

NEW JERSEY



COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2005

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**STATE OF NEW JERSEY
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 FISCAL YEAR ENDED JUNE 30, 2005
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DEPARTMENT OF THE TREASURY
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RICHARD J. CODEY
Acting Governor

JOHN E. MCCORMAC, CPA
State Treasurer

December 30, 2005

Acting Governor Richard J. Codey
Members of the State Legislature
New Jersey Citizens

In accordance with the provisions of N.J.S.A. 52:27B-46, we are pleased to transmit to you the New Jersey Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005. The Department of the Treasury's Office of Management and Budget prepared this report and is responsible for data accuracy as well as the completeness and fairness of the presentation, including all disclosures.

This Comprehensive Annual Financial Report, which has earned an unqualified audit opinion from the Office of the State Auditor, presents the financial position and operating results of the State under generally accepted accounting principles (GAAP) applicable to State and Local governments as established by the Governmental Accounting Standards Board (GASB). The State also participates in the Government Finance Officers Association of the United States and Canada's (GFOA) review program for the Certificate of Achievement for Excellence in Financial Reporting.

The State operates in accordance with the standards provided in GASB Statements No. 34 and No. 35. The objectives of this reporting model as reflected in these statements are to provide a clear picture of the government as a single unified entity as well as providing traditional fund based financial statements. All revenues, costs, assets, and liabilities of the State are shown to more clearly portray the State's fiscal health. Management's Discussion and Analysis is included on pages 16 to 29 in order to provide users with an objective and easily readable analysis of New Jersey's financial performance for the fiscal year ended June 30, 2005. We are confident that the data is accurate in all material respects, that it is presented in a manner designed to set forth fairly the financial position and results of the State's operations as measured by the financial activity of its various funds, and that all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs have been included.

The New Jersey Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005 is organized in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter and the 2004 GFOA Certificate of Achievement for Excellence in Financial Reporting. The financial section includes the independent auditor's report on the basic financial statements, management's discussion and analysis, government-wide financial statements, fund financial statements for governmental funds, proprietary funds, fiduciary funds, and component units, together with notes to the basic financial statements as well as additional required supplementary information (Budgetary Schedules), and the other supplementary information (Combining Fund Statements). The statistical section includes financial trends, revenue capacity, debt capacity, demographic, economic, and operating information.

HIGHLIGHTS AND INITIATIVES

Fiscal Year 2005

- The cornerstone of the Fiscal Year 2005 Appropriations Act was the implementation of the FAIR (Fair And Immediate Relief) Plan, which folded the NJSAVER rebates into the Homestead Rebate Program and provided property tax relief to New Jersey's senior citizens and middle income taxpayers. The three pronged plan called for immediate relief, spending reforms, and long-term

structural changes to New Jersey's property tax system. Immediate relief came in the form of increased rebate checks. Maximum rebates for senior citizens increased to \$1,200 from \$775 under the FAIR Program. Approximately 540,000 senior citizens with incomes under \$200,000 received an average of \$1,152 in Fiscal Year 2005. Another 1.1 million non-senior homeowners received rebates averaging \$681, compared with average rebates of \$250 in Fiscal Year 2004. In all, approximately 2.5 million families received increased rebates, including 840,000 tenants. In order to provide this property tax relief, an additional 2.6 percent tax on income over \$500,000 was enacted. Spending reforms under the FAIR Plan included limiting municipal governments' and school districts' annual spending increases on operations to 2.5 percent or less. Long-term reforms included the creation of a Citizens Task Force to recommend to the State Legislature the structure and scope of a Constitutional Convention on property tax reform.

- Aid to Education continued to be a major component of State spending. The Fiscal Year 2005 Appropriations Act provided \$8.9 billion in school aid, an increase of \$753.3 million over Fiscal Year 2004. Three percent increases in formula aid were provided to non-Abbott school districts. Abbott school districts were provided increases for mandated programs and services as well as increases for the expansion of preschool programs. Fiscal Year 2005 also provided funding for new aid categories, which included \$17.0 million to develop and implement strategies for enhanced teaching and learning in low income, non-Abbott school districts; \$15.0 million for a new preschool program in non-Abbott school districts; and \$12.0 million in additional formula aid for school districts that have experienced unusually high enrollment growth. The Fiscal Year 2005 Appropriations Act also included \$305.3 million for school facilities aid programs.

