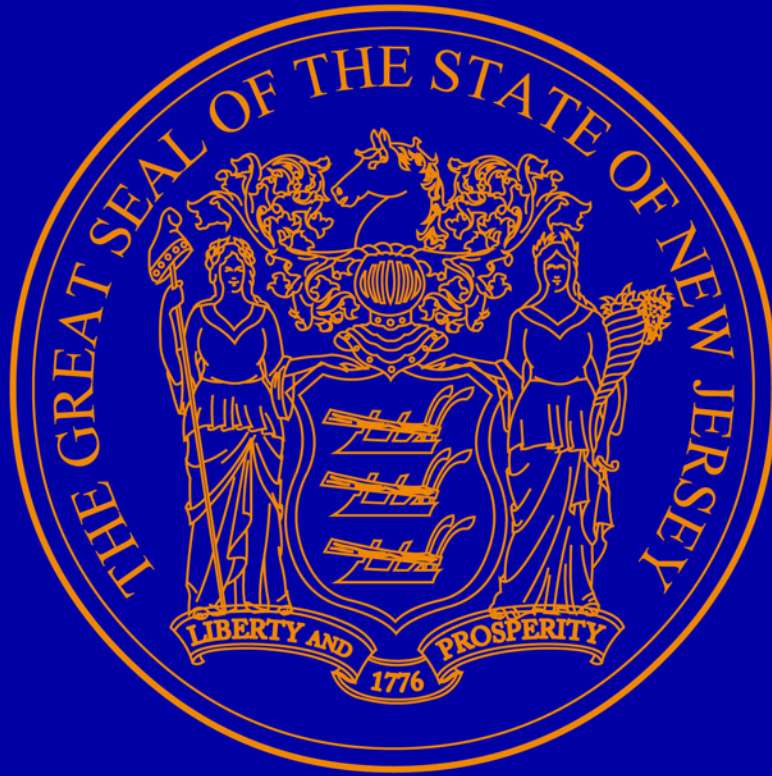


For the Fiscal Year Ended June 30, 2010
State of New Jersey



Comprehensive Annual Financial Report

Chris Christie, Governor
Kim Guadagno, Lieutenant Governor



STATE OF NEW JERSEY



COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2010

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

CHARLENE M. HOLZBAUR
Director
Office of Management and Budget

Kathy A. Steepy
Assistant Director
Financial Management

Robert L. Peden
Deputy Director
Office of Management and
Budget

James F. Kelly
Manager
Financial Reporting



**STATE OF NEW JERSEY
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 FISCAL YEAR ENDED JUNE 30, 2010
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Introduction





State of New Jersey

CHRIS CHRISTIE
Governor

DEPARTMENT OF THE TREASURY
OFFICE OF MANAGEMENT AND BUDGET
P.O. BOX 221
TRENTON, NJ 08625-0221

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

KIM GUADAGNO
Lt. Governor

CHARLENE M. HOLZBAUR
Director

December 1, 2010

Governor Chris Christie
Members of the State Legislature
New Jersey Citizens

In accordance with the provisions of N.J.S.52:27B-46, it is our pleasure to transmit to you the State of New Jersey's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2010. The Department of the Treasury's Office of Management and Budget prepared this report, and is responsible for the accuracy, completeness, and fairness of all data presented, including all disclosures.

This CAFR 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 (GFOA) of the United States and Canada's Certificate of Achievement for Excellence in Financial Reporting review program.

The State operates in accordance with the standards provided in GASB Statements No. 34 and No. 35. In addition to providing traditional fund financial statements, the objective of this reporting model is to provide a single, unified, transparent picture of the State's fiscal health; thus, this CAFR clearly displays all of the State's revenues, costs, assets, and liabilities. This report also includes a Management's Discussion and Analysis section, which provides users with an objective and easy-to-read analysis of New Jersey's financial performance for the fiscal year ended June 30, 2010. We are confident that the data is accurate in all material respects and presented in a manner designed to set forth fairly the financial position and results of the State's operations, as measured by the fiscal activity of its various funds, and includes all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs.

