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

TO THE HONORABLE
JAMES E. McGREEVEY
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor McGreevey:

The Board of Trustees of the

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2003 Annual Report in accordance with the provisions of N.J.S.A. 43:15A-21.

Respectfully submitted,

GEORGE B. BABULA
Chairperson

Public Employees' Retirement System

2003 BOARD OF TRUSTEES

SIGNIFICANT LEGISLATION

Chapter 42, P.L. 2002

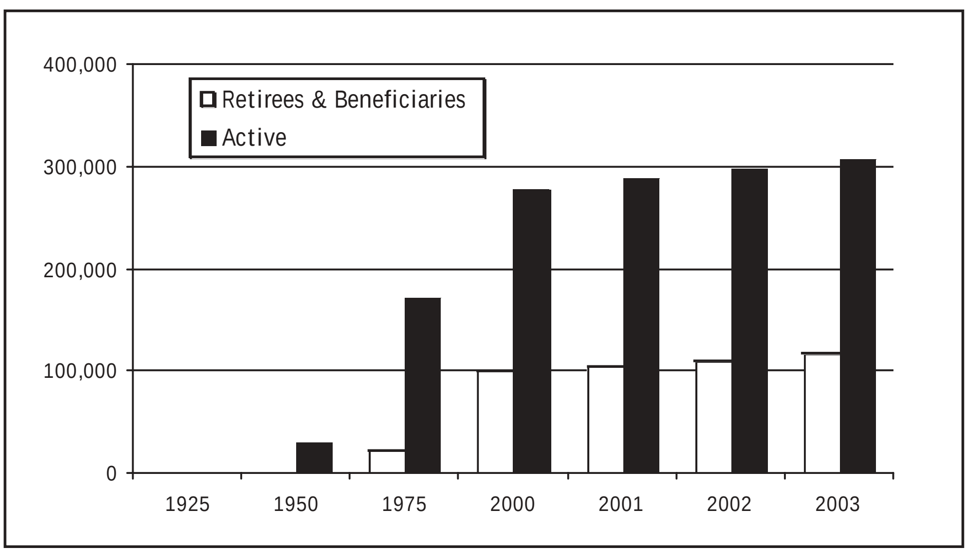
This law allows units of local governments (municipalities, counties, authorities, school boards, etc.) to issue refunding bonds to retire their unfunded accrued liability owed to the State's various pension systems created through the granting of early retirement benefits to their employees. Refunding bonds may be issued to retire the pension liabilities for a local governmental unit's participation in an early retirement incentive program established pursuant to P.L. 1991, c. 229, P.L. 1991, c. 230, P.L. 1991, c. 231, P.L. 1993, c. 138, P.L. 1993, c. 181, P.L. 1993, c. 163 and P.L. 1993, c. 99. The law would also allow units of local governments to use refunding bonds when they offer early retirement incentive programs for employees affected by consolidation agreements authorized by Chapter 59, P.L. 1999. The adoption and issuance procedures would be the same as procedures that exist under current law for the issuance of refunding bonds by the local unit.

This law also permits county improvement authorities and the Economic Development Authority to pool early retirement benefit refunding bonds from local units in order to obtain better interest rates and terms.

This law was effective July 12, 2002.

MEMBERSHIP

- As of June 30, 2003, the active membership of the System totaled 307,474 This includes 90,510 State employees and 216,964 employees from 1,672 participating local employers. Total inactive membership as of June 30, 2003 was 48,895.
- There were 115,427 retirees and beneficiaries receiving annual pensions totaling $1,414,899,860. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act).*
- Beneficiaries of 783 active and 4,055 retired members received lump sum death benefits in the amount of $96,314,762.
- The System’s assets totaled $21,103,328,107 at the close of the fiscal year 2003.



MEMBERSHIP ACTIVITY

During fiscal year 2003, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Public Employees' Retirement System of New Jersey.

