

**DEPARTMENT OF
THE TREASURY**

Bradley I. Abelow
State Treasurer

**DIVISION OF PENSIONS
AND BENEFITS**

Frederick J. Beaver
Director

**STATE POLICE
RETIREMENT SYSTEM
BOARD OF TRUSTEES**

as of June 30, 2005

JAMES GRANT
Chairperson

PETER GORMAN
State Treasurer's Representative

JOHN K. SAYERS

KORNEILUS VANDERPLOEG

WENDY JAMISON
Secretary

BUCK CONSULTANTS
Actuaries and Consultants

MEDICAL BOARD

David Jenkins, M.D.
William E. Ryan, M.D.



State of New Jersey
DIVISION OF PENSIONS AND BENEFITS
PO Box 295 • Trenton, NJ 08625-0295

TO THE HONORABLE
JON S. CORZINE
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor Corzine:

The Board of Trustees of the

STATE POLICE RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2005 Annual Report in accordance with the provisions of N.J.S.A. 53:5A-30.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "JAMES GRANT", written over a horizontal line.

JAMES GRANT

Chairperson

State Police Retirement System
BOARD OF TRUSTEES



James Grant
Chairperson
State Police Appointment



John K. Sayers
Governor's Appointment



Peter Gorman
Treasurer's Representative



Wendy Jamison
Board Secretary



Jackie Bussanich
Support Staff

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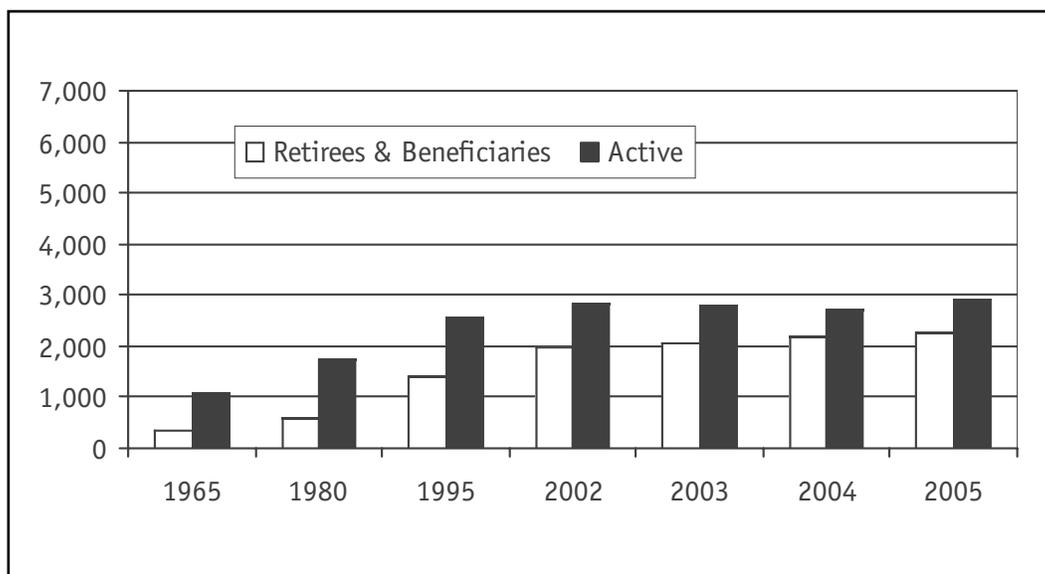
Korneilus Vanderploeg
Governor's Appointment

SIGNIFICANT LEGISLATION

There were no significant changes in legislation governing the Prison Officers' Pension Fund of New Jersey during fiscal year 2005.

MEMBERSHIP

- As of June 30, 2005, the active membership of the System totaled 2,950. There were 124 inactive members as of June 30, 2005.
- There were 2,299 retirees and beneficiaries receiving annual pensions totaling \$97,942,622. *(Includes benefits paid under the provisions of the Pension Adjustment Act.)*
- Beneficiaries of 43 members received lump sum death benefits in the amount of \$927,128.
- The System's assets totaled \$2,026,126,514 at the close of the fiscal year 2005.



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

Independent Auditors' Report

The Board of Trustees
State of New Jersey
State Police Retirement System:

We have audited the accompanying statement of fiduciary net assets of the State of New Jersey State Police Retirement System (the System) as of June 30, 2005, and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey State Police Retirement System as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis and the supplementary information included in the schedule of funding progress and schedule of employer contributions are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The schedule of changes in fiduciary net assets by fund is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

KPMG LLP

December 14, 2005

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Management's Discussion and Analysis

June 30, 2005

Our discussion and analysis of the State Police Retirement System (the System) financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2005 - 2004

- Net assets held in trust for pension benefits increased by \$56,836,485 as a result of fiscal year 2005's operations from \$1,687,084,896 to \$1,743,921,381.
- Additions for the year were \$156,275,192, which are comprised of member pension contributions of \$15,450,745, State appropriation and interfund employer transfer \$437,652, and investment and other income of \$140,386,795.
- Deductions for the year were \$99,438,707, which are comprised of benefit and refund payments of \$98,948,480 and administrative expenses of \$490,227.