HIGHLIGHTS AND INITIATIVES

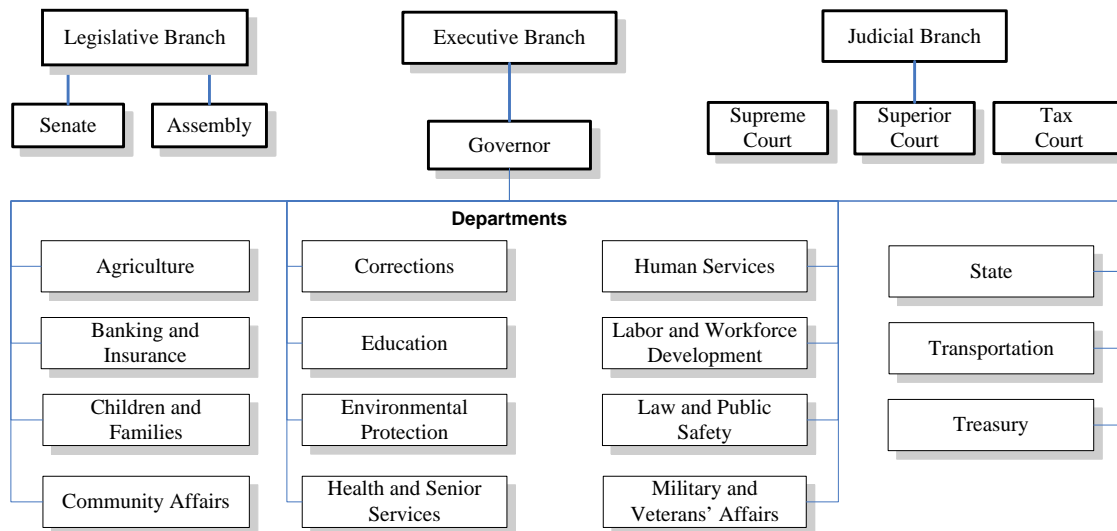
During the period July 1, 2009 through June 30, 2010, the State of New Jersey continued to experience first-hand the on-going impact of the nationwide recession. To commence restoring the State's fiscal integrity, while continuing to ensure the availability of scarce resources for New Jersey's most vulnerable citizens, the following Fiscal Year 2010 measures were taken:

- On January 20, 2010, Governor Chris Christie signed Executive Order No. 8, establishing the Government Transparency Center to ensure increased transparency of all State government operations. The Center, which is a single source from which citizens can identify and evaluate revenues and expenditures of funds derived from State taxes, fees, and other revenues and debts of the State, will be phased-in commencing during Fiscal Year 2011. Phase 1 implementation will include State information for monthly revenue reports, quarterly spending reports, and quarterly payroll data. Phase 2 will focus on reporting of all State authorities' revenues, spending, and debt, while Phase 3 will incorporate all State authorities' payroll data. All of this information, to include State debt and the establishment of a new statewide performance budgeting program, will be accessible via: <http://www.yourmoney.nj.gov/>.
- On February 23, 2010, Governor Chris Christie also issued Executive Order No. 15, which ordered a comprehensive review of all State authorities, boards, and commissions. This Executive Order also directed that immediate action be taken to reform abusive fiscal practices in:
 - Employee or Authority Board member travel;
 - All contractual agreements, either new or existing, with lobbyists or legislative agents; and
 - Financial compensation or incentives relating to employee termination or separation from employment.

