Jersey represents \$2.9 billion of this increase.

Fund Level

- The State's governmental funds reported June 30, 2004 combined ending fund balances of \$7.1 billion, a decrease of \$1.3 billion from the prior fiscal year. Of this amount, \$601.4 million represents unreserved undesignated fund balances with the remainder reserved for specific, legislated purposes, management reserves, and constitutional dedications. The General Fund's total ending fund balance is \$2.9 billion, with \$376.5 million unrestricted.
- Proprietary Funds reported June 30, 2004 net assets of \$1.7 billion. During the fiscal year, this amount decreased by \$522.2 million.

Long-term Debt

- The State's long-term debt obligations increased 12.1 percent, to \$25.0 billion, which includes a net increase in bonded debt of \$2.3 billion.
- During the fiscal year, the State issued \$3.4 billion in bonds. New money issuances represented \$2.9 billion for transportation and education system improvements, while \$466.6 million represented four refunding transactions that provided the State with \$23.6 million in net present value savings. During the fiscal year ended June 30, 2004, the State paid \$1.8 billion in debt service on its long-term debt components. Non-bonded portions of the State's long-term debt total \$3.0 billion. This amount represents a \$346.7 million increase from the prior fiscal year and is mainly attributable to an increase in net pension obligations and capital leases.

OVERVIEW OF THE FINANCIAL STATEMENTS

The basic financial statements include government-wide financial statements and fund financial statements. Both statements present different views of the State's financial information. The Comprehensive Annual Financial Report includes Notes to the Financial Statements; Required Supplementary Information (Budgetary Schedules) as well as Other Information.

Major Features of the Basic Financial Statements				
Features	Government-wide Financial Statements	Fund Financial Statements		
		Governmental Funds	Proprietary Funds	Fiduciary Funds
Scope	Entire State government (except fiduciary funds) and the State's component units	State activities that are not proprietary or fiduciary	State activities that are operated similar to a private business	Instances in which the State is the trustee or agent for someone else's resources
Required Financial Statements	* Statement of Net Assets * Statement of Activities	* Balance Sheet * Statement of Revenues, Expenditures, and Changes in Fund Balance	* Statement of Net Assets * Statement of Revenues, Expenses, and Changes in Net Assets * Statement of Cash Flows	* Statement of Fiduciary Net Assets * Statement of Changes in Fiduciary Net Assets
Accounting Basis and Measurement Focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Types of Asset/Liability Information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be available and liabilities that are due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long term	All assets and liabilities, both short-term and long-term
Types of Inflow/Outflow Information	All revenues and expenses during the year, regardless of when cash is received or paid	* Revenues for which cash is received during or soon after the end of the fiscal year * Expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Government-wide Financial Statements

Government-wide financial statements provide a broad view of the State's operations conforming to private sector accounting standards and provide both short-term and long-term information regarding the State's overall financial position through the fiscal year end. The government-wide financial statements include the following two statements:

- **Statement of Net Assets** Shown on page 31, the Statement of Net Assets presents all of the State's assets and liabilities and calculates net assets. Increases or decreases in the State's net assets over time may serve as a useful indicator as to whether or not the State's overall financial position is improving or deteriorating.

- **Statement of Activities** Shown on pages 32 and 33, the Statement of Activities presents how the State's net assets changed during Fiscal Year 2004. All changes in net assets are reported when the underlying event occurs, giving rise to the change, regardless of the timing of related cash flows. This statement also presents a comparison between direct expenses and program revenues for each State function.

Both the Statement of Net Assets and the Statement of Activities have separate sections that report three activities:

- **Governmental Activities** The majority of State service functions fall into this category, which includes Executive, Legislative, and Judicial Branch operations. Governmental activity functions rely heavily on State taxes and federal grant receipts for funding their respective programs and functions.
- **Business-type Activities** Certain State operations that are legislatively able to charge fees to external users to recover all or a portion of the cost of the services that are provided are classified as business-type activities. The State Lottery Fund and the Unemployment Compensation Fund are two such examples.
- **Component Units** Legally separate operations and organizations for which the State has financial accountability are considered component units. The State has 22 authorities, of which the New Jersey Building Authority, the Garden State Preservation Trust, the New Jersey Transportation Trust Fund Authority, and the Tobacco Settlement Financing Corporation, Inc. are blended into governmental activities, and 12 colleges and universities that are reported as component units. These component units operate as business-type activities and are presented in two categories, major and non-major which is determined, generally, by the relative size of the entity's assets, liabilities, revenues, and expenses when compared to the total of the related component units. A list of the State's component units is shown in Notes 1B – Significant Accounting Policies – Financial Reporting Entity and Note 18 – Component Units in the Notes to the Financial Statements. Audit reports of the individual component units can be obtained from their respective administrative offices.