THE STATEMENT OF FIDUCIARY NET ASSETS AND THE STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

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

The Statement of Fiduciary Net Assets show the balances in all of the assets and liabilities of the System at the end of the fiscal year. The difference between assets and liabilities represents the System's fiduciary net assets. Over time, increases or decreases in the System's fiduciary net assets provide one indication of whether the financial health of the System is improving or declining. *The Statement of Changes in Fiduciary Net Assets* show the results of financial operations for the year. The statements provide an explanation for the change in the System's fiduciary net assets since the prior year. These two financial statements should be reviewed along with the information contained in the financial statement footnotes, including the required supplementary schedules, to determine whether the System is becoming financially stronger or weaker.

FINANCIAL ANALYSIS

STATEMENT OF FIDUCIARY NET ASSETS

2005 - 2004

| | 2005 | 2004 | Increase (Decrease) |
|-------------|-----------------|-----------------|---------------------|
| Assets | \$2,026,126,514 | \$1,948,180,043 | \$77,946,471 |
| Liabilities | 282,205,133 | 261,095,147 | 21,109,986 |
| Net Assets | \$1,743,921,381 | \$1,687,084,896 | \$56,836,485 |

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Management's Discussion and Analysis, Continued

The System's assets mainly consist of cash, securities lending collateral, investments, contributions due from members, accrued investment income, and members' loan receivable. Between fiscal years 2004 and 2005, total assets increased by \$77.9 million or 4.0% due to increase in fair value of investments.

Liabilities consist of pension and death benefit payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the System's insurance provider, securities lending collateral and rebates payable, and other payables. Total liabilities increased by \$21.1 million or 8.1% primarily due to increase in retirement benefits payable to increased number of retirees.

Net assets held in trust for pension benefits increased by \$56.8 million or 3.4% primarily due to an increase in fair value of investments.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS

2005 - 2004

| | 2005 | 2004 | Increase (Decrease) |
|------------------------|---------------|---------------|---------------------|
| Member Contributions | \$15,450,745 | \$14,682,524 | \$768,221 |
| Employer Contributions | 437,691 | 45,405 | 392,286 |
| Investment & Other | 140,386,756 | 216,208,991 | (75,822,235) |
| Totals | \$156,275,192 | \$230,936,920 | \$(74,661,728) |

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions rose by 5.2% due to increase in membership. There was an increase in employer contributions by 864.0% due to the State contribution of \$0.2 million and also due to increase in the number of transfers from other retirement systems.

The State started to make a contribution to the System in fiscal year 2005, the first time since 1997, to satisfy the actuarially accrued liability. The normal contributions had been funded using net assets (excess assets above the required funding level) till fiscal year 2004 due to Pension Security legislation passed in 1997.

Investment & other revenues decreased by \$75.8 million or 35.1% due to a decrease in earned income from investments.

The total investment gain for all pension funds was estimated to be 8.7% compared to 14.2% gain in the prior year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS

2005 - 2004

| | 2005 | 2004 | Increase (Decrease) |
|-------------------------|--------------|--------------|---------------------|
| Benefits | \$98,869,750 | \$89,272,063 | \$9,597,687 |
| Refunds & Adjustments | 78,730 | 53,968 | 24,762 |
| Administrative Expenses | 490,227 | 264,858 | 225,369 |
| Totals | \$99,438,707 | \$89,590,889 | \$9,847,818 |

Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the System. Benefit payments increased by \$9.6 million or 10.8% primarily because more members are receiving benefits. There was an increase in the number of withdrawals and transfers to other retirement systems, which accounts for the increase by 45.9% in refunds & adjustments. Administrative expenses increased by 85.1% mainly due to the reimbursement to the State General Fund for the Special Project Fund Appropriation for the system reengineering project.

STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM
Management's Discussion and Analysis, Continued

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 97.3% for fiscal year 2005 and 102.7% for 2004 indicate that the System has sufficient assets to meet its benefit obligations.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

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

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Statement of Fiduciary Net Assets

June 30, 2005

| | |
|--|-------------------------|
| Assets: | |
| Securities lending collateral | \$ 273,620,853 |
| Investments, at fair value: | |
| Cash Management Fund | 115,047,240 |
| Common Pension Fund A | 874,350,488 |
| Common Pension Fund B | 387,544,934 |
| Common Pension Fund D | 330,268,014 |
| Mortgage Backed Securities | <u>6,756,191</u> |
| Total investments | <u>1,713,966,867</u> |
| Receivables: | |
| Contributions: | |
| Members | 939,761 |
| Accrued interest and dividends | 8,764,347 |
| Members' loans | 28,757,540 |
| Other | <u>77,146</u> |
| Total receivables | <u>38,538,794</u> |
| Total assets | <u>2,026,126,514</u> |
| Liabilities: | |
| Accounts payable and accrued expenses | 217,304 |
| Retirement benefits payable | 8,269,034 |
| Cash overdraft | 97,942 |
| Securities lending collateral and rebates payable | <u>273,620,853</u> |
| Total liabilities | <u>282,205,133</u> |
| Net Assets: | |
| Held in trust for pension benefits | <u>\$ 1,743,921,381</u> |

See schedule of funding progress on pages 21-22.