- In compliance with New Jersey’s constitutional mandate of a balanced budget, on February 11, 2010, Governor Chris Christie declared a State of Fiscal Emergency and signed Executive Order No. 14 that froze State spending to address the projected \$2.2 billion budget gap for the 4-1/2 month balance of Fiscal Year 2010. About half of the Fiscal Year 2010 budget was already spent, which left about \$14 billion of unspent monies as of January 31, 2010; of that amount, \$8 billion was restricted - by contract, as in the case of State employees or maintenance of effort for federal stimulus money; by constitutional requirement; by bond covenant; or by law. Thus, to offset the \$2.2 billion shortfall within the remaining \$6 billion unexpended balance, on February 11, 2010, Governor Chris Christie cut spending in 375 different State programs that included:
 - \$475 million in local school aid for the balance of the fiscal year, with the amount of individual aid reductions tied to surpluses in the school districts;
 - \$286 million in unexpended Board of Public Utilities balances (\$158 million from the Clean Energy Fund and \$128 million from alternative energy source grants);
 - \$121.9 million in unexpended New Jersey Economic Development Authority balances (\$25 million from Business Employment Incentive Program underexpenditures, \$57.9 million from InvestNJ subsidies to businesses for operating/capital grants, and \$39 million from Main Street Program subsidies to commercial banks for lending programs);
 - \$78.1 million in undesignated Urban Enterprise Zone project balances and reimbursements to the State of past overpayments;
 - \$62.1 million in aid to county and senior public colleges and universities, with the amount tied to existing surpluses;
 - \$48.3 million in additional federal Title IV-E and Title XIX funds enabled a similar lapse of State funds;
 - \$18.6 million in unspent grant funding for Cancer Institute of New Jersey - South Jersey; and
 - \$13.8 million in surplus balance from the Homestead Rebate program.
- On February 11, 2010, Governor Chris Christie also proposed abolishing the Cabinet-level Department of the Public Advocate (DPA). Due to its statutory reestablishment under P.L.2005, c.155, DPA’s abolishment required legislation as well, which occurred on June 29, 2010 under P.L.2010, c.34. Although the State realized some savings during Fiscal Year 2010, the majority will occur during Fiscal Year 2011.
- To achieve meaningful, lasting property tax reform for New Jersey taxpayers, Governor Chris Christie introduced a “tool kit” of 33 pieces of legislation on May 10, 2010. Bi-partisan support of the cornerstone of this legislative package occurred on July 13, 2010, with the enactment of P.L.2010, c.44. This specific statute restricts all New Jersey property tax (school district, county and municipal) levy increases to 2.0 percent annually, with only the following four exceptions: capital expenditures, including debt service; pension benefits; health benefits; and expenses incurred in connection with a state of emergency. To ensure that this hard cap remains successful, the remaining pieces of legislation in the areas of civil service, collective bargaining, employee pensions and benefits, red tape and unfunded mandates, election reform, and shared services still require enactment, which has not occurred to date.

NEW JERSEY GOVERNMENT

One of the original thirteen colonies, the State of New Jersey was the third state to ratify the United States Constitution in 1787. Adopted on July 2, 1776, New Jersey’s original State Constitution subsequently was superseded by the State Constitution of 1844. During the summer of 1947, a constitutional convention met to prepare the current State Constitution, which State voters ratified in the general election held on November 4, 1947. New Jersey’s State Constitution continues to be a living document, as State voters passed an amendment creating the position of Lieutenant Governor of New Jersey, effective with the 2009 election. The State Constitution divides the powers of government between three co-equal independent branches: Legislative, Executive, and Judicial.



Legislative: The State’s bicameral Legislative Branch, which consists of a total of 120 members from 40 legislative districts with elections held in odd-numbered years, meets in annual sessions in Trenton, the State’s capital. The 40 members of the State Senate are elected to terms of four years, except for the election following a decennial census, in which case the term is for two years. The 80 members of the General Assembly are elected to terms of two years. Neither State Senators nor Assembly Members are subject to term limits. The Office of Legislative Services (OLS) is a nonpartisan agency that provides legislators with legal, fiscal, research, information, and administrative services. Key OLS positions include an executive director, a legislative counsel, the state auditor, a legislative budget and finance officer, a director of central staff, a director of data management, and a director of administration.

Executive: The Office of the Chief Executive, which oversees the entire Executive Branch, consists of the Governor, the Lieutenant Governor, Cabinet-level department heads, and staff who are responsible for carrying out the Governor’s constitutional powers and duties. Upon direct election by a plurality of the State’s voters, both the Governor and the Lieutenant Governor may serve two successive terms of four years. With the exception of the Secretary of Agriculture, who is chosen by the Board of Agriculture with the Governor’s approval, the New Jersey State Constitution grants the Governor the authority to appoint the entire cabinet as well as all superior court judges and county prosecutors, subject to confirmation by the New Jersey Senate. Department heads remain in office until their successors are named and confirmed by the Senate; the only exceptions are the Attorney General and the Secretary of State, who are appointed to serve throughout the Governor’s entire term. Although the State Constitution permits a maximum of 20 departments, the State’s payroll consisted of approximately 64,900 employees in 16 departments as of January 2010. The Executive Branch also oversees the performance of 566 municipalities and 604 school districts, and the incarceration and rehabilitation of approximately 21,700 prisoners. In addition to reliable transportation and protection for the State’s citizenry and environment, the Executive Branch provides social services for one out of every eight New Jersey citizens.