Reconciliation of Government-wide and Fund Financial Statements

The Comprehensive Annual Financial Report includes two schedules (shown on pages 35 and 37) that reconcile the amounts reported on the governmental fund financial statements (modified accrual basis of accounting) with government-wide financial statements (accrual basis of accounting). The following summarizes the major differences between the financial reporting impacts of transitioning from a modified accrual basis of accounting to a full accrual basis of accounting:

- Capital assets used in governmental activities are not reported on governmental fund financial statements.
- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures on the governmental fund statements.
- Bond and note proceeds result in liabilities on the government-wide financial statements, but are recorded as other financing sources on the governmental fund financial statements.
- Certain other outflows represent either increases or decreases in liabilities on the government-wide financial statements, but are reported as expenditures on the governmental fund financial statements.

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide financial statements and fund financial statements. The notes can be found on pages 52 to 95 of this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004.

Fund Financial Statements

Fund financial statements begin on page 106. A fund is a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations. The State's fund financial statements reflect financial reporting practices in accordance with this definition. The State's funds, which excludes components units, are divided into three categories – governmental, proprietary, and fiduciary.

- **Governmental Funds Financial Statements** Most direct state services are financed through governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. The governmental funds financial statements focus on current inflows and outflows of expendable resources and the unexpended balances at the end of a fiscal year that are available for future spending. Governmental fund information helps determine whether or not there was an addition or a reduction in financial resources that can be spent in the near future to finance State programs.

The State's governmental funds are the General Fund, Debt Service Fund, Special Revenue Funds, and Capital Projects Funds. These funds are reported using the modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- **Proprietary Funds Financial Statements** Proprietary funds are used to account for State business-type activities. Since these funds charge fees to external users, they are known as enterprise funds. Proprietary funds provide the same information as government-wide financial statements and use the accrual basis of accounting.
- **Fiduciary Funds Financial Statements** Fiduciary funds, which include State pension fund systems, are used to account for resources held by the State for the benefit of parties outside of State government. Fiduciary funds are reported using the accrual basis of accounting, in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets as shown on pages 42 to 44. Government-wide financial statements exclude fiduciary fund activity and balances since the assets are legislatively restricted in purpose and do not represent discretionary assets the State can use to fund its operations.

Notes to the Financial Statements

Beginning on page 52, the Notes to the Financial Statements provide additional background information that assist the reader in understanding the data provided in the government-wide financial statements and fund financial statements.

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes budgetary schedules that reconcile the statutory intent of the program with fund balances in accordance with generally accepted accounting principles at fiscal year end as well as variances between the final budget and actual results on a budgetary basis. Also there is a Schedule of Funding Progress for all Pension Trust Funds.

Other Information

Combining financial statements for non-major governmental funds, proprietary funds, fiduciary funds, and non-major component units are shown in this section. They are not reported individually, as with major funds, on the Governmental Fund Financial Statements. The Schedule of Appropriations and Expenditures, shown in this section details the comparison of expenditures at the legal level of control to the final budget. The Schedule of Anticipated Revenue and the Schedule of Appropriated Revenue provide detailed information on major and miscellaneous taxes, fees and other revenues. The Schedule of

Anticipated Revenue provides further analysis by showing dollar and percentage variances of actual collections as compared to the original anticipation.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net Assets

The State's fiscal year ended combined net assets totaled a negative \$2.3 billion. Fiscal Year 2004 activities showed a \$3.5 billion decrease in combined net assets, with net assets of governmental activities decreasing by \$3.0 billion, and business-type activities decreasing by \$522.2 million.

**Net Assets
For Fiscal Year Ended June 30
(Expressed In Millions)**

	Governmental Activities		Business-type Activities		Total Primary Government	
	2004	2003*	2004	2003	2004	2003*
Current and other noncurrent assets	\$ 10,495.0	\$ 13,311.2	\$ 3,170.7	\$ 3,761.5	\$ 13,665.7	\$ 17,072.7
Capital assets, net	13,857.4	12,960.8	--	--	13,857.4	12,960.8
Total Assets	<u>24,352.4</u>	<u>26,272.0</u>	<u>3,170.7</u>	<u>3,761.5</u>	<u>27,523.1</u>	<u>30,033.5</u>
Current liabilities	3,434.0	5,071.9	499.9	501.8	3,933.9	5,573.7
Noncurrent liabilities	24,958.1	22,266.1	973.1	1,039.9	25,931.2	23,306.0
Total Liabilities	<u>28,392.1</u>	<u>27,338.0</u>	<u>1,473.0</u>	<u>1,541.7</u>	<u>29,865.1</u>	<u>28,879.7</u>
Net Assets:						
Invested in capital assets, net of related debt	5,221.8	4,907.4	--	--	5,221.8	4,907.4
Restricted	3,715.3	4,175.0	1,697.7	2,219.8	5,413.0	6,394.8
Unrestricted	(12,976.8)	(10,148.4)	--	--	(12,976.8)	(10,148.4)
Total Net Assets	<u>\$ (4,039.7)</u>	<u>\$ (1,066.0)</u>	<u>\$ 1,697.7</u>	<u>\$ 2,219.8</u>	<u>\$ (2,342.0)</u>	<u>\$ 1,153.8</u>

*Fiscal Year 2003 Governmental Activities and Total Primary Government have been restated.