Fiscal Year 2006

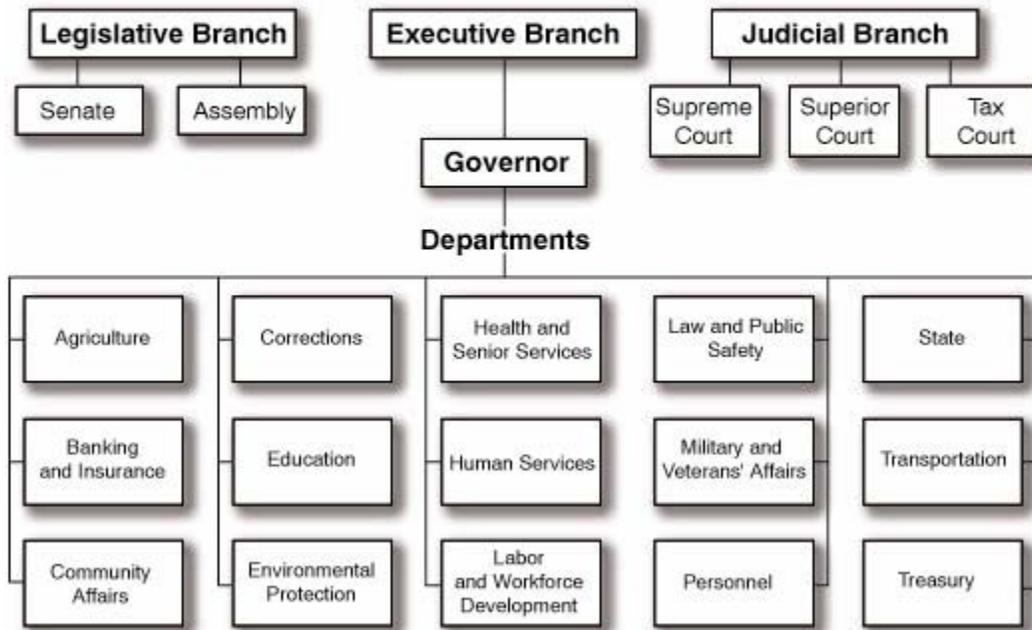
- Following the tragic death of several children due to abuse and neglect, a federal class action lawsuit was settled by the State in June 2003. The settlement created a Child Welfare Reform Panel whose role was to approve a reform plan and to oversee its implementation over an 18 month period. The plan, titled A New Beginning: Child Welfare Reform in New Jersey, was approved on June 9, 2004, and incorporated as part of the settlement. The Fiscal Year 2006 Appropriations Act provides an additional \$55.0 million in State funds to sustain and expand Child Welfare Reform efforts. Some of the reforms being implemented are as follows:
 - Organization of Children's Services. All child welfare services within the Department of Human Services are being restructured under the Office of Children's Services. Within this new organization, the Division of Youth and Family Services, the Division of Child Behavioral Health, the Division of Prevention and Community Partnerships, and the Child Welfare Training Academy have merged.
 - Additional Caseworkers and Support Staff. The Fiscal Year 2006 Appropriations Act provides funding for additional employees that will allow the Division of Youth and Family Services to move towards its goal of achieving caseload to staff ratios of 12 to 1 for protective staff and 15 to 1 for permanency staff.
- Approximately half of all adults with mental health concerns presently live at home with aging parents, and many of the State's 8,000 chronically homeless people also suffer from some type of mental illness. Unfortunately, the waiting list for housing today can last as long as five years. To ensure that New Jersey's most vulnerable citizens have a place to call home, a \$200 million Housing Trust Fund has been established as an initial step in creating 10,000 permanent, affordable community housing opportunities over a 10 year period.
- The Fiscal Year 2006 Appropriations Act increases State Appropriations for several programs that benefit the developmentally disabled. As part of the Department of Human Services Division of Developmental Disabilities' ongoing Community Service Waiting List initiative, funding has been made available to place 200 people from the existing Community Services Waiting List and the seven State developmental centers into group homes. This is an increase of 3.0 percent over the prior fiscal year, with full year funding totaling \$12.6 million. Real Life Choices is a new

program that provides in-home/respite services for people on the Community Services Waiting List and for people living at home with parents and guardians. Real Life Choices reduces the Community Services Waiting List by providing home support for disabled persons and their families as an alternative to residential placements. Each year, the Division of Developmental Disabilities receives approximately 200 requests for immediate, emergency residential placements. The requests include people whose caregivers, usually elderly parents, are no longer able to provide care because of their own medical problems. An additional \$7.0 million has been earmarked to meet this anticipated need.

