

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Financial Statements and Schedule

June 30, 2001 and 2000

(With Independent Auditors' Report Thereon)

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

Independent Auditors' Report

Director, Division of Pension and Benefits
State of New Jersey
Pension Adjustment Fund:

We have audited the accompanying statements of plan net assets of the State of New Jersey Pension Adjustment Fund as of June 30, 2001 and 2000, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State of New Jersey Pension Adjustment Fund as of June 30, 2001 and 2000, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/S/

KPMG LLP

September 7, 2001

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Statements of Plan Net Assets

June 30, 2001 and 2000

	2001	2000
Assets:		
Cash	\$ 49,646	27,602
Investments, at fair value:		
Cash Management Fund	4,366,819	4,686,773
Receivables:		
State-related employer contributions	3,248,356	3,648,270
Due from Pension Trust Funds	26,812	16,580
Total receivables	3,275,168	3,664,850
Total assets	7,691,633	8,379,225
Liabilities:		
Due to Pension Trust Funds:		
Pension adjustment payroll payable	1,019,417	1,093,827
Other	2,195,254	2,228,097
Total liabilities	3,214,671	3,321,924
Net assets held for state-related employers and the State of New Jersey General Fund	\$ 4,476,962	5,057,301

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Statements of Changes in Plan Net Assets

Years ended June 30, 2001 and 2000

	2001	2000
Revenues and additions:		
Employer contributions	\$ 13,660,439	14,987,545
Interest income	535,403	524,819
Total revenues and additions	14,195,842	15,512,364
Expenditures and deductions:		
Benefits:		
State of New Jersey Prison Officers' Pension Fund	1,401,416	1,419,684
State of New Jersey Consolidated Police and Firemen's Retirement System	12,778,836	13,524,542
State of New Jersey Central Pension Fund	24,785	25,739
Transfer to State of New Jersey General Fund	571,144	546,140
Total expenditures and deductions	14,776,181	15,516,105
Net decrease	(580,339)	(3,741)
Net assets held for state-related employers and the State of New Jersey:		
Beginning of year	5,057,301	5,061,042
End of year	\$ 4,476,962	5,057,301

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Notes to Financial Statements

June 30, 2001 and 2000

(1) DESCRIPTION OF THE FUND

The State of New Jersey Pension Adjustment Fund (the Fund) is a pay-as-you-go multiple-employer defined benefit plan which was established in 1958 under the provisions of N.J.S.A. 43:3B. The Fund provides cost-of-living increases in retirement allowances to certain retired public employees and beneficiaries of retired members in the State of New Jersey Consolidated Police and Firemen's Pension Fund, State of New Jersey Prison Officers' Pension Fund and State of New Jersey Central Pension Fund.

The financial statements of the Fund are included along with other state-administered pension trust and agency funds in the general purpose financial statements of the State of New Jersey.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of the Fund are prepared on the accrual basis of accounting and conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans." Plan assets and liabilities are recorded at fair value. Employer contributions are recognized when payable to the Fund. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

Investment Valuation

State of New Jersey Cash Management Fund units are stated at fair value.

The State of New Jersey, Department of the Treasury, Division of Investment, issues publicly available financial reports that include the financial statements of the State of New Jersey Cash Management Funds. The financial reports may be obtained by writing to the State of New Jersey, Department of the Treasury, Division of Investment, P.O. Box 290, Trenton, New Jersey 08625-0290.

The State of New Jersey Division of Investment, under the jurisdiction of the State Investment Council, has the investment responsibility for all funds administered by the State of New Jersey Division of Pensions and Benefits. All investments must conform to standards set by state law.

The purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the Fund, through the State Treasurer, and custodian banks as agents for the Fund. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institutions, amount of the portfolio to be covered by the agreements, and other pertinent matters.

No investments held by the Fund are subject to GASB Statement No. 3, which requires that investments be categorized to indicate the level of risk assumed by the Fund.

Administrative Expenses

The Fund is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid and expensed by the State of New Jersey, which is responsible for such costs.

Benefit Provisions

The pension adjustment program covers eligible retirees and their survivors of the Consolidated Police and Firemen's Pension Fund, Prison Officers' Pension Fund, and Central Pension Fund. Eligible retirees and/or survivors are those who have been retired at least 24 months.

Those eligible for benefits are entitled to cost-of-living increases equal to 60% of the change in the average consumer price index for the calendar year in which the pensioner retired as compared to the average consumer price index for a 12-month period ending with each August 31st immediately preceding the year in which the adjustment becomes payable. The regular retirement allowance is multiplied by the 60% factor as developed and results in a dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits after 24 months of retirement.

Legislation passed during 2001 (Chapter 4, P.L. 2001) provides increased benefits to certain members of the Consolidated Police and Firemen's Pension Fund who retired prior to December 29, 1989 with at least 25 years of creditable service. The benefit increase is effective November 1, 2001. The maximum amount of the increase is 5% of the retiree's final compensation. For those with 30 or more years of service, the total pension benefit would increase from 65% to 70% of final compensation.

As a result of this legislation, cost-of-living benefits payable to eligible retirees will also increase. The State, not the local municipalities, will be responsible for these costs.

Cash and Cash Equivalents

GASB Statement No. 3 also requires that deposits held in financial institutions be categorized to indicate the level of risk assumed by the entity. Category 1 consists of deposits that are insured or collateralized with securities held by the entity or by its agent in the entity's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name. Category 3 consists of deposits which are uninsured and uncollateralized.

Based upon aggregate collateral levels maintained for all state bank accounts as a whole, substantially all cash balances maintained in financial institutions as of June 30, 2001, which include funding for the July 1, 2001 retirement payroll, are designated Category 3.

The categorization of cash and cash equivalents for all state funds, including the pension trust funds, can be found in the notes to the general purpose financial statements of the State of New Jersey.

(3) CONTRIBUTIONS

The contribution requirements were established by N.J.S.A. 43:3B-4 and are not actuarially determined. An actuarial valuation is not performed to determine the actuarial implications of the contribution requirements. The State of New Jersey and state-related employers' contributions required to provide the cost-of-living benefits under this program are determined and requested by the Division of Pensions and Benefits annually. The benefits are contributed only if the State of New Jersey appropriates the amount necessary to meet the cost of the increases to eligible retirees. If the State of New Jersey does not appropriate funds, then the cost-of-living portion of benefits to all retirees and beneficiaries of applicable state-administered retirement systems will cease.

(4) INCOME TAX STATUS

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