Restricted net assets are the largest component of the State's net assets. Capital assets, net of depreciation are used by the State to provide services to citizens; consequently these assets are not available for future spending. Land, land improvements, buildings and improvements, machinery and equipment, infrastructure (roads, bridges and other immovable assets), and construction in progress are shown less any related outstanding debt used to acquire these assets.

Changes in Net Assets

The State's Fiscal Year 2004 net assets decreased by \$3.5 billion. During Fiscal Year 2004, the State made \$1.6 billion in expenditures that were supported by the balance of the Fiscal Year 2003 sale of tobacco rights. Another \$1.6 billion was disbursed to the New Jersey Schools Construction Corporation to help finance school facilities construction throughout the state. Approximately 52.1 percent of the State's total revenue came from general taxes, while 23.5 percent was derived from operating grants. Charges for services amounted to 21.5 percent of total revenues, while other items such as governmental subsidies and grants, capital grants, interest and investment earnings, and miscellaneous revenues accounted for the remainder. State expenditures cover a range of services. The largest expense, 28.7 percent was for educational, cultural, and intellectual development. Physical and mental health amounted to 20.1 percent of total expenditures, while government direction, management, and control amounted to 12.7 percent. Other major expenditures focused on economic planning, development, and security, public safety and criminal justice, and community development and environmental management. During Fiscal Year 2004, governmental activity expenses exceeded program revenues, resulting in the use of \$22.7 billion of general

revenues (mostly taxes). Revenues from business-type activities in Fiscal Year 2004 exceeded expenses by \$203.8 million.

The deficit in unrestricted governmental net assets arose primarily as a result of the cost of the State's school facilities construction program, depreciation expense related to capital assets, and certain liabilities that are required to be included in the government-wide financial statements.

**Statement of Activities
For Fiscal Year Ended June 30
(Expressed In Millions)**

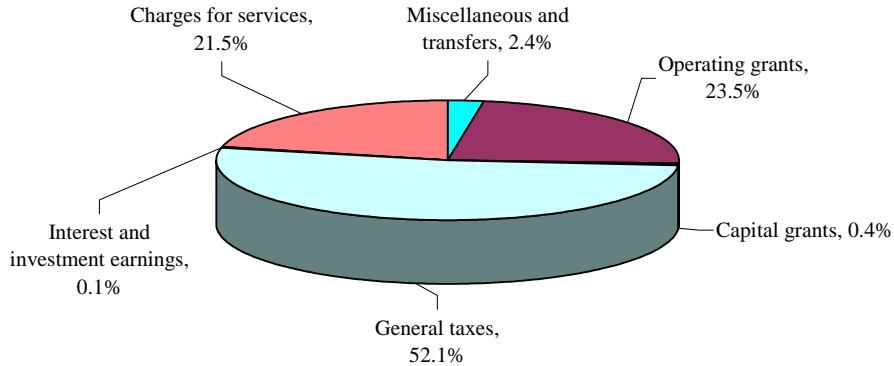
	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Primary Government Total</u>	
	<u>2004</u>	<u>2003*</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003*</u>
Revenues						
Program revenues						
Charges for services	\$ 3,341.0	\$ 3,900.7	\$ 5,317.4	\$ 4,706.4	\$ 8,658.4	\$ 8,607.1
Operating grants	8,985.0	9,151.1	481.8	897.8	9,466.8	10,048.9
Capital grants	140.9	30.6	--	--	140.9	30.6
General revenues						
General taxes	20,940.6	19,347.3	--	--	20,940.6	19,347.3
Interest and investment earnings	59.8	61.1	--	--	59.8	61.1
Miscellaneous	1,890.8	1,647.5	--	--	1,890.8	1,647.5
Total Revenues	<u>35,358.1</u>	<u>34,138.3</u>	<u>5,799.2</u>	<u>5,604.2</u>	<u>41,157.3</u>	<u>39,742.5</u>
Expenses						
Public safety and criminal justice	2,667.9	2,504.5	--	--	2,667.9	2,504.5
Physical and mental health	8,806.4	9,305.6	--	--	8,806.4	9,305.6
Educational, cultural, and intellectual development	12,548.5	10,686.3	--	--	12,548.5	10,686.3
Community development and environmental management	2,040.8	1,959.0	--	--	2,040.8	1,959.0
Economic planning, development, and security	3,714.8	4,050.2	--	--	3,714.8	4,050.2
Transportation programs	1,902.6	1,561.1	--	--	1,902.6	1,561.1
Government direction, management, and control	5,547.6	5,759.7	--	--	5,547.6	5,759.7
Special government services	267.2	236.3	--	--	267.2	236.3
Interest expense	624.3	460.0	--	--	624.3	460.0
State Lottery Fund	--	--	1,413.2	1,339.0	1,413.2	1,339.0
Unemployment Compensation Fund	--	--	2,481.5	2,876.3	2,481.5	2,876.3
Other	--	--	1,700.7	1,367.1	1,700.7	1,367.1
Total Expenses	<u>38,120.1</u>	<u>36,522.7</u>	<u>5,595.4</u>	<u>5,582.4</u>	<u>43,715.5</u>	<u>42,105.1</u>
Excess (Deficiency) Before Contributions and Transfers	(2,762.0)	(2,384.4)	203.8	21.8	(2,558.2)	(2,362.6)
Transfers	(211.7)	716.9	(726.0)	(716.9)	(937.7)	--
Gain on Sale of Tobacco Rights	--	5.5	--	--	--	5.5
Increase (Decrease) In Net Assets	<u>(2,973.7)</u>	<u>(1,662.0)</u>	<u>(522.2)</u>	<u>(695.1)</u>	<u>(3,495.9)</u>	<u>(2,357.1)</u>
Net Assets - July 1, 2003	<u>(1,066.0)</u>	<u>596.0</u>	<u>2,219.9</u>	<u>2,914.9</u>	<u>1,153.9</u>	<u>3,510.9</u>
Net Assets - June 30, 2004	<u><u>\$(4,039.7)</u></u>	<u><u>\$(1,066.0)</u></u>	<u><u>\$ 1,697.7</u></u>	<u><u>\$ 2,219.8</u></u>	<u><u>\$(2,342.0)</u></u>	<u><u>\$ 1,153.8</u></u>