- **ENROLLMENTS** - 30,447 new members were enrolled in PERS during fiscal year 2003.
- **LOANS** - 77,599 loans were issued to members. The total loans receivable as of June 30, 2003 is $444,068,570.
- **WITHDRAWALS** - there were 6,124 withdrawals during fiscal year 2003.
- **RETIREMENT** - 11,344 members retired under the following retirement types:

TYPE OF RETIREMENT	
Service	6,145
Early	2,858
Deferred	353
Ordinary Disability	1,144
Accidental Disability	50
Veteran	794
TOTAL	11,344

OPTION SELECTION	
Maximum	5,473
Option 1	1,203
Option 2	357
Option 3	139
Option 4	26
Option A	1,579
Option B	624
Option C	1,253
Option D	687
Other	3
TOTAL	11,344

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
Public Employees' Retirement System:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Public Employees' Retirement System (the System) as of June 30, 2003 and 2002, and the related statements of changes in fiduciary net assets for the years 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 audits.

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 financial position of the State of New Jersey Public Employees' Retirement System as of June 30, 2003 and 2002, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. 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 financial statements of the System. Such information has been subjected to the auditing procedures applied in the audits 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.

September 19, 2003

KPMG LLP

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis
June 30, 2003 and 2002

Our discussion and analysis of the Public Employees' Retirement System (the System)'s financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2003 and 2002. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2003 - 2002

- Net assets held in trust for pension and post-retirement medical benefits decreased by $590,755,902 as a result of this year's operations from $21,552,247,016 to $20,961,491,114.
- Additions for the year were $1,143,686,224, which are comprised of member and employer pension contributions of $425,722,558 and investment income of $717,963,666.
- Deductions for the year were $1,734,442,126, which are comprised of benefit and refund payments of $1,714,860,990 and administrative expenses of $19,581,136.
- The System utilized net assets (excess assets above the required funding level) to meet the employers' portion of normal pension contribution requirements in part.
- Net assets held in trust for post-retirement medical benefits were used this year to pay part of premiums and other periodic charges for health care benefits for qualified retirees and their dependents.

2002 - 2001

- Net assets held in trust for pension and post-retirement medical benefits decreased by $2,996,912,338 as a result of the year's operations from $24,549,159,354 to $21,552,247,016.
- Additions for the year were ($1,548,241,044), which are comprised of member and employer pension contributions of $341,572,081 and investment losses of ($1,889,813,125).
- Deductions for the year were $1,448,671,294, which are comprised of benefit and refund payments of $1,428,680,724 and administrative expenses of $19,990,570.
- The System utilized net assets (excess assets above the required funding level) to meet the employers' portion of normal pension contribution requirements.
- Net assets held in trust for post-retirement medical benefits were used to pay premiums and other periodic charges for health care benefits for qualified retirees and their dependents.

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

This annual report consists of two financial statements: *The Statements of Fiduciary Net Assets* and *The Statements 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 Statements 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 Statements 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

STATEMENTS OF FIDUCIARY NET ASSETS

2003 - 2002
The System's assets mainly consist of cash, investments and contributions due from members and participating employers. Between fiscal years 2002 and 2003, total assets decreased by $595,531,943 or 2.7% from $21,698,860,050 to $21,103,328,107. The total assets decreased because pension benefit payments to retirees and beneficiaries exceeded the revenues received by the System.

Liabilities consist of pension and death benefit payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the System's insurance provider, and other payables. Total liabilities decreased by $4,776,041 or 3.3% over last year from $146,613,034 to $141,836,993. This is mainly due to a decrease in insurance benefit payments.

Net assets held in trust for pension and post-retirement medical benefits decreased by $590,755,902 or 2.8%.

2002 - 2001
Between fiscal years 2001 and 2002, total assets decreased by $2,954,863,066 from $24,653,723,116 to $21,698,860,050. The decrease in total assets is mainly due to a loss in the fair value of the System's investments and an increase in benefit payments. During the year, the System had an estimated investment loss of 9.0%.

Total liabilities increased by $42,049,272 or 40.2% over last year from $104,563,762 to $146,613,034. This is mainly due to an increase in retirement and insurance benefit payments. In addition, accruals for insurance benefit payments include three months of premium charges and increased by $15 million.