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2005

Additions:

| | |
|---|-------------------------|
| Contributions: | |
| Members | \$ 15,450,745 |
| Employers | 437,652 |
| Other | <u>39</u> |
| Total contributions | <u>15,888,436</u> |
| Investment income: | |
| Net appreciation in fair value of investments | 90,220,101 |
| Interest | 32,426,017 |
| Dividends | <u>17,811,325</u> |
| | 140,457,443 |
| Less: investment expense | <u>70,687</u> |
| Net investment income | <u>140,386,756</u> |
| Total additions | <u>156,275,192</u> |
| Deductions: | |
| Benefits | 98,869,750 |
| Refunds of contributions | 78,730 |
| Administrative expenses | <u>490,227</u> |
| Total deductions | <u>99,438,707</u> |
| Change in net assets | 56,836,485 |
| Net assets - Beginning of year | <u>1,687,084,896</u> |
| Net assets - End of year | <u>\$ 1,743,921,381</u> |

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements

June 30, 2005

(1) DESCRIPTION OF THE SYSTEM

The State of New Jersey State Police Retirement System (the System; SPRS) is a single-employer contributory defined benefit plan which was established as of July 1, 1965, under the provisions of N.J.S.A. 53:5A. The System is included along with other state-administered pension trust and agency funds in the basic financial statements of the State of New Jersey.

The System's designated purpose is to provide retirement, death and disability benefits to its members. Membership in the System is mandatory for all uniformed officers and troopers of the Division of State Police of the State of New Jersey. The System's Board of Trustees is primarily responsible for its administration.

According to State of New Jersey Administrative Code, all obligations of the System will be assumed by the State of New Jersey should the System terminate.

Vesting and Benefit Provisions:

The vesting and benefit provisions are set by N.J.S.A. 53:5A. The System provides retirement as well as death and disability benefits. All benefits vest after ten years of service (as defined). Retirement benefits are available after 20 years of service (as defined) at any age with mandatory retirement at age 55. The retirement benefit is based upon final compensation, which is defined as salary (as defined) plus maintenance allowance (as defined) during the last 12 months prior to retirement, and is a life annuity equal to the greater of the following: (a) 50% of final compensation; (b) for members retiring due to mandatory retirement, 50% of final compensation, plus 2% for each year of service in excess of 20 years to a maximum of 60% of final compensation; or (c) for members retiring with 25 or more years of service, 65% of final compensation, plus 1% for each year of service in excess of 25 years, to a maximum of 70% of final compensation. Members may elect deferred retirement after ten years of service in which case benefits in the form of life annuity would begin at age 55 equal to 2% of final compensation for each year of service up to 20 years.

Members are always fully vested for their own contributions.

Membership and Contributing Employers:

Membership in the System consisted of the following at June 30, 2004, the date of the most recent actuarial valuation:

| | |
|---|--------------|
| Retirees and beneficiaries receiving benefits | |
| currently and terminated employees entitled | |
| to benefits but not yet receiving them | <u>2,204</u> |
| Active members: | |
| Vested | 1,767 |
| Non-vested | <u>917</u> |
| Total active members | <u>2,684</u> |
| Total | <u>4,888</u> |

The State of New Jersey is the only contributing employer of this System.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus and Basis of Accounting:

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The System is accounted for using an economic resources measurement focus. The System that focuses on total economic resources employs the accrual basis of accounting, which recognizes increases and decreases in economic resources as soon as the underlying event or transaction occurs.

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

Adoption of Accounting Standard:

Effective July 1, 2004, the Division adopted Statement No. 40 of the Governmental Accounting Standards Board (GASB), "Deposit and Investment Risk Disclosures", an amendment of GASB Statement No. 3.

Valuation of Investments:

Investments are reported at fair value as follows:

- U.S. Government and Agency, Foreign and Corporate obligations – prices quoted by a major dealer in such securities.
- Common Stock and Equity Funds, Foreign Equity Securities, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.
- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund – closing bid price on the last day of trading during the period as determined by the Transfer Agent.

Investment Transactions:

Investment transactions are accounted for on a trade date basis. Gains and losses from investment transactions are determined by the average cost method. Interest and dividend income is recorded on the accrual basis, with dividends accruing on the ex-dividend date.

Unit Transactions:

The net asset values of Common Funds A, B and D (Common Funds) are determined as of the close of the last day of business of each month. Purchases and redemptions of participants' units are transacted each month within fifteen days subsequent to that time and at such net asset value.

Dividends and interest earned per unit are calculated monthly and distributed quarterly for Common Fund A and B. Dividends and interest earned per unit are calculated monthly for Common D, and the income earned on Common Fund D units is reinvested.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

Securities Lending:

Common Funds A, B and D and several of the direct pension plan portfolios participate in securities lending programs with their custodian banks, whereby securities are loaned to brokers and, in return, the pension funds have rights to the collateral received. All of the securities held in Common Funds A, B and D are eligible for the securities lending program. Collateral received may consist of cash, letters of credit, or government securities having a market value equal to or exceeding 102% (U.S. dollar denominated) or 105% (non-U.S. dollar denominated) of the value of the loaned securities at the time the loan is made. For Common Funds A and B, in the event that the market value of the collateral falls below 101% of the market value of all the outstanding loaned securities, additional collateral shall be transferred by the borrower to the respective funds no later than the close of the next business day so that the market value of such additional collateral, when added to the market value of the other collateral, shall equal 102% of the market value of the loaned securities. For Common Fund D, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% of the market value of the outstanding loaned securities, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. As of June 30, 2005, the Common Funds have no aggregate credit risk exposure to brokers because the collateral amount held by the Common Funds exceeded the market value of the securities on loan.

The contracts with the Common Funds' custodian banks require them to indemnify the Common Funds if the brokers fail to return the securities or fail to pay the Common Funds for income distributions by the securities' issuers while the securities are on loan. The securities loans can be terminated by notification by either the broker or the Common Funds. The term to maturity of the securities loans is generally matched with the term to maturity of the investment of the cash collateral.