* Fiscal Year 2003 Governmental Activities and Total Primary Government have been restated.

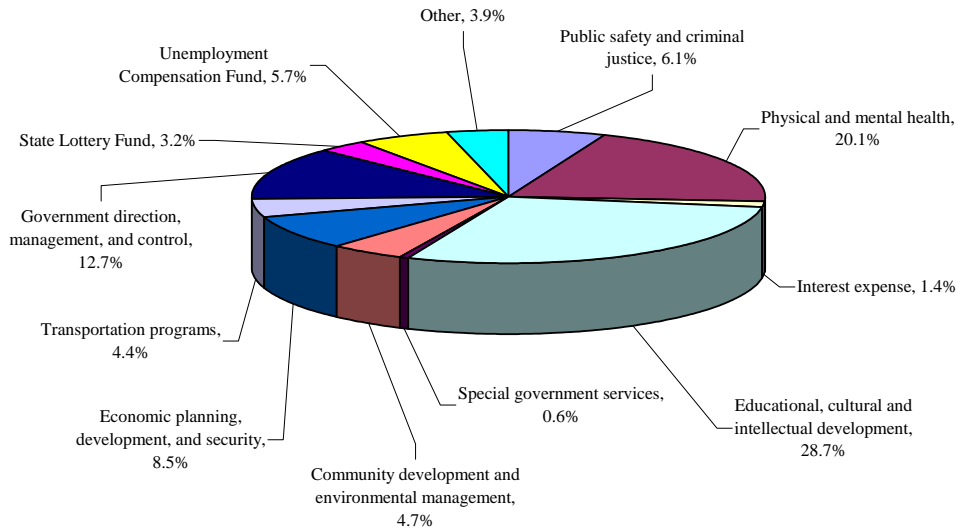
Governmental Activities – Revenues and Expenditures

The following pie charts depict governmental activities for revenues and expenditures for the fiscal year ended June 30, 2004:

**Revenues – Governmental Activities
Fiscal Year Ended June 30, 2004**



**Expenditures – Governmental Activities
Fiscal Year Ended June 30, 2004**



Fiscal Year 2004 Revenue and Expenditures

During Fiscal Year 2004, State revenues, net of transfers, totaled \$40.2 billion, an increase of \$471.6 million from the prior fiscal year. General taxes totaled \$20.9 billion and accounted for 52.1 percent of total State revenues for Fiscal Year 2004. This amount reflects a \$1.6 billion increase from the prior fiscal year. The State’s Gross Income Tax totaled \$7.3 billion, the Sales and Use Tax totaled \$6.3 billion and the Corporation Business Tax totaled \$2.4 billion. The State’s three major taxes comprised 76.0 percent of the total general taxes that were collected during Fiscal Year 2004.

Fiscal Year 2004 expenditures totaled \$43.7 billion, an increase of \$1.6 billion from the prior fiscal year. The largest increase in expenditures occurred in educational, cultural, and intellectual development areas.

This increase of \$1.9 billion represented a 17.4 percent increase over the prior fiscal year. Public safety and criminal justice increased \$163.5 million primarily as a result of increased funding in domestic security initiatives. Overall, 48.8 percent of all State expenditures occurred in the areas of education, higher education and physical and mental health.

Business-type Activities

For the fiscal year ended June 30, 2004, net assets of business-type activities totaled \$1.7 billion, a \$522.2 million decrease over the prior fiscal year. The major factor for this decrease was claims exceeding contributions in the Unemployment Compensation Fund.

FINANCIAL ANALYSIS OF THE STATE’S MAJOR FUNDS

The focus of the State’s major governmental funds reported in the fund financial statements is on near term inflows, outflows, and balance of expendable resources, which are essential elements in assessing the State’s financing needs and serve as useful measures of the government’s net resources available for future spending. The State’s governmental funds reported June 30, 2004 fund balances of \$7.1 billion. Of this amount, \$601.4 million, or 8.5 percent constituted unreserved undesignated fund balances.