Net assets held in trust for pension and post-retirement medical benefits decreased by $2,996,912,338 or 12.2% primarily due to the investment losses realized by the System.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS
2003 - 2002

	2003	2002	Increase (Decrease)
Member Contributions	$354,900,256	$340,363,504	$14,536,752
Employer Contributions	70,817,688	1,208,577	69,609,111
Investment & Other	717,968,280	(1,889,813,125)	2,607,781,405
Totals	$1,143,686,224	$(1,548,241,044)	$2,691,927,268

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions rose 4.3% due to normal salary increases and increased membership.

The State made a contribution of $69.9 million for fiscal year 2003 post-retirement medical (PRM). In addition, the PRM reserve of $66.5 million was used to cover additional premiums due in fiscal year 2003.

For fiscal year 2003, the 84% of available excess valuation assets could be utilized to offset normal contributions. Thereafter, a certain percentage of available excess valuation assets may be used as specified in the legislation. The State and local employers were not required to make a normal contribution to the System between 1997 and 2003 based on Pension Security legislation passed in 1997.

After the prior two consecutive years of investment losses, the System had investment gain in fiscal year 2003. The total investment gain for all pension funds was estimated to be 3.3% compared to 9.0% loss in the prior year.

2002 - 2001

	2002	2001	Increase (Decrease)
Member Contributions	$340,363,504	$314,235,958	$26,127,546
Employer Contributions	1,208,577	86,099,027	(84,890,450)
Investment & Other	(1,889,813,125)	(2,569,536,756)	679,723,631
Totals	$(1,548,241,044)	$(2,169,201,771)	$620,960,727

Member contributions rose 8.3% due to normal salary increases and increased membership. Employer contributions decreased significantly due to the fact that the State was not required to make a contribution in fiscal year 2002 toward the cost of post-retirement medical benefits. Under legislation passed during the year (Chapter 11, P.L. 2002), the State was permitted to use net assets held in trust for post-retirement medical benefits to cover the year's anticipated premiums. This legislation also suspended for 2002 and 2003 the annual State contribution to the Post-retirement Medical Fund.

Fiscal year 2002 was the fifth consecutive year that the State and local participating employers have not been required to make a normal pension contribution to the System. The normal contributions have been funded using net assets (excess assets above the required funding level). Net assets have been available mainly due to Pension Security legislation passed in 1997. This legislation authorized the New Jersey Economic Development Authority to issue bonds and to use the proceeds from the bond sale to eliminate the State's portion of the unfunded accrued liabilities of the retirement systems. The System received bond proceeds of $241,106,642 in 1997. This influx of funds, coupled with investment returns in the late 1990s, has produced excess net assets which have been utilized to cover the normal contributions from 1998 through 2002.

In fiscal year 2002, the total investment loss for all pension funds was estimated to be 9.0% compared to 10.4% in the prior year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS
2003 - 2002

	2003	2002	Increase (Decrease)
Benefits	$1,647,607,309	$1,358,160,290	$289,447,019
Refunds & Adjustments	67,253,681	70,520,434	(3,266,753)
Administrative Expenses	19,581,136	19,990,570	(409,434)
Totals	$1,734,442,126	$1,448,671,294	$285,770,832

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 21.3% partly due to the benefit enhancements which were effective with the November 1, 2001 retirement checks. (The new rate affected only eight months in the prior fiscal year.) Also, the number of retirees receiving benefits has increased due to the State Early Retirement Incentive. The number of refunds processed has decreased compared to last year due to fewer terminations. Administrative expenses have decreased by 2.1% mainly due to decrease in fringe benefit costs.

2002 - 2001

	2002	2001	Increase (Decrease)
Benefits	$1,358,160,290	$1,191,297,283	$166,863,007
Refunds & Adjustments	70,520,434	74,428,304	(3,907,870)
Administrative Expenses	19,990,570	16,233,802	3,756,768
Totals	$1,448,671,294	$1,281,959,389	$166,711,905

Benefit payments increased primarily because legislation was passed (Chapter 353, P.L. 2001 and Chapter 133, P.L. 2001) that provides a 9.09% increase in benefits to retirees and beneficiaries. The benefit enhancements were effective with the November 1, 2001 retirement checks. The number of retirees receiving benefits has also increased. The number of refunds processed has decreased compared to last year due to fewer terminations. Administrative expenses have increased mainly due to contractual increases in salaries and higher fringe benefit costs.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 107.3% for fiscal year 2003 and 117.1% for 2002 indicate that the System has assets sufficient 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
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statements of Fiduciary Net Assets