Derivatives:

The Common Funds' international managers utilize forward foreign currency contracts, a derivative security, as a means to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in market prices or currency rates will cause the value of a financial instrument to decrease or become more costly to settle.

Forward foreign currency contracts are agreements to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed upon price. Forward foreign currency contracts are used to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios.

The fair value of foreign forward currency contracts outstanding as of June 30, 2005 is as follows:

| | <u>Amount</u> |
|-----------------------------|----------------|
| Forward currency receivable | \$ 745,577,063 |
| Forward currency payable | 745,525,163 |
| Net unrealized gain | (51,900) |

The net unrealized gain is included in investments at June 30, 2005.

The Common Funds utilize covered call options in an effort to add value to the portfolio (collect premiums). Covered call options are agreements that give the owner of the option the right, but not obligation, to buy a specific amount of an asset from the Common Funds for a specific price (called the strike price) on or before a specified expiration date. As the writer of financial options, the Common Funds receive a premium at the outset of the agreement and bear the risk of an unfavorable change in the price of the instrument underlying the option.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

The Common Funds have written call options on 215,400 shares with a fair value of \$548,100 at June 30, 2005 which are reflected as a contra-asset to the fair value of the portfolio.

Members' Loans:

Members who have at least three years of service in the System may borrow up to 50% of their accumulated member contributions. Repayment of loan balances is deducted from payroll checks and bears an interest rate of 4%. Members who retire with an outstanding loan have the option of paying the loan in full prior to receiving any benefits or continuing their monthly loan payment schedule into retirement.

Under the Internal Revenue Service regulations effective January 1, 2004, the Division changed its pension loan repayment policy: Members who take multiple loans must repay the outstanding balance of the original loan, and all subsequent loans taken before the original loan is completely paid off, within a period not to exceed 5 years from the issuance of the first loan taken after January 1, 2004. Failure to repay the loan within the five-year period will result in the unpaid balance being declared a taxable distribution.

Administrative Expenses:

The System is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the System to the State of New Jersey, Department of the Treasury and are included in the accompanying statement of changes in fiduciary net assets.

(3) INVESTMENTS

The System is invested in Common Pension Fund A, Common Pension Fund B, Common Pension Fund D, and other investments, including mortgage backed securities, which represent 2.46%, 2.21%, 2.41%, and 0.54%, respectively, of each investment total of the pension funds.

The pension funds investments as of June 30, 2005 are as follows:

| | Amount |
|--|--------------------------|
| Domestic equities | \$ 34,782,276,119 |
| International equities | 11,232,483,997 |
| Domestic fixed income | 16,521,446,786 |
| International fixed income | 2,201,826,936 |
| Domestic floating rate securities | 77,922,181 |
| Police and Firemen's mortgages | 896,706,544 |
| Net forward foreign exchange contracts | 51,900 |
| | \$ 65,712,714,463 |

New Jersey state statute provides for a State Investment Council (Council) and a Director. Investment authority is vested in the Director of the Division and the role of the Council is to formulate investment policies. The Council issues regulations which establish guidelines for permissible investments which include domestic and international equities, obligations of the U.S. Treasury, government agencies, corporations, finance companies and banks, international government and agency obligations, Canadian obligations, New Jersey State and Municipal general obligations, public authority revenue obligations, collateralized notes and mortgages, commercial paper, certificates of deposit, repurchase agreements, bankers acceptances, guaranteed income contracts and money market funds.

The pension funds investments are subject to various risks. Among these risks are credit risk, concentration of credit risk, interest rate risk and foreign currency risk. Each one of these risks is discussed in more detail below.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally recognized statistical rating agencies such as Moody's Investors Service, Inc. (Moody's) or Standard & Poor's Corporation (S&P). Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. There are no restrictions in the amount that can be invested in United States treasury and government agency obligations. Council regulations require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue as follows:

| <u>Category</u> | <u>Minimum Rating</u> | | <u>Limitation of Issuer's Outstanding</u> | <u>Limitation of Issue</u> | <u>Other Limitations</u> |
|---|-----------------------|----------------|---|--------------------------------|--|
| | <u>Moody's</u> | <u>S&P</u> | <u>Debt</u> | | |
| Corporate obligations | Baa | BBB | 25% | 25% | — |
| U.S. finance company debt, bank debentures and NJ state & municipal obligations | A | A | 10% | 10% | — |
| Canadian obligations | A | A | 10% | 10% | Purchase cannot exceed \$10 million |
| International government and agency obligations | Aa | AA | 2% | 10% | Not more than 1% of fund assets can be invested in any one issuer |
| Public Authority revenue obligations | A | A | — | 10% | Not more than 2% of fund assets can be invested in any one public authority |
| Collateralized notes and mortgages | Baa | BBB | — | 33.3% | Not more than 2% of fund assets can be invested in any one issuer |
| Commercial paper | P-1 | A-1 | — | — | — |
| Certificates of deposit and Banker's acceptances (rating applies to international) | Aa/P-1 | — | — | — | Uncollateralized certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital |
| Guaranteed income contracts | P-1 | — | — | — | A+ rating from A.M. Best for insurance companies |
| Money market funds | — | — | — | — | Not more than 10% of fund assets can be invested in money market funds; limited to 5% of shares or units outstanding |