Judicial: New Jersey’s Supreme Court consists of a Chief Justice, who is the administrative head of all courts under the State’s jurisdiction, as well as six Associate Justices. In addition to Municipal and Tax Courts located throughout the State, there are Superior Courts, with a minimum of two Judges, in each of New Jersey’s 21 counties. After nomination by the Governor and subsequent confirmation by the State Senate, all Supreme Court Justices and Superior Court Judges serve initial terms of seven years. Should they be deemed eligible by both the Governor and the State Senate, Supreme Court Justices and Superior Court Judges acquire tenure with retirement at age 70 as mandated by the State Constitution. 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 seven million new cases are filed in New Jersey’s courts every year, including six million in Municipal Court and one million in Superior Court. These cases address matters concerning civil, criminal, and family law.

With a total land area of 7,417.3 square miles, New Jersey ranks as the fifth smallest state within the United States of America. An estimated population of 8,708,000 as of July 2009 makes New Jersey the eleventh largest state in population, as well as the most densely populated of all the states with an average of 1,174 people per square mile.

The higher education system in New Jersey includes 3 public research universities, 9 State colleges and universities, 19 community colleges, 14 independent four-year colleges and universities, 6 proprietary institutions with degree-granting authority, 10 rabbinical schools and theological seminaries, and 2 independent two-year religious colleges.

COMPONENT UNITS

In accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, this CAFR for fiscal year ended June 30, 2010 includes the accounts of 20 public authorities and 12 State colleges and universities. 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.

Executive Order No. 122, signed on July 23, 2004, was established to direct the Board of Directors for each State Authority to create an Audit Committee whose members are to assist in the oversight of the financial reporting and audit processes of the Authority. Each member of the Audit Committee is independent of the Authority, with at least one member having a background in accounting or related financial expertise. The Audit Committee must assist the Board in retaining an independent auditor to conduct an audit. The auditor selection process must be based on public, competitive bidding principles and shall take place no less than once every five years. In order to ensure the independence of the auditor selection process, an evaluation committee shall be established by the Board to conduct the solicitation and evaluation of eligible auditors. The auditor selected shall report directly to the Audit Committee or the Board. At no time shall the auditor report to any staff member of the Authority. At least twice a year, the Audit Committee shall hold a private meeting with the auditor. In carrying out these duties, the Audit Committee shall proactively assist the Board in overseeing the integrity and quality of the Authority's financial statements, the Authority's compliance with legal, regulatory, and ethical requirements, the auditor's performance and ability to perform, and the performance of the Authority's own internal audit and internal control functions.

NEW JERSEY'S ECONOMIC CONDITION

The State and national economies continue to experience high unemployment rates, a weak employment picture, and sluggish growth in personal income. For the calendar quarter ending in September 2010 the trend in New Jersey's payroll employment indicates that the rate of decrease from a year earlier remained unchanged at negative 0.86 percent, the same as reported for the previous quarter. The State's unemployment rate for September 2010 was 9.4 percent, which came in below the national unemployment rate of 9.6 percent, and was down for a second straight month.

Personal income appears to be improving steadily, with year-over-year gains for the first two quarters of 2010. According to the United States Bureau of Economic Analysis (release dated September 20, 2010), the preliminary annual rate of growth for New Jersey's personal income was 2.2 percent for the second quarter of 2010, a bit below the revised growth rate of 3.0 percent for the first quarter of 2010. Although quarter-over-quarter income growth has been positive for five straight quarters, the level for the second quarter of 2010 remains slightly below the 2008 results. If the economy continues to recover from the great recession, New Jersey personal income growth is expected to pick up over time.