June 30, 2003 and 2002

	2003			2002		
	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Assets:						
Investments, at fair value:						
Cash Management Fund	$ 546,045,650	25,564	546,071,214	547,458,853	1,751,724	549,210,577
Bonds	267,594,519	12,528	267,607,047	292,062,291	934,523	292,996,814
Common Pension Fund A	9,647,348,735	451,657	9,647,800,392	9,469,749,791	30,300,709	9,500,050,500
Common Pension Fund B	6,189,402,157	289,768	6,189,691,925	6,362,426,820	20,358,092	6,382,784,912
Common Pension Fund D	3,388,626,257	158,644	3,388,784,901	3,471,196,393	11,106,915	3,482,303,308
Mortgage Backed Securities	342,951,140	16,056	342,967,196	644,574,127	2,062,468	646,636,595
Total investments	20,381,968,458	954,217	20,382,922,675	20,787,468,275	66,514,431	20,853,982,706
Receivables:						
Contributions:						
Members	54,743,195	—	54,743,195	51,994,449	—	51,994,449
Employers	100,372,530	—	100,372,530	203,751,526	—	203,751,526
Accrued interest and dividends	119,243,689	—	119,243,689	132,790,054	—	132,790,054
Members' loans	444,068,570	—	444,068,570	453,087,166	—	453,087,166
Other	1,977,448	—	1,977,448	3,254,149	—	3,254,149
Total receivables	720,405,432	—	720,405,432	844,877,344	—	844,877,344
Total assets	21,102,373,890	954,217	21,103,328,107	21,632,345,619	66,514,431	21,698,860,050
Liabilities:						
Accounts payable and accrued expenses	19,679,321	—	19,679,321	23,790,049	—	23,790,049
Retirement benefits payable	116,673,568	—	116,673,568	103,272,186	—	103,272,186
NCGI premiums payable	5,120,098	—	5,120,098	18,486,585	—	18,486,585
Cash overdraft	364,006	—	364,006	1,064,214	—	1,064,214
Total liabilities	141,836,993	—	141,836,993	146,613,034	—	146,613,034
Net Assets:						
Held in trust for pension benefits	$ 20,960,536,897	954,217	20,961,491,114	21,485,732,585	66,514,431	21,552,247,016

See schedule of funding progress on page 10.
See accompanying notes to financial statements.

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2003 and 2002

	2003			2002		
	PENSION FUND	**POST-RETIREMENT MEDICAL FUND**	**TOTAL**	**PENSION FUND**	**POST-RETIREMENT MEDICAL FUND**	**TOTAL**
Additions:						
Contributions:						
Members	$ 354,900,256	—	354,900,256	340,363,504	—	340,363,504
Employers	899,789	69,917,899	70,817,688	1,208,577	—	1,208,577
Other	4,614	—	4,614	4,673	—	4,673
Total contributions	355,804,659	69,917,899	425,722,558	341,576,754	—	341,576,754
Investment income:						
Net (depreciation) appreciation in fair value of investments	37,060,277	914,573	37,974,850	(2,598,973,862)	(15,087,606)	(2,614,061,468)
Interest	523,444,265	—	523,444,265	583,563,248	—	583,563,248
Dividends	161,204,573		161,204,573	145,434,993		145,434,993
	721,709,115	914,573	722,623,688	(1,869,975,621)	(15,087,606)	(1,885,063,227)
Less: investment expense	4,660,022	—	4,660,022	4,754,571	—	4,754,571
Net investment income	717,049,093	914,573	717,963,666	(1,874,730,192)	(15,087,606)	(1,889,817,798)
Total additions	1,072,853,752	70,832,472	1,143,686,224	(1,533,153,438)	(15,087,606)	(1,548,241,044)
Deductions:						
Benefits	1,511,214,623	136,392,686	1,647,607,309	1,272,122,263	86,038,027	1,358,160,290
Withdrawals	67,253,681	—	67,253,681	70,520,434	—	70,520,434
Administrative expenses	19,581,136	—	19,581,136	19,990,570	—	19,990,570
Total deductions	1,598,049,440	136,392,686	1,734,442,126	1,362,633,267	86,038,027	1,448,671,294
Change in net asets	(525,195,688)	(65,560,214)	(590,755,902)	(2,895,786,705)	(101,125,633)	(2,996,912,338)
Net assets - Beginning of year	21,485,732,585	66,514,431	21,552,247,016	24,381,519,290	167,640,064	24,549,159,354
Net assets - End of year	$ 20,960,536,897	954,217	20,961,491,114	21,485,732,585	66,514,431	21,552,247,016