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

For securities exposed to credit risk in the fixed income portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2005:

| (000's) | Moody's Rating | | | |
|---|----------------------|------------------|------------------|------------------|
| | Aaa | Aa | A | Baa |
| United States Treasury Notes | \$ 1,813,358 | — | — | — |
| United States Treasury TIPS | 598,125 | — | — | — |
| United States Treasury Bonds | 2,193,224 | — | — | — |
| United States Treasury Strips | 42,326 | — | — | — |
| Title XI Merchant Marine Notes | 3,956 | — | — | — |
| Federal Agricultural Mortgage Corp. Notes | — | 101,698 | — | — |
| Federal Farm Credit Bank Bonds | 102,225 | — | — | — |
| Federal Home Loan Bank Bonds | 521,527 | — | — | — |
| Federal Home Loan Bank Discounted Notes | 4,244 | — | — | — |
| Federal Home Loan Mortgage Corp. Notes | 265,077 | 26,953 | — | — |
| Federal National Mortgage Association Notes | 698,324 | 26,078 | — | — |
| Resolution Funding Corp. Obligations | 7,337 | — | — | — |
| Floating Rate Notes | 25,026 | 19,983 | 9,999 | 22,914 |
| Corporate Obligations | 645,239 | 594,643 | 2,722,186 | 1,310,398 |
| Real Estate Investment Trust Obligations | — | — | — | 99,301 |
| Finance Company Debt | 285,528 | 963,800 | 757,113 | 132,094 |
| Supranational Obligations | 122,496 | — | — | — |
| International Bonds and Notes | 420,419 | — | — | — |
| Foreign Government Obligations | 1,293,765 | 283,284 | 58,319 | — |
| Remic/FHLMC | 638,865 | — | — | — |
| Remic/ FNMA | 73,982 | — | — | — |
| Remic/ GNMA | 17,993 | — | — | — |
| GNMA Mortgage Backed Certificates | 112,091 | — | — | — |
| FHLM Mortgage Backed Certificates | 774,802 | — | — | — |
| FNMA Mortgage Backed Certificates | 645,810 | — | — | — |
| Asset Backed Obligations | 252,973 | — | — | — |
| Private Export Obligations | 34,127 | — | — | — |
| Exchange Traded Securities | — | — | 56,050 | — |
| | <u>\$ 11,592,839</u> | <u>2,016,439</u> | <u>3,603,667</u> | <u>1,564,707</u> |

The table does not include certain investments which do not have a Moody's rating which include foreign government obligations totaling \$18,842,884 with an S&P rating of AAA and convertible zero coupon bonds totaling \$4,701,462 with an S&P rating of BBB. The Police and Firemen's Mortgages and the Cash Management Fund are unrated.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Commercial paper must mature within 270 days. Certificates of deposits and bankers acceptances are limited to a term of one year or less. The maturity of repurchase agreements shall not exceed 15 days. The investment in a guaranteed income contract is limited to a term of 10 years or less.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

The following table summarizes the maturities of the fixed income portfolio at June 30, 2005:

| (000's) | Fixed Income Investment Type | Total Market Value | Maturities in Years | | | |
|---------|---|-----------------------|---------------------|------------------|------------------|------------------|
| | | | Less than 1 | 1-5 | 6-10 | More than 10 |
| | United States Treasury Notes | \$ 1,813,358 | 111,930 | 795,152 | 906,276 | — |
| | United States Treasury Tips | 598,125 | — | — | 517,312 | 80,813 |
| | United States Treasury Bonds | 2,193,224 | — | — | — | 2,193,224 |
| | United States Treasury Strips | 42,326 | — | — | — | 42,326 |
| | Title XI Merchant Marine Notes | 3,956 | — | — | — | 3,956 |
| | Federal Agricultural Mortgage Corp. Notes | 101,698 | — | 101,698 | — | — |
| | Federal Farm Credit Bank Bonds | 102,225 | 49,578 | 52,647 | — | — |
| | Federal Home Loan Bank Bonds | 521,527 | 49,610 | 471,917 | — | — |
| | Federal Home Loan Bank Discounted Notes | 4,244 | — | — | — | 4,244 |
| | Federal Home Loan Mortgage Corp. Notes | 292,030 | — | 174,938 | 117,092 | — |
| | Federal National Mortgage Association Notes | 724,402 | 226,752 | 315,835 | 26,078 | 155,737 |
| | Resolution Funding Corp. Obligations | 7,337 | — | — | — | 7,337 |
| | Floating Rate Notes | 77,922 | — | 67,923 | 9,999 | — |
| | Corporate Obligations | 5,272,466 | 492,077 | 1,632,208 | 1,509,472 | 1,638,709 |
| | Real Estate Investment Trust Obligations | 99,301 | — | 19,836 | 79,465 | — |
| | Finance Company Debt | 2,138,535 | 405,222 | 1,021,737 | 576,593 | 134,983 |
| | Supranational Obligations | 122,496 | 25,227 | — | — | 97,269 |
| | International Bonds and Notes | 420,419 | 54,846 | 300,229 | 19,865 | 45,479 |
| | Foreign Government Obligations | 1,654,211 | 45,065 | 632,606 | 567,437 | 409,103 |
| | Remic/FHLMC | 638,865 | — | 9,872 | 20,959 | 608,034 |
| | Remic/ FNMA | 73,982 | 196 | 4,734 | 18,358 | 50,694 |
| | Remic/ GNMA | 17,993 | — | — | — | 17,993 |
| | Police and Firemen's Mortgages | 896,707 | — | — | — | 896,707 |
| | GNMA Mortgage Backed Certificates | 112,091 | 41 | 1,479 | — | 110,571 |
| | FHLM Mortgage Backed Certificates | 774,802 | — | 265 | 4,999 | 769,538 |
| | FNMA Mortgage Backed Certificates | 645,810 | — | 7,343 | 29,116 | 609,351 |
| | Asset Backed Obligations | 252,973 | — | 153,828 | 34,509 | 64,636 |
| | Private Export Obligations | 34,127 | — | 12,289 | 21,838 | — |
| | Convertible Zero Coupon Bonds | 4,701 | — | — | 4,701 | — |
| | | <u>\$ 19,641,853</u> | <u>1,460,544</u> | <u>5,776,536</u> | <u>4,464,069</u> | <u>7,940,704</u> |