The housing sector is expected to remain weak in the months ahead with permits in 2010 to stay below 20,000 units. New motor vehicle registrations fell by 20.0 percent in calendar year 2009, following declines of 16.0 percent in 2008 and 4.3 percent in 2007. New motor vehicle registrations are projected to remain below the 500,000 level in 2010 and 2011. For the first two months of fiscal year 2011 (July through August 2010), new motor vehicle registrations were 1.4 percent less than a year earlier.

New Jersey's and the nation's economies are expected to recover at a modest pace through the remainder of 2010 into 2011. According to the latest Beige Book (released on October 20, 2010), the Federal Reserve Board reported a continuation of growth in national economic activity, albeit at a modest pace, suggesting that the recovery may be firming up. However, the weak labor market and tight credit conditions will constrain the growth path with a tenuous near-term recovery. The latest New Jersey economic forecasts from Global Insight, Moody's Economy.com, and Rutgers University expect economic conditions to improve in 2010 and 2011. However, as recently as September, Global Insight was maintaining a 25 percent chance of a double-dip recession with the observation "in an economy with little momentum, it would not require a major shock to tip the balance downward."

New Jersey's economic trends are expected to be similar to the national trends in the remaining months of 2010. For the year as a whole, payroll employment is projected to be about 0.9 percent less than in 2009, but grow around 0.5 percent in 2011. Personal income is expected to grow around 2.0 percent in 2010 and improve to around 3.2 percent in 2011.

Underlying inflation is expected to be minimal as unemployment stays high and capacity utilization remains low, and is not likely to be a serious concern until after spending and employment growth move higher. Enhanced availability of credit,

continued improvement in financial market stability, and gains in consumer and business confidence are critical factors necessary for a more pronounced economic turnaround in the nation and in New Jersey.

BUDGET AND ACCOUNTING

Legal Level of Control

The State's Annual Appropriations Act includes the General Fund, as well as certain Special Revenue Funds (Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief). The departments maintain legal control at the appropriation line item level and exercise budgetary control by individual appropriations and allocations within annual 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. Revisions to the annual Appropriations Act, reflecting program changes or interdepartmental transfers of an administrative nature, may be effected during the budget year with certain Executive and Legislative Branch approvals. Language, located in the "General Provisions" section of the State's annual Appropriations Act, enables management to amend a department's budget with approval by the Director of the Office of Management and Budget; 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

The Office of Management and Budget directs and supervises a central accounting system, which maintains all accounting records for the various State departments. The State's annual budget provides individual appropriations to departments for specific programs and purposes, while component units maintain separate accounting systems.

To ensure expenditures do not exceed appropriations and allocations, the State employs encumbrance accounting. 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 guarantee 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 the evaluation of costs and benefits requires managerial estimates and judgments. All internal control evaluations occur within this framework.

RELEVANT FINANCIAL POLICIES

The New Jersey State Constitution, which mandates an annual balanced budget, directs, 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. Accordingly, 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.

Created as a "rainy day fund," the Surplus Revenue Fund is part of the General Fund's resources and fund balance, and accounts for excess revenues from prior fiscal years that are reserved legislatively 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. Such an example occurred during Fiscal Year 2009 when, in response to the national recession, the State drained its entire Surplus Revenue Fund to help balance its budget. As of June 30, 2010, this Fund continued to have a zero balance.

The State employs a budgetary basis of accounting for all of its annual fiscal transactions. The budgetary basis differs from the GAAP basis, which is used to present fund financial statements, in that the former: 1) recognizes encumbrances as expenditures, 2) recognizes all federal revenues related to such encumbrances, and 3) reflects only current fiscal year transactions. The GAAP basis also requires that certain grants and other financial assistance be recorded as revenues and/or expenditures.

FINANCIAL TRENDS

Revenue History

Both national and local economic woes continued having a detrimental effect on the State, as Fiscal Year 2010 again experienced an unprecedented decline in State budgeted revenue. Total Fiscal Year 2010 revenue collections of \$27.9 billion were \$771 million below total Fiscal Year 2006 revenue collections. The Gross Income Tax collections were \$183.7 million less than Fiscal Year 2006. The trend is continuing with the current Fiscal Year 2011 estimate at only \$28.2 billion. The Statistical Section provides a ten-year history of State budgeted revenue collections.