The following table presents a fund balance comparison of the components of the State’s budgeted ending undesignated fund balance for Fiscal Year 2004 and Fiscal Year 2003:

**Fund Balance Comparison
(Expressed In Millions)**

Fund	Fiscal Year		Change
	2004	2003	
General Fund	\$ 376.5	\$ 373.0	\$ 3.5
Surplus Revenue Fund	282.4	--	282.4
Property Tax Relief Fund	175.2	--	175.2
Casino Control Fund	4.9	4.3	0.6
Casino Revenue Fund	22.7	--	22.7
Total	\$ 861.7	\$ 377.3	\$ 484.4

General Fund

The General Fund is the State’s chief operating fund and is the fund into which all State revenues, not otherwise restricted by statute, are deposited. The General Fund’s fiscal year ending fund balance totaled \$2.9 billion, of which, \$1.5 billion represented unreserved fund balances. During Fiscal Year 2004, total fund balance increased by \$601.9 million.

On a budgetary basis, general revenues of \$23.7 billion were \$3.0 billion lower than the final budget. Negative variances were primarily the result of reductions in federal and other grants of \$2.2 billion, licenses and fees of \$169.3 million, and service and assessments of \$124.8 million.

Total expenditures were \$3.3 billion lower than original appropriations set forth in the budget enacted during June 2003 plus supplemental appropriations during the fiscal year. This amount includes \$863.0 million from public safety and criminal justice, \$758.4 million from physical and mental health, \$493.7 million from community development and environmental management, \$479.2 million from economic planning, development and security, and \$333.3 million from government direction, management, and control. Other reductions include \$252.1 million from educational, cultural, and intellectual development, \$68.7 million from special government services, and \$64.3 million from transportation programs.

Even though general revenues were lower than the final budget, momentum from the State's economic recovery resulted in State General Fund revenues growing \$564.8 million higher than original certifications. During Fiscal Year 2004, the State deposited \$282.4 million into the Surplus Revenue Fund. The Surplus Revenue Fund is an account within the State's General Fund that is used as a "Rainy Day Fund." Surplus revenue is defined as an amount equivalent to 50.0 percent of the excess between the amount certified by the Governor at the time of the approval of the annual appropriations act and the amount of General Fund revenue reported from the annual financial report of the General Fund for that fiscal year.

Property Tax Relief Fund

The Property Tax Relief Fund accounts for revenues from the Gross Income Tax. Appropriations from this fund must be used exclusively for the constitutional purpose of reducing or offsetting property taxes. During Fiscal Year 2004, \$7.2 billion of property tax relief expenditures were made. The Property Tax Relief Fund's Fiscal Year 2004 ending undesignated fund balance is \$175.2 million.

State Lottery Fund

Monies derived from the sale of State lottery tickets are deposited into this fund. Disbursements are authorized for the payment of prizes to holders of winning lottery tickets and for the administrative expenses of the Division of State Lottery. Available fund balances are transferred to the State's General Fund in support of the amounts annually appropriated for State institutions and for education. The present value of obligations for future installment payments of lottery prizes, which are funded by the purchase of deposit fund contracts, are accounted for in this fund.

In Fiscal Year 2004, gross revenues totaled \$2.2 billion, of which 55.6 percent was returned in prizes, 35.6 percent went to State education and institutions, 7.8 percent was paid to sales agents and ticket vendors, and 1.0 percent covered Lottery operational and promotional expenses. As of June 30, 2004, the State Lottery, since its inception, has generated over \$34.7 billion in gross revenues, \$17.8 billion in prizes, and contributed \$14.0 billion to the State.

Unemployment Compensation Fund

The Unemployment Compensation Fund accounts for monies deposited from employers and employees contributions for unemployment compensation, amounts credited or advances made by the Federal Government, and amounts received from any other source. After consideration is given to any claim for refund of overpayment of contributions, the Division of Employment Security transfers the remainder to the Treasurer of the United States for credit to the State of New Jersey Unemployment Compensation Fund.

Component Units

Combined operating revenues and expenses for the State's component units for Fiscal Year 2004 amounted to \$7.5 billion and \$7.8 billion respectively. Total operations along with other financing sources and uses contributed to total combined net assets at fiscal year end of \$12.7 billion. The component units received \$1.8 billion in State appropriations during Fiscal Year 2004.

CAPITAL ASSET AND DEBT ADMINISTRATION

Administration of the State's capital assets falls under the purview of the Department of the Treasury. Capital assets are recorded under the State's General Fixed Asset System in the New Jersey Office of Management and Budget. The New Jersey Office of Public Finance is responsible for issuing the State's short-term and long-term debt obligations as well as overseeing the State's credit ratings.