See accompanying notes to financial statements.

(1) DESCRIPTION OF THE SYSTEM

The State of New Jersey Public Employees' Retirement System (the System; PERS) is a cost-sharing multiple-employer contributory defined benefit plan which was established as of January 1, 1955, under the provisions of N.J.S.A. 43:15A. 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.

At June 30, 2002 and June 30, 2001, the dates of the most recent actuarial valuations, participating employers consisted of the following:

	2002	2001
State of New Jersey	1	1
County agencies	66	66
Municipalities	578	578
School districts	561	561
Other public agencies	466	466
Total	1,672	1,672

The System's designated purpose is to provide retirement, death, disability and medical benefits to certain qualified members. Membership in the System is mandatory for substantially all full-time employees of the State of New Jersey or any county, municipality, school district or public agency, provided the employee is not required to be a member of another state-administered retirement system or other state pension fund or local jurisdiction's pension fund. The System's Board of Trustees is primarily responsible for the administration of the System.

According to the 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. 43:15A and 43:3B. The System provides retirement, death and disability benefits, as well as medical benefits for certain qualified members. All benefits vest after eight to ten years of service, except for medical benefits, which vest after 25 years of service or under the disability provisions of the System. Retirement benefits for age and service are available at age 60 and are generally determined to be 1/55 of final average salary for each year of service credit (as defined). Final average salary equals the average salary for the final three years of service prior to retirement (or highest three years' compensation if other than the final three years). Members may seek early retirement after achieving 25 years service credit, as defined, or they may elect deferred retirement after achieving eight to ten years of service credit, in which case benefits would begin the first day of the month after the member attains normal retirement age.

Members are always fully vested for their own contributions and, after three years of service credit, become vested for earnings on their contributions at 2% per annum. In the case of death before retirement, members' beneficiaries are entitled to full interest credited to the members' accounts.

Eligible retirees receiving monthly 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.

Significant Legislation:

Chapter 108, P.L. 2003, effective July 1, 2003, provides that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by the PERS as follows: 20% for payments due in State FY 2005; not more than 40% in FY 2006; not more than 60% in FY 2007; and not more than 80% in FY 2008. According to the Budget Appropriations Act of 2004, the State as well will pay pension obligations through a five-year phase-in. In FY 2004, the State will pay 20% of the normal and accrued liability pension costs by using the benefit enhancement fund.

Chapter 42, P.L. 2002 permitted local government units to issue refunding bonds to retire an unfunded accrued liability resulting from early retirement benefits, effective July 12, 2002.

Chapter 23, P.L. 2002 provided early retirement incentive benefits to State employees who meet specified age and service requirements and who retire within a specified time period that generally extended from February 1, 2002 to July 1, 2002. The incentive benefits include an additional three years of service credit to employees who are at least 50 years of age with at least 25 years of service credit; State paid health care benefits to employees who are at least 60 years of age with at least 20, but less than 25, years of service credit; and an additional monthly benefit of $500 per month for 24 months following the date of retirement to employees who are at least 60 years of age with at least 10, but not more than 20, years of service credit. For those eligible for veterans' retirement benefit, the incentive is an additional pension of 3/55 of the compensation upon which the retirement benefit is based to employees who are at least 55 years of age with 25 or more years of service credit.