NEW JERSEY GOVERNMENT

The Executive Branch is headed by the Office of the Chief Executive, which includes the Governor and staff that assist in the execution of the Governor’s constitutional powers and duties. The Governor is the State’s chief operating officer, and assists in directing and coordinating the activities of the various State departments. These duties include the implementation of new laws and activities, as well as ongoing responsibilities associated with existing laws, and other essential aspects of governing. The Office of the Chief Executive is active in the review and formulation of proposals of law that are ultimately submitted to the State Legislature. Staff assists in the development of public policy affecting the citizens of the State, and in the implementation of the State’s fiscal plan once it is adopted.

ORGANIZATION OF NEW JERSEY STATE GOVERNMENT



The Executive Branch consists of 15 departments comprising approximately 68,600 employees. The maximum number of departments permitted by the State Constitution is 20. Each department is headed by a single executive; four also have boards with policy-making and oversight responsibilities. Department heads and board members are appointed by the Governor with the advice and consent of the Senate, except for the Secretary of Agriculture, who is chosen by the Board of Agriculture with the approval of the Governor. Department heads continue in office until successors are named and confirmed by the Senate, with the exception of the Attorney General and the Secretary of State, who are appointed to serve during

the Governor's term. The Executive Branch oversees the performance of 566 municipalities and 611 school districts, and the incarceration and rehabilitation of approximately 28,200 prisoners. The Executive Branch also provides social services for one out of eight New Jersey citizens, reliable transportation, and protection for the State's citizenry and environment.

The State Senate and the General Assembly comprise New Jersey's Legislative Branch. There are 40 legislative districts with elections being held in odd-numbered years. There are 40 members of the State Senate. State Senators are elected to terms of four years, except for the election following a decennial census, in which case the term is for two years. There are 80 members of the General Assembly; each is elected to a two-year term. The Office of Legislative Services is a nonpartisan agency that provides legislators with legal, fiscal, research, information, and administrative services. It is organized with an executive director, a legislative counsel, the state auditor, a director of central staff, a director of data management, and a director of administration.

The Judicial Branch consists of the Supreme Court, the Appellate Division of the Superior Court, and the Tax Court. Judges are nominated by the Governor and must be confirmed by the Senate. Terms are for seven years. For purposes of judicial administration, the State is divided into 15 vicinages, each consisting of a single county or a combination of counties. The Administrative Office of the Courts provides support services. Approximately 7.0 million new cases are filed in New Jersey's courts every year, including 6.0 million in Municipal Court and 1.0 million in Superior Court. These cases address matters concerning civil, criminal, and family law.

COMPONENT UNITS

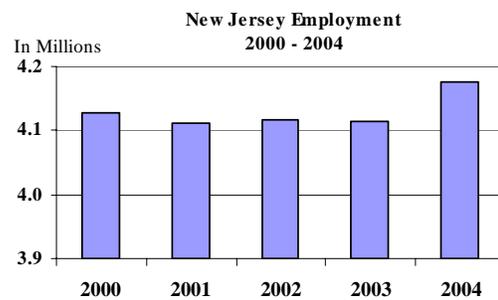
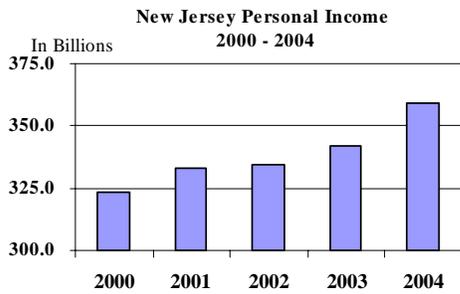
This Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005 includes the accounts of 22 public authorities, and 12 State colleges and universities in accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*. Public authorities are legal, separate entities that are not operating departments of the State. Governing boards are vested with the power to independently manage. Each component unit is established for a specific purpose for the benefit of the State's citizenry. GASB Statement No. 14 provides that the State's financial statements should emphasize the primary government and permit financial statement users to distinguish between the primary government and its component units. As a result, the transmittal letter, management's discussion and analysis, and the financial statements focus on the primary government of the State and its activities, although information pertaining to the component units is presented. For additional information, please see Note 18 – Component Units on page 97.