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Funds invest in global markets. The Funds can invest in securities of companies incorporated in one of thirty countries approved by the Council. The market value of international preferred and common stocks and issues convertible into common stocks, when combined with the market value of international government and agency obligations, cannot exceed 22 percent of the market value of forward contracts totaling approximately \$650 million at June 30, 2005. At June 30, 2005, the Common Funds had the following foreign currency exposure (expressed in U.S. dollars):

| <u>Currency</u> | <u>Total Market Value</u> | <u>Equities</u> | <u>Foreign Government Obligations</u> |
|--------------------|-------------------------------|-----------------------|---|
| Australian dollar | \$ 401,418,580 | 272,431,668 | 128,986,912 |
| Canadian dollar | 587,693,580 | 502,887,128 | 84,806,452 |
| Danish krone | 148,396,127 | 148,396,127 | — |
| Euro | 4,447,969,733 | 3,646,096,193 | 801,873,540 |
| Hong Kong dollar | 167,808,826 | 167,808,826 | — |
| Japanese yen | 2,218,395,101 | 2,213,693,639 | 4,701,462 |
| Mexican peso | 40,732,398 | 40,732,398 | — |
| New Zealand dollar | 72,765,425 | 32,928,859 | 39,836,566 |
| Norwegian krone | 198,279,321 | 91,284,080 | 106,995,241 |
| Pound sterling | 2,181,964,380 | 1,957,488,690 | 224,475,690 |
| Singapore dollar | 75,677,979 | 75,677,979 | — |
| South Korean won | 141,633,342 | 141,633,342 | — |
| Swedish krona | 735,391,335 | 628,135,901 | 107,255,434 |
| Swiss franc | 1,017,523,657 | 1,017,523,657 | — |
| | <u>\$ 12,435,649,784</u> | <u>10,936,718,487</u> | <u>1,498,931,297</u> |

The Cash Management Fund is unrated. The Cash Management Fund is not evidenced by securities that exist in physical or book entry form held by the pension funds.

Net appreciation or depreciation in fair value of investments includes net realized gains and the change in net unrealized gains and losses on investments for the fiscal year ended June 30, 2005. The net realized gain from investment transactions amounted to \$2,729,925,208 and the net increase in unrealized gains on investments amounted to \$935,762,205 for the year ended June 30, 2005.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

(4) SECURITIES LENDING COLLATERAL

The System's share in the securities lending program is 2.3% of the total market value of the collateral at June 30, 2005.

The securities lending collateral is subject to various risks. Among these risks are credit risk, concentration of credit risk and interest rate risk. Agreements with the lending agents require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue as follows:

| <u>Category</u> | <u>Minimum Rating</u> | | <u>Limitation of Issuer's Outstanding Debt</u> | <u>Limitation of Issue</u> | <u>Other Limitations</u> |
|--|-----------------------|----------------|--|--------------------------------|--|
| | <u>Moody's</u> | <u>S&P</u> | | | |
| Corporate obligations | A3 | A- | 25% | 25% | — |
| U.S. finance company debt and bank debentures | A2 | A | 10% | 10% | — |
| Collateralized notes and mortgages | Aaa | AAA | — | 33.3% | Limited to not more than 10% of the assets of the collateral portfolio |
| Commercial paper | P-1 | A-1 | — | — | — |
| Certificates of deposit/ Banker's acceptances | Aa3/P-1 | — | — | — | Uncollateralized cer- tificates of deposit and banker's ac- ceptances' cannot exceed 10% of issuer's primary capital |
| Guaranteed income contracts | P-1 | — | — | — | Limited to 5% of the assets of the col- lateral portfolio; A+ rating from A.M. Best for insurance companies |
| Money market funds | — | — | — | — | Limited to 10% of the assets of the collateral portfolio; limited to approved money market funds |

Maturities of corporate obligations, U.S. finance company debt, bank debentures, collateralized notes and mortgages and guaranteed income contracts must be less than 25 months. Commercial paper maturities cannot exceed 270 days. Repurchase agreement maturities cannot exceed 15 days. Certificates of deposit and banker's acceptances must mature in one year or less.