Chapter 11, P.L. 2002, effective March 26, 2002, allowed the State to use net assets in post-retirement medical (PRM) fund to cover required pay-as-you-go medical premiums. This legislation also suspended in fiscal years 2002 and 2003 the additional PRM contribution to increase the fund balance by 1/2 of 1% of active member salaries for the valuation period. The additional PRM contribution will resume in fiscal year 2004 and will be computed to provide an increase in the reserve fund of 3/5 of 1% of active member salaries for the valuation period.

Membership:

Membership in the System consisted of the following at June 30, 2002 and 2001, the dates of the most recent actuarial valuations:

2002	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	109,546	14,779
Active members:		
Vested	155,861	11,118
Non-vested	135,108	77,438
Total active members	290,969	88,556
Total	400,515	103,335

2001	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	106,982	13,952
Active members:		
Vested	140,604	10,096
Non-vested	140,224	75,675
Total active members	280,828	85,771
Total	387,810	99,723

(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" and No. 26, "Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans." Plan assets are recorded at fair value. Employer contributions are recognized when payable to the System. Benefits and refunds are recognized when payable in accordance with the terms of the System.

Financial Reporting Model:

Effective July 1, 2000, the Division adopted two new statements of financial accounting standards issued by the Governmental Accounting Standards Board (GASB):

Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*

Statement No. 37 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*

Statement No. 34 (as amended by Statement No. 37) requires as required supplementary information Management's Discussion and Analysis which includes an analytical overview of the System's financial activities.

Investment Valuation:

Investments, including short-term investments (State of New Jersey Cash Management Funds), are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgage backed securities are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value.

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 State of New Jersey Division of Investment administers three common pension funds which are utilized by the System. A brief description of each common pension fund is as follows:

Common Pension Fund A - The operations of Common Pension Fund A are governed by the provisions of Article 62 of the State of New Jersey Investment Council regulations for the purpose of investing in corporate common stocks, securities convertible into corporate common stocks or covered call options.

Common Pension Fund B - The operations of Common Pension Fund B are governed by the provisions of Article 63 of the State of New Jersey Investment Council regulations for the purpose of investing in fixed income and debt securities.

Common Pension Fund D - The operations of Common Pension Fund D are governed by the provisions of Article 67 of the State of New Jersey Investment Council regulations for the purpose of investing in international debt and equity securities, currencies, currency futures, and options.

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, Common Pension Fund A, Common Pension Fund B and Common Pension Fund D. 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 purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the System, through the State Treasurer, and custodian banks as agents for the System. 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.

In 2001, the Board of Trustees approved that the Post-Retirement Medical Fund earn a rate of return consistent with the System and henceforth. In prior years, the Post-Retirement Medical Fund earned a statutorily determined fixed rate of return of 8.75%.

GASB Statement No. 3 requires disclosure of the level of risk assumed by the System. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the

System's name. As of June 30, 2003 and 2002, all investments held by the System (other than mortgage backed securities and the State of New Jersey Cash Management Funds which are not categorized) are classified as Category 1.

Federal securities are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the System. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the System. The custodian banks, as agents for the System, maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the System.

Securities not maintained by the Federal Reserve Banks or DTC are in the name of a designated nominee representing the securities of the System, which establishes the System's unconditional right to the securities.

Members' Loans:

Members can borrow up to 50% of their accumulated member contributions. To obtain a loan, a member must have at least three years of service credit in the System. 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.

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 statements of changes in fiduciary net assets.

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, 2003, which include funding for the July 1, 2003 retirement payroll, are designated Category 3.

(3) CONTRIBUTIONS

The contribution policy is set by N.J.S.A. 43:15A and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. Members contribute at a uniform rate. The full normal employee contribution rate is 5% of base salary. However, as a result of special legislation (Chapter 415, P.L. 1999), the employee rate was reduced to 3% of base salary effective January 1, 2000. The rate will remain at 3% for as long as actuarially determined excess valuation assets are available in the System. On the other hand, the rate for members who are eligible for the Prosecutors Part of the PERS (Chapter 366, P.L. 2001) is 7.5% of base salary, and the rate for the Workers' Compensation Judges Part of the PERS (Chapter 259, P.L. 2001) is 5% of base salary. Employers are required to contribute at an actuarially determined rate. The annual employer contribution includes funding for basic retirement allowances, cost-of-living adjustments, and noncontributory death benefits. The State of New Jersey's contribution also includes funding for the cost of medical premiums after retirement for qualified retirees. In accordance with Chapter 62, P.L. 1994, post-retirement medical benefits have been funded on a pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial reserve basis. Beginning in 1996, the State has made an additional contribution to the Post-Retirement Medical Reserve Fund to ensure an increase in the fund balance of 1/2 of 1% of the salary of active state employees.