NEW JERSEY'S ECONOMIC CONDITION

New Jersey's economy continued to steadily expand in 2005, following 2004's recovery. New Jersey added 93,000 jobs between the bottom of the employment cycle in March 2003, and July 2005. New Jersey's payroll employment has stayed above the four million mark for fourteen straight months since June of last year. Payroll employment in July 2005 grew at a 1.1 percent average annual rate, continuing the positive year over year growth trend for the eighteenth consecutive month. The level of payroll employment in July 2005, 4.1 million, surpassed the last record level reported in December 2000 for the ninth month in a row.

Generally improving labor market conditions have kept the State's jobless rate below 5.0 percent for the fifteenth straight month since May 2004. New Jersey's unemployment rate inched up slightly to 4.1 percent in July 2005, remaining well below the corresponding rate of 5.0 percent for the nation.

The preliminary growth rate for New Jersey's personal income of 6.3 percent for the first quarter of 2005 remained slightly below the revised growth rate of 6.9 percent for the fourth quarter of 2004. Personal income for New Jersey is expected to grow at a steady pace throughout the rest of the year.



The housing sector remains robust with permits estimated to stay above 37,000 units for 2005. New motor vehicle registrations through June 2005 remain 4.3 percent below the corresponding level of a year ago, but registrations for the month of June remain substantially above the May 2005 level. A lack of both large financial incentives and pent-up demand had contributed to the downward trend. However, July motor vehicle registrations again rose substantially above the June level as employee discount incentives took hold in the market.

New Jersey's and the nation's economy is expected to continue expanding at a steady pace through 2005 and into 2006. In the Beige Book released July 27, 2005, the United States Federal Reserve reported expanding economic activity in June through early July in all of the twelve Federal Reserve Districts. Despite the recent disruption due to Hurricane Katrina, particularly on energy prices, the United States economy is expected to withstand the shock and remain on track.

New Jersey's economy is expected to follow the national trend for the rest of the year, and into 2006. Employment is projected to grow steadily around a 1.4 percent rate in 2005 with an improvement in 2006. Personal income is expected to grow steadily around a positive 5.0 percent level in 2005 and 2006. After another strong year in 2004, the housing sector is expected to remain robust in 2005 with a slight moderation in 2006. New motor vehicle registrations are projected to soften but remain above 600,000 units in 2005 and 2006. Low interest rates have supported spending on housing and other consumer durables. However, with the recent increase in the federal funds rate and other future rate increases expected by the Federal Reserve Board, interest rates are expected to rise through 2005 and have a moderating influence on interest sensitive spending.

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

The Statistical Section contains various demographic and economic tables for New Jersey.

BUDGET AND ACCOUNTING

Budget Process

The State Constitution, as well as certain statutes, governs the State's budget and appropriation process. Each department, board, commission, office or other agency of the State begins the budget process by filing with the Director of the Office of Management and Budget (the "Director") a request for appropriation or permission to spend, specifying all expenditures proposed to be made by such spending agency during the following fiscal year. The Director examines each request and determines the necessity or advisability of the appropriation request. After review and examination, the Director submits the requests, together with

findings, comments, and recommendations, to the Governor. It is the Governor's responsibility to examine and consider all requests and formulate budget recommendations. The Governor's Budget Message is transmitted on the fourth Tuesday in February, unless otherwise provided through legislation.

During the course of the fiscal year, the Governor may take steps to reduce State expenditures if it appears that revenues have fallen below those originally anticipated. The Governor, with approval from the State Legislature, may enact supplemental appropriations after the adoption of the annual Appropriations Act, should there be sufficient revenues on hand or anticipated, as certified by the Governor, to meet such appropriation.