The collateral for repurchase agreements is limited to obligations of the U.S. Government or certain U.S. Government agencies.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Notes to Financial Statements, Continued

Total exposure to any individual issuer is limited, except for U.S. Treasury and Government Agency Obligations. For money market funds, the total amount of shares or units purchased or acquired of any money market fund shall not exceed five percent of the shares or units outstanding of said money market fund. For Collateralized Notes and Mortgages, not more than two percent of the assets of the collateral portfolio shall be invested in the obligations of any one issuer. For Guaranteed Income Contracts, the total investment in any one issuer shall be limited to 2.5% of the collateral portfolio. The Division sets individual issuer limits for Commercial Paper and Certificate of Deposits. For Corporate Obligations, U.S. Finance Company Debt, Bank Debentures and Bankers Acceptances, exposure to any one issuer shall be limited to the following percentages of the collateral portfolio in accordance with the issuer's rating from Moody's: Aaa (4%), Aa (3%) and A (2%).

For securities exposed to credit risk in the collateral portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2005:

| (000's) | Moody's Rating | | | | S&P |
|---------------------------------|-----------------------|------------------|------------------|------------------|-------------------|
| | Aaa | Aa | A | P-1 | Rating (1) |
| Corporate Obligations | \$ 440,053 | 3,748,203 | 2,052,074 | — | — |
| Commercial Paper | — | — | — | 2,373,183 | — |
| Certificates of Deposit | — | 1,357,406 | — | — | 97,900 |
| Repurchase Agreements | — | — | — | — | — |
| Guaranteed Investment Contracts | — | 150,000 | 200,000 | — | — |
| Money Market Funds | 103,815 | — | — | — | — |
| Collateralized Notes | 10,000 | — | — | — | — |
| | <u>\$ 553,868</u> | <u>5,255,609</u> | <u>2,252,074</u> | <u>2,373,183</u> | <u>97,900</u> |

(1) Moody's rating not available

In addition, the collateral portfolio includes money market funds with a current market value of \$1,074,355 and repurchase agreements with a current market value of \$1,588,984,270 at June 30, 2005 which are not rated.

The following table summarizes the maturities of the collateral portfolio at June 30, 2005:

| (000's) | Total Market Value | Maturities | |
|---------------------------------|-------------------------------|-------------------------------|----------------------------------|
| | | Less than one year | One year to 25 months |
| Corporate Obligations | \$ 6,240,331 | 4,753,161 | 1,487,170 |
| Commercial Paper | 2,373,183 | 2,373,183 | — |
| Certificates of Deposit | 1,455,306 | 1,455,306 | — |
| Repurchase Agreements | 1,588,984 | 1,588,984 | — |
| Guaranteed Investment Contracts | 350,000 | 250,000 | 100,000 |
| Money Market Funds | 104,889 | 104,889 | — |
| Collateralized Notes | 10,000 | 10,000 | — |
| | <u>\$ 12,122,693</u> | <u>10,535,523</u> | <u>1,587,170</u> |

STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM

Notes to Financial Statements, Continued

As of June 30, 2005, the Common Funds had received cash collateral of \$12,166,888,240 for outstanding loaned investment securities having market values of \$11,780,098,612. In addition, as of June 30, 2005, the Common Funds loaned investment securities having market values of \$38,245,996, against which it had received non-cash collateral with a current value of \$39,118,460, which is not reflected in the accompanying financial statements.

(5) CONTRIBUTIONS

The contribution policy is set by N.J.S.A. 53:5A-34 and requires contributions by active members and the State of New Jersey. Plan member and employer contributions may be amended by State of New Jersey legislation. Members contribute at a uniform rate of 7.5% of base salary. Employers are required to contribute at an actuarially determined rate. The annual employer contributions include funding for basic retirement allowances, cost-of-living adjustments and noncontributory death benefits.

The State made a contribution of \$188 thousand to the System in fiscal year 2005, the first time since 1997, to satisfy the actuarially accrued liability. The normal contributions had been funded using net assets (excess assets above the required funding level) till fiscal year 2004 due to Pension Security legislation passed in 1997. According to the Appropriation Act of 2003, the State is paying pension obligations through a five-year phase-in.

(6) FUNDS

This System maintains the following legally required funds:

Members' Annuity Savings Fund (\$142,516,383)

The Members' Annuity Savings Fund (ASF) is credited with all contributions made by active members of the System.

Contingent Reserve Fund (\$1,051,611,513)

The Contingent Reserve Fund is credited with the contributions of the State of New Jersey. Interest earnings, after crediting the Members' Annuity Savings Fund and the Retirement Reserve Fund, as required, are credited to this account. Additionally, payments for life insurance premiums are made from this Fund.

Retirement Reserve Fund (\$549,793,485)

The Retirement Reserve Fund is the account from which retirement benefits other than life insurance premiums, including cost-of-living benefits, are paid. Upon retirement of a member, accumulated contributions are transferred to the Retirement Reserve Fund from the ASF. Any additional reserves needed to fund the balance of the retirement benefit are transferred from the Contingent Reserve Fund. Annually, interest as determined by the State Treasurer (8.75% for fiscal year 2005) is credited to the Retirement Reserve Fund.