The Fiscal Year 2004 capital budget included \$2.4 billion of State and matching Federal funds for both the Department of Transportation and the New Jersey Transit Corporation. The State's share, funded through the New Jersey Transportation Trust Fund Authority produced \$460.0 million for State highways, \$150.0 million for local highways, and \$618.2 million for mass transit. During Fiscal Year 2004, the New Jersey Economic Development Authority issued \$1.6 billion of School Facilities Construction Bonds to help fund the New Jersey Schools Construction Corporation's program. As of June 30, 2004, a total of

\$2.7 billion of the \$8.6 billion school facilities construction bond program has been issued. For Fiscal Year 2004, another \$98.0 million of State funds were appropriated to the Garden State Preservation Trust for conservation purposes, while 4.0 percent of the Corporation Business Tax was appropriated to fund hazardous discharge cleanup, underground storage tank improvements, and surface water quality projects.

Capital Assets are shown in the table below. The State's investment in capital assets, net of accumulated depreciation, totaled \$13.9 billion as of June 30, 2004. Depreciation charges for Fiscal Year 2004 totaled \$424.1 million.

**Capital Assets (Net of Depreciation)
As of June 30
(Expressed In Millions)**

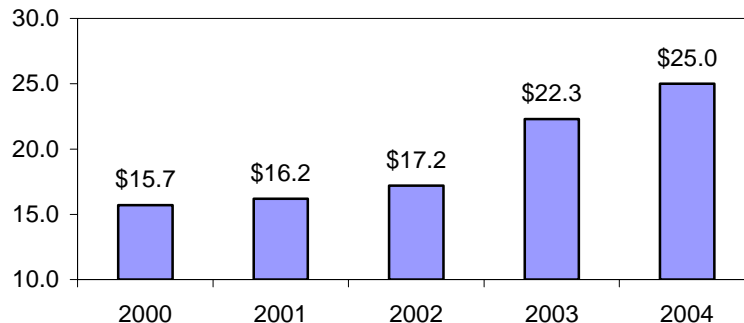
	Total Primary Government	
	2004	2003
Land	\$ 651.5	\$ 579.5
Land Improvements	25.0	24.9
Buildings and Improvements	1,460.3	1,390.9
Equipment	81.3	95.1
Infrastructure	11,290.9	10,681.3
Sub-Total	13,509.0	12,771.7
Construction-In-Progress	348.4	189.1
Total	\$ 13,857.4	\$ 12,960.8

More detailed information about the State's capital assets is presented in Note 6 – Capital Assets, in the Notes to the Financial Statements.

Long-Term Debt

As of June 30, 2004, New Jersey's outstanding long-term debt totaled \$25.0 billion, a \$2.7 billion increase over the prior fiscal year. In addition, the State has \$8.4 billion of legislatively authorized bonding capacity that has not yet been issued. During Fiscal Year 2004, the legislatively authorized bonding capacity decreased by \$2.4 billion. The State's long-term debt for the past five fiscal years is shown below:

**Long-Term Debt
Fiscal Year 2000 to Fiscal Year 2004
(Expressed in Billions)**



Note: Fiscal Year 2003 has been restated to \$22.3 billion, from \$18.8 billion due to the inclusion of Tobacco Settlement Financing Corporation, Inc. indebtedness as applied under GASB Technical Bulletin 2004-1, and the inclusion of \$99.6 million of capital leases excluded from last year's balance.

The State's long-term debt can be broken into bonded and non-bonded categories. Bonded categories include General Obligation Bonds, Revenue Bonds, Installment Obligations, Certificates of Participation, Tobacco Settlement Financing Corporation, Inc. Bonds, Unamortized Premium, and Unamortized Deferral on Refunding. Non-bonded categories include Capital Leases, Loans Payable, Accumulated Sick and Vacation Payable, Net Pension Obligation, and Other. A description of each category is as follows:

- **General Obligation Bonds** The State is empowered by voters to authorize, issue, and incur debt subject to certain constitutional restrictions. General obligation bond acts are both legislatively and voter-approved and are backed by the State's full faith and credit. Examples of capital projects financed by State General Obligation Bonds include correctional facilities, psychiatric institutions, dams, reservoirs, and transportation projects. As of June 30, 2004, the State had \$3.2 billion of State General Obligation Bonds outstanding with another \$742.4 million of bonding authorization remaining from various State General Obligation Bond Acts.
- **Revenue Bonds** This debt classification represents bond issuances whose segment of debt service is derived solely from legally restricted revenues. Revenue bonds include debt issued by the New Jersey Building Authority for the purpose of erecting office structures to support State operations, the Garden State Preservation Trust for the purpose of acquiring land to preserve for open space, and the New Jersey Transportation Trust Fund Authority for the purpose of constructing various transportation and transit related projects. As of June 30, 2004 the State had \$7.0 billion of Revenue Bonds outstanding with another \$1.7 billion of bonding authorization remaining for funding for Garden State Preservation Trust and New Jersey Transportation Trust Fund Authority programs. On May 6, 2004, the Garden State Preservation Trust sold \$500.0 million of its Open Space Farmland Preservation Bonds, 2005 Series A (Forward Delivery Bonds). The Garden State Preservation Trust expects to deliver these bonds on or about December 1, 2005.
- **Installment Obligations** This debt classification represents obligations whose debt service is subject to and dependent upon the State Legislature making annual appropriations. Installment obligations include bonds issued to help fund the State's school facilities construction program, and help fund the installation of college and university dormitory fire suppression equipment. The State's Installment Obligation Bonds outstanding as of June 30, 2004 total \$7.9 billion. Total authorized but unissued Installment Obligations equal \$6.0 billion as of June 30, 2004.
- **Certificates of Participation** Proceeds from certificates of participation are used primarily to finance State equipment needs under the State's master lease program. Currently, the State uses a line of credit as its preferred financing method. The State's Certificates of Participation outstanding as of June 30, 2004 equal \$77.4 million.
- **Tobacco Settlement Financing Corporation, Inc.** In November, 1998 the State entered into a master settlement agreement with participating cigarette manufacturers, 46 states, and six other United States jurisdictions in the settlement of certain smoking-related litigation. During Fiscal Year 2003, the State sold to the newly established Tobacco Settlement Financing Corporation, Inc., the State's right, title, and beneficial ownership interest in the State's right to receive tobacco settlement rights under the master settlement agreement. In return, the Tobacco Settlement Financing Corporation, Inc. issued \$3.5 billion of bonds to pay for the tobacco settlement rights. Proceeds of the two bond issuances were used to fund General Fund expenditures during Fiscal Year 2003 and Fiscal Year 2004. Under GASB Technical Bulletin No. 2004-1, the Tobacco Settlement Financing Corporation, Inc. has been re-classified as a blended component unit of the State from that of a discretely presented component unit. Therefore, the debt of the Tobacco Settlement Financing Corporation, Inc. is reflected as a part of the State's debt. After taking into account its bond discount, the Tobacco Settlement Financing Corporation, Inc. as of June 30, 2004 had \$3.3 billion of bonds outstanding.
- **Unamortized Premium (Net)** During Fiscal Year 2004, unamortized premium totaled \$498.6 million, a \$133.4 million increase from the prior fiscal year's end. This increase is mainly

attributed to the State issuing \$2.8 billion of bonds with associated premium. GASB Statement No. 34 requires the premium to be deferred and amortized over the life of the refunding bonds.

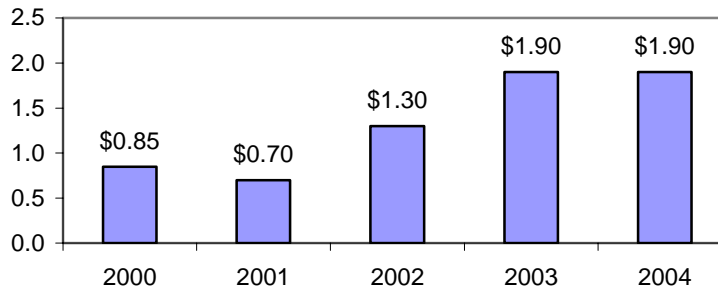
- **Unamortized Deferral on Refunding** Under GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, unamortized deferral on refunding shows the actual gain or loss on refunding transactions. Gains are shown as an asset and amortized over the shorter of the life of the refunding bonds or the bonds that were refunded. As of June 30, 2004 the State has issued \$466.6 million of refunding bonds that are to be amortized over a time period of 14.7 years to 19.8 years. GASB Statement No. 23 defines a gain/loss as the total outstanding amount of the old bonds minus the new refunding bonds issued minus the cost of issuance on the new refunding bonds. The refunding bonds, applicable to GASB Statement No. 23 interpretation, have a total loss of \$223.8 million.
- **Capital Leases** Capital Leases represent long-term contractual obligations that the State has entered into for the purpose of utilizing office space for State operations and program usage. Total Capital Leases outstanding as of June 30, 2004 equal \$691.5 million.
- **Loans Payable** Loans Payable represents amounts received by the New Jersey Automobile Insurance Guaranty Fund, from the New Jersey Property-Liability Insurance Guaranty Association (PLIGA). The loans were made in an effort to depopulate the New Jersey Automobile Insurance Guaranty Fund and to help satisfy its unfunded liability. PLIGA loans of \$1.3 billion remain outstanding as of June 30, 2004.
- **Accumulated Sick and Vacation** Pursuant to GASB Statement No. 16, *Accounting for Compensated Balances*, Accumulated Sick and Vacation payable represents the liability due to employees for unused sick and vacation time. As of June 30, 2004, this amount totals \$466.1 million.
- **Net Pension Obligation** Net Pension Obligation represents the \$361.1 million pension fund liability due to the State Police Retirement System, the Consolidated Police and Firemen's Retirement System, and the Teachers' Pension Annuity Fund as of June 30, 2004. Financial reporting requirements for net pension fund obligations fall under the purview of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.
- **Other** Other includes obligations required to be reported as long-term indebtedness in accordance with the National Council on Governmental Accounting (NCGA) Statement No. 1. These obligations include health (\$120.6 million), dental (\$5.6 million), and Medicaid benefit claims (\$251.6 million of which \$119.7 million is federally reimbursable), which have been incurred but not reported.