Over the past two decades, New Jersey's budget process has evolved into a strategic planning initiative in which the budget is directly related to the program objectives of governmental activities. Each agency program's costs and benefits are weighed and justified at various alternative funding levels.

Legal Level of Control

The State's Annual Appropriations Act includes the General Fund and certain Special Revenue Funds (Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief Funds). Legal control is maintained within the departments at the appropriation line item level. Budgetary control is exercised at the department level by individual appropriations and allocations within appropriations to various programs and major expenditure objects. Program classifications represent a lower level, operating program function, consisting of closely related activities with identifiable objectives or goals. During the budget year, revisions to the annual Appropriations Act reflecting program changes or interdepartmental transfers of an administrative nature may be effected with certain Executive and Legislative Branch approvals. Under the "General Provisions" section of the State's annual Appropriations Act, management may amend the budget within a department with the Director of the Office of Management and Budget's approval. Under specific conditions, additional approval by the Office of Legislative Services is required. Only the State Legislature, however, may transfer appropriations between departments.

Accounting Systems

For the various State departments, accounting records are maintained by a central accounting system. The system operations are directed and supervised by the Office of Management and Budget. The State's annual budget is composed of individual appropriations to departments for specific programs and purposes. Component units maintain separate accounting systems.

Encumbrance accounting is employed to ensure that expenditures do not exceed appropriations and allocations. Purchase orders, contracts, and other commitments involving monetary expenditures are encumbrances. Any unencumbered and unexpended non-continuing appropriations lapse at fiscal year's end.

Consideration as to the adequacy of internal controls is paramount in developing and maintaining the State's accounting system. Internal accounting controls are designed to provide reasonable assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, and that financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from its use, and that the evaluation of costs and benefits require managerial estimates and judgments. All internal control evaluations occur within this framework.

RELEVANT FINANCIAL POLICIES

The State Constitution mandates a balanced budget. It provides, in part, that no money shall be drawn from the State Treasury but for appropriations made by law and that no law appropriating money for any State purpose shall be enacted if the appropriations contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of the revenue on hand and anticipated to be available to meet such appropriations during such fiscal period, as certified by the Governor. During the fiscal year, the State may have to make several revenue and expenditure adjustments to ensure a positive

fund balance. The State has had a balanced budget in every fiscal year since the adoption of the State Constitution in 1947.

As part of the General Fund's resources and fund balance, the Surplus Revenue Fund was created as a rainy day fund. It is used to account for excess revenues from prior fiscal years that are legislatively reserved and may be used to support current year's appropriations in the event that anticipated revenues in the General Fund are estimated to be less than those certified by the Governor upon approval of the annual Appropriations Act. The Surplus Revenue Fund was designed to build fund balance during economic upswings, and to be expended during economic downturns and emergency situations. An example of revenue collections outpacing projections occurred during Fiscal Year 2004, when \$282.4 million was deposited into the Surplus Revenue Fund. An example of an emergency situation that resulted in tapping the Surplus Revenue Fund occurred in Fiscal Year 2000 when the State needed \$26.9 million in emergency disaster relief funds to aid flood victims of Hurricane Floyd.

The State's budgetary basis of accounting differs from that utilized to present fund financial statements in conformance with GAAP. The main differences between the budgetary basis and the GAAP basis used to present fund financial statements, are that under the budgetary basis encumbrances are recognized as expenditures, the federal revenue related to such encumbrances is also recognized, and the budgetary basis reflects transactions only for the current fiscal year. In addition, under the GAAP basis in the fund financial statements, certain grants and other financial assistance are required to be recorded as revenues and expenditures.

FINANCIAL TRENDS

Education

State aid for elementary and secondary education continues to be one of the largest components of the State budget at one third of the Fiscal Year 2006 State appropriations. State funding for Education has historically been a struggle, especially in times of limited resources. The cost of compliance with State Supreme Court mandates for funding the poorest school districts, known as Abbott districts, forces the direction of a large portion of those resources, reducing the amount available for distribution to non-Abbott school districts. Having one of the highest per pupil spending amounts in the country and a high reliance on property taxes for the local support adds to the pressure to increase the level of State support. Federal legislation such as the No Child Left Behind Act and the Individuals with Disabilities Education Act have placed additional requirements on districts that result in spending increases beyond the federal funding provided for the programs. The State reviews its funding formulas to effectively balance competing needs.