(7) INCOME TAX STATUS

Based on a 1986 declaration of the Attorney General of the State of New Jersey, the System is a qualified plan as described in Section 401(a) of the Internal Revenue Code.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Funding Progress

| ACTUARIAL VALUATION DATE | ACTUARIAL VALUE OF ASSETS (a) | ACTUARIAL ACCRUED LIABILITY (b) | UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY (b - a) | FUNDED RATIO (a / b) | COVERED PAYROLL (c) | UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY AS A PERCENTAGE OF COVERED PAYROLL ((b - a) / c) |
|--------------------------------|--|--|--|----------------------------|---------------------------|--|
| June 30, 1997 | \$1,322,406,703 | \$1,272,242,451 | \$(50,164,252) | 103.9% | \$142,636,260 | (35.2%) |
| June 30, 1998 | 1,458,600,992 | 1,369,277,968 | (89,323,024) | 106.5% | 167,145,161 | (53.4%) |
| June 30, 1999 | 1,600,165,104 | 1,469,144,146 | (131,020,958) | 108.9% | 178,203,420 | (73.5%) |
| June 30, 2000 | 1,752,423,441 | 1,512,909,805 | (239,513,636) | 115.8% | 188,466,237 | (127.1%) |
| June 30, 2001 | 1,829,414,353 | 1,626,631,656 | (202,782,697) | 112.5% | 199,727,203 | (101.5%) |
| June 30, 2002 | 1,853,684,177 | 1,739,427,739 | (114,256,438) | 106.6% | 215,161,126 | (53.1%) |
| June 30, 2003 | 1,865,079,083 | 1,815,725,256 | (49,353,827) | 102.7% | 217,448,864 | (22.7%) |
| June 30, 2004 | 1,897,525,210 | 1,949,309,641 | 51,784,431 | 97.3% | 223,552,154 | 23.2% |

STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2004 actuarial valuation included the following:

| | |
|-------------------------------|--------------------------------|
| Actuarial cost method | Projected unit credit |
| Asset valuation method | 5 year average of market value |
| Amortization method | Level dollar, closed |
| Remaining amortization period | 30 years |
| Actuarial assumptions: | |
| Interest rate | 8.25% |
| Salary range | 5.45% |
| Cost-of-living adjustments | 1.80% |

Annual covered payroll is an estimate based upon annualizing one quarter's actual payroll.

STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM
 Required Supplementary Information, Continued
 Schedule of Employer Contributions

| YEAR ENDED JUNE 30, | ANNUAL REQUIRED CONTRIBUTION | EMPLOYER CONTRIBUTIONS⁽¹⁾ | PERCENTAGE CONTRIBUTED |
|------------------------------------|---|---|-----------------------------------|
| 1997 | \$44,384,679 | \$120,308,862 ⁽²⁾ | 271.1% |
| 1998 | 33,317,314 | — | 0.0% |
| 1999 | 33,116,255 | — | 0.0% |
| 2000 | 33,598,843 | — | 0.0% |
| 2001 | 35,341,259 | — | 0.0% |
| 2002 | 24,990,652 | — | 0.0% |
| 2003 | 29,449,164 | — | 0.0% |
| 2004 | 37,600,821 | — | 0.0% |
| 2005 | 37,943,519 | 187,909 ⁽³⁾ | 0.5% |

Notes to Schedule

- (1) Employer contributions exclude contributions received primarily from the Police and Firemen's Retirement System of New Jersey for certain members who transferred their eligible prior service credit to the State Police Retirement System.

In accordance with Chapter 115, P.L. 1997, available excess valuation assets were used to fund the required employer contributions.

- (2) For the year ended June 30, 1997, the employer contributions exceeded the annual required contributions as a result of legislation that was enacted (Chapter 114, P.L. 1997), authorizing the New Jersey Economic Development Authority to issue bonds, notes or other obligations for the purpose of financing, in full or in part, the State of New Jersey's portion of the unfunded accrued liability under the State of New Jersey retirement systems.
- (3) In accordance with the provisions of the Appropriation Act for fiscal year 2005, the State fiscal year 2005 statutory required contribution of \$939,544 has been reduced to \$187,909.

**STATE OF NEW JERSEY
STATE POLICE RETIREMENT SYSTEM**

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2005

| | MEMBERS' ANNUITY SAVINGS FUND | CONTINGENT RESERVE FUND | RETIREMENT RESERVE FUND | TOTAL |
|--|--|-------------------------------|-------------------------------|---------------|
| Additions: | | | | |
| Contributions: | | | | |
| Members | \$ 15,450,745 | — | — | 15,450,745 |
| Employers | — | 437,652 | — | 437,652 |
| Other | — | 39 | — | 39 |
| Total contributions | 15,450,745 | 437,691 | — | 15,888,436 |
| Distribution of net investment income | — | 95,181,224 | 45,205,532 | 140,386,756 |
| Total additions | 15,450,745 | 95,618,915 | 45,205,532 | 156,275,192 |
| Deductions: | | | | |
| Benefits | — | 927,128 | 97,942,622 | 98,869,750 |
| Refunds of contributions | 78,730 | — | — | 78,730 |
| Administrative expenses | — | 490,227 | — | 490,227 |
| Total deductions | 78,730 | 1,417,355 | 97,942,622 | 99,438,707 |
| Net increase (decrease) before transfers among reserves | 15,372,015 | 94,201,560 | (52,737,090) | 56,836,485 |
| Transfers among reserves: | | | | |
| Retirements | (10,485,862) | (75,410,059) | 85,895,921 | — |
| Net increase | 4,886,153 | 18,791,501 | 33,158,831 | 56,836,485 |
| Net assets held in trust for pension benefits: | | | | |
| Beginning of year | 137,630,230 | 1,032,820,012 | 516,634,654 | 1,687,084,896 |
| End of year | \$ 142,516,383 | 1,051,611,513 | 549,793,485 | 1,743,921,381 |