Short-term Debt

The State's short-term note program provides effective cash flow management of imbalances that occur in the timing between collections and disbursements of State revenues and appropriations during the fiscal year. The State Treasurer is authorized to issue short-term debt instruments without it constituting a general obligation of the State, or a debt, or a liability within the meaning of the State Constitution. All short-term notes must be retired within twelve months of their issuance date. During Fiscal Year 2004, the State issued and retired \$1.9 billion in short-term notes.

The following chart details the amount of short-term borrowings the State has issued and retired since Fiscal Year 2000:

**Short-Term Debt
Fiscal Year 2000 to Fiscal Year 2004
(Expressed in Billions)**



More detailed information about the State’s short-term debt program is presented in Note 8 – Short-term Debt, in the Notes to the Financial Statements.

Credit Ratings

Standard & Poor’s Corporation, Moody’s Investors Service, and Fitch Investors Service rate the State’s debt. As of the date of the transmittal letter, the State’s short-term and long-term credit rating are as follows:

<u>Rating Agency</u>	<u>Short-Term</u>	<u>Long-Term</u>
Standard & Poor’s Corporation	SP-1+	AA-
Moody’s Investors Service	MIG 1	Aa3
Fitch Investors Service	F1+	AA-

ECONOMIC CONDITION AND OUTLOOK

New Jersey’s economy continues to expand with the recovery showing signs of momentum in 2004. The State outperformed the nation in terms of job creation at a faster pace over last year. The State added over 103,000 jobs between the bottom of the employment cycle in March 2003 and September 2004. Payroll employment increased over 1.5 percent during the first nine months through September 2004 after declining slightly by 0.1 percent last year. New Jersey’s jobless rate stayed at 4.8 percent in September 2004, well below the corresponding rate of 5.4 percent for the nation.

New Jersey’s employment increased by 1.7 percent in September 2004 from over a year ago adding close to 69,000 jobs and continuing the positive year over year growth trend for the fifteenth consecutive month since July 2003, surpassing the pre-recession level. Overall, the State added 61,700 jobs between January and September of 2004. Employment gains were primarily spread across the service providing sectors with particularly strong growth in Professional and Business Services (12,800 jobs). The Government sector grew by 2.4 percent adding over 14,000 jobs during this period.

However, the State continues to suffer from job losses in manufacturing and downsizing in the telecommunications industry. Practically all the job losses in New Jersey, between January and September 2004, were concentrated in manufacturing (-3,300 jobs), which has been declining for more than a decade, but the pace of job losses appears to be leveling off. New Jersey’s employment level remained consistently above the 4.0 million mark for the last seven months.

The United States' Department of Commerce's Bureau of Economic Analysis preliminary report released on September 28, 2004 indicates that during the second quarter of calendar year 2004, New Jersey's growth rate for personal income continued to improve at 4.7 percent over the revised growth of 4.1 percent during the first quarter of this year. Despite the slight increase in inflation rate (around 3.0 percent), the improving labor market conditions benefit New Jersey consumers and businesses. In addition, low interest rates continue to support spending on housing and other consumer durables in the State.

The State and the nation may experience further near-term slow growth and the expected recovery may stall into early calendar year 2005 if consumers, investors, and businesses become more concerned about geopolitical conditions. The future direction of economic expansion nationally and in New Jersey to a large extent hinges on the assumptions of no further terrorist attacks, stable energy prices, supportive monetary and fiscal policies and no further turmoil in the financial markets. However, the fundamentals of the State economic health remain stable and the long run prospects for economic growth of the State in calendar year 2005 and beyond are favorable.

New Jersey State Government has undertaken several budgetary initiatives to address revenue pressures facing the State while the pace of the economic recovery becomes more consistent and stable. These initiatives include imposing a new fee on mobile telecommunications and telecommunications exchange customers and sale of new motor vehicle tires, implementing annual toxic surcharge based on emissions, increasing the tax rate on high income Gross Income Tax payers and cigarettes, and imposing a 6.0 percent gross receipts tax on certain cosmetic medical procedures. Other initiatives include limiting the Corporation Business Tax application on net operating loss provision to 50.0 percent of taxable income for tax years 2004 and 2005, revising outdoor advertising law and local tax treatment of certain outdoor signs, changing the phase-out schedule for the transitional energy facility assessment unit rate surcharges, and imposing "general purpose fee" on certain realty transfers and a fee on the purchase of residential property for over \$1.0 million.

REQUEST FOR INFORMATION

This Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004 is designed to provide a general overview of the State of New Jersey's finances to our citizens, taxpayers, customers, investors, and creditors and to demonstrate the State's accountability for the money it receives and the stewardship over its resources. Requests concerning any of the data presented in this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004 or for additional information should be addressed to the State of New Jersey, Office of Management and Budget, P.O. Box 221, 33 West State Street, 6th Floor, Trenton, New Jersey, 08625. Copies of this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003, the State Budget, and the Appropriations Handbook are also available at the following website: www.state.nj.us/treasury/omb.