Pension and Other Postemployment Benefits (OPEB) Obligations

The State has not fully funded its various pension plans for several years, and its post-retirement medical program is funded on a pay-as-you-go basis. This continued underfunding, coupled with the on-going investment decline and increased number of retirees receiving distributions, has led to the State's current net pension obligation of \$8.4 billion and an OPEB obligation of \$10.0 billion as of June 30, 2010. The total unfunded actuarial accrued liability for State and local pension plans was \$45.8 billion as of June 30, 2009, or an increase of \$11.4 billion from June 30, 2008, while the total State and local OPEB unfunded actuarial accrued liability at June 30, 2009 was \$66.8 billion, or an increase of \$2.0 billion from the prior year. For updated information, Fiscal Year 2009 actuarial reports can be accessed via: <http://www.state.nj.us/treasury/pensions/actuarial-rpts.shtml>.

Pension and Health Care Reforms

On September 14, 2010, as part of his aforementioned "tool kit" to achieve meaningful, lasting property tax reform for New Jersey taxpayers, Governor Chris Christie announced a comprehensive reform package that is intended to stabilize New Jersey's pension and health care systems, both of which are underfunded currently by approximately \$46 billion and \$67 billion, respectively. Without any reform, underfunding of both systems is expected to continue to grow annually. Some of the proposed reforms will require legislative approval.

Over a projected thirty-year period, Governor Chris Christie's proposed pension system reforms are designed to drastically reduce total underfunding and increase the system's aggregate funded ratio from its present level of 66 percent to more than 90 percent by 2041. To achieve this necessary stability in New Jersey's pension system, Governor Chris Christie has proposed the following policy changes affecting future service of all employees:

- Adjusting the benefit formula to effectively roll back the 9 percent increase authorized in 2001, and
- Setting a uniform 8.5 percent employee pension contribution rate.

For all employees with fewer than 25 years of service:

- Establishing the retirement age at 65 for full pension benefits,
- Increasing eligibility for early retirement from the current 25 years of employment to 30, and
- Adjusting the early retirement penalty to 3 percent for each year.

In addition to the aforementioned, Governor Chris Christie proposes eliminating automatic annual cost of living adjustments for both current and future retirees.

Finally, to ensure a more accurate financial forecast of the pension fund, Governor Chris Christie advocates:

- Lowering its anticipated investment rate of return from 8.5% to 7.5%, and
- Revising the amortization methodology to retire its unfunded liability earlier.

The majority (\$57 billion) of New Jersey's health care system's current underfunding is the State's obligation, while local municipalities are responsible for the remaining \$10 billion that is attributable to employees participating in the State Health Benefits Program. To achieve stability throughout New Jersey's health care system, Governor Chris Christie has proposed the following policy changes:

- Transitioning to a cost-sharing model that has the employer paying 70 percent of the cost and the employee paying 30 percent,
- Basing employee costs on the health care premium versus a percentage of salary,
- Providing a variety of options that enable employees to choose the right health care plan for them, and
- Modifying benefits to bring the State's health care plan in line with those offered by the federal government and private sectors.

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. Private sector public accounting firms have been used for the audits of 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 various State agencies.

Additional information regarding the State's financial status, including prior year budgets, appropriations acts, and financial reports, is available on the State's web site (<http://www.state.nj.us/treasury/omb/>).

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 CAFR for the fiscal year ended June 30, 2009. In order to qualify for this certificate, a governmental entity must publish an easily readable and efficiently organized comprehensive annual financial report, of which the contents 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.

ACKNOWLEDGEMENTS

Finally, we express our grateful appreciation to the many dedicated professionals in the Office of Management and Budget and the Office of the State Auditor, whose work made possible the preparation of this report. We believe 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,



Andrew P. Sidamon-Eristoff
State Treasurer



Charlene M. Holzbaur
Director, Office of Management and Budget

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, 2009

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.



President

Executive Director