Environmental Protection

The Department of Environmental Protection's mission is to protect and improve New Jersey's air, land, water, and natural resources, to ensure public health, sustain economic growth, and preserve and enhance the quality of life for all New Jersey citizens and future generations. The Fiscal Year 2006 Appropriations Act allows for a total appropriation of \$542.7 million, including federal funds, and continues to provide \$25.0 million for shore protection projects from the Realty Transfer Fee dedication. These funds will leverage up to \$56.0 million in federal funds, and \$7.2 million in local funds for beach replenishment projects. The Fiscal Year 2006 Appropriations Act also includes a 4.0 percent constitutional dedication from the State's Corporation Business Tax to provide funds to finance the cleanup of privately owned underground storage tanks, remediation of contaminated sites, as well as watershed monitoring and planning. This past year, the Department preserved almost 400,000 acres in the Highlands region, a source of clean drinking water for more than 5.0 million New Jersey residents. This region will be managed by the Highlands Water Protection and Planning Council that will develop a master plan over the next two years to accommodate growth in the region while protecting critical water supplies and natural resources. The Department has also implemented several initiatives to place New Jersey at the national forefront of water policy. This includes the adoption of the most comprehensive storm water control regulations in the country, the adoption of a new standard for arsenic in drinking water that is half the contaminant level permitted by federal law, and the adoption of protections for another 600 miles of high quality waterways that provide drinking water and serve as critical wildlife habitat.

Health and Senior Services

The Department of Health and Senior Services is responsible for fostering accessible health and senior services of the highest quality for all people in New Jersey to ensure optimal health, dignity, and independence. The Department's initiatives prevent disease, promote and protect the well-being at all life stages, and encourage informed choices that enrich the quality of life for individuals and communities. The Fiscal Year 2006 Appropriations Act totals \$3.34 billion, including federal funds, and allows the Department to employ over 2,200 persons. The Department has several objectives. The first is to prepare New Jersey to rapidly detect, identify, and respond to health-related aspects of biological, chemical, radiological, nuclear, explosive, and incendiary act of terrorism as well as natural disasters and disease outbreaks. Another objective is to eliminate disparities in health care access, treatment, and clinical outcomes between racial, ethnic, and socioeconomic populations, in part through cultural competency, education, and partnering with minority-oriented health organizations.

AUDIT INFORMATION

The principal auditor of the State's reporting entity is the Office of the State Auditor, which resides in the legislative branch of State government. The State Auditor's examination was conducted in accordance with generally accepted auditing standards and its opinion precedes the Basic Financial Statements. Outside public accounting firms have been used for the audits for separately issued component units and college and university financial statements. In addition, the Office of the State Auditor conducts periodic financial and expanded scope audits of the various State agencies. This audit received an unqualified opinion on the Basic Financial Statements contained in this Comprehensive Annual Financial Report.

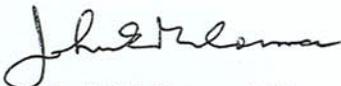
CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The GFOA awarded the Certificate of Achievement for Excellence in Financial Reporting to the State of New Jersey for its Comprehensive Annual Financial Report for the year ended June 30, 2004. In order to qualify, a governmental entity must publish an easily readable and efficiently organized comprehensive annual financial report, the contents of which conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. The State of New Jersey has received this award every year since 1993. It is our belief that this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005 continues this tradition and conforms to the GFOA's Certificate of Achievement Program requirements.

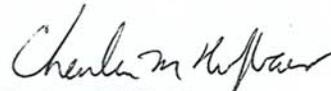
ACKNOWLEDGEMENTS

Finally, we would like to express our appreciation to the many dedicated professionals in the Office of Management and Budget and the Office of the State Auditor whose efforts made possible the preparation of this report. We believe that their combined efforts have produced a report that will provide a means for government, the financial community, decision makers, and concerned citizens to better understand and evaluate the State's financial condition.

Sincerely,



John E. McCormac, CPA
State Treasurer



Charlene M. Holzbaaur
State Comptroller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of New Jersey

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Nancy L. Ziehl

President

Jeffrey R. Emer

Executive Director