For fiscal year 2003, the 84% of available excess valuation assets could be utilized to offset normal contributions. Thereafter, a certain percentage of available excess valuation assets may be used as specified in the legislation. The State and local employers were not required to make a normal contribution to the System between the years 1997 and 2003. The normal contribution for basic pension benefits, noncontributory death benefits, and cost-of-living adjustments was funded by excess valuation assets in accordance with Chapter 115, P.L. 1997. This legislation provides for actuarially determined excess valuation assets to offset required normal contributions of the State of New Jersey and the local participating employers.

The State made a contribution of $69.9 million for fiscal year 2003 post-retirement medical (PRM). In addition, PRM reserve of $66.5 million was used to cover additional premiums due in fiscal year 2003. The State made no PRM contribution in fiscal year 2002. Legislation passed in 2002 (Chapter 11, P.L. 2002) allowed the State to use net assets in PRM Fund to cover required pay-as-you-go medical premiums. This legislation also suspended in fiscal years 2002 and 2003 the additional PRM contribution to increase the fund balance by 1/2 of 1% of active member salaries for the valuation period. The additional PRM contribution will resume in fiscal year 2004 and will be computed to provide an increase in the reserve fund of 3/5 of 1% of active member salaries for the valuation period.

To fund the benefit increases provided by Chapter 133, the legislation provided for the use of excess assets. A special benefit enhancement fund (BEF) was established from which the required normal contributions for the increased benefits will be charged. To fund the accrued liabilities incurred by the System, the actuarial value of assets for the valuation period ending June 30, 1999 was adjusted to reflect the full market value of assets.

The BEF will also provide funding for the benefit increases under Chapter 353, P.L. 2001. Actuarially determined excess valuation assets will cover the additional accrued liability incurred by the retirement system. No additional formula State contribution is required in fiscal year 2004; instead, that contribution will be covered by the BEF.

Chapter 108 (P.L. 2003) provides that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by the PERS as follows: 20% for payments due in State fiscal year 2005; not more than 40% in fiscal year 2006; not more than 60% in fiscal year 2007; and not more than 80% in fiscal year 2008. According to the Budget Appropriations Act of 2004, the State as well will pay pension obligations through a five-year phase-in. In fiscal year 2004, the State will pay 20% of the normal and accrued liability pension costs by using the benefit enhancement fund.

(4) FUNDS

This System maintains the following legally required funds:

Members' Annuity Savings and Accumulative Interest Fund (2003 - $6,246,682,986; 2002 - $6,124,856,638)

The Members' Annuity Savings Fund is credited with all contributions made by active members of the System. Interest earned on member contributions is credited to the Accumulated Interest Fund. The annual rate of interest on member contributions, as required by Chapter 62, P.L. 1994, is 8.75%.

Contingent Reserve Fund (2003 - $1,137,846,163; 2002 - $3,991,477,386)

The Contingent Reserve Fund is credited with the contributions of contributing employers other than post-retirement medical contributions. Interest earnings, after crediting the Accumulated Interest Fund, Retirement Reserve Fund and Special Reserve Fund, are credited to this account. Additionally, payments for life insurance premiums are made from this Fund.

Retirement Reserve Fund (2003 - $12,722,540,303; 2002 - $10,629,869,683)

The Retirement Reserve Fund is the account from which retirement benefits other than life insurance premiums, contributory group insurance premiums, and post-retirement medical premiums, including cost-of-living benefits and medical benefits for certain retirees, are paid. Upon retirement of a member, accumulated contributions, together with accumulated regular interest, are transferred to the Retirement Reserve Fund from the Members' Annuity Savings Fund and Accumulative Interest Fund. Any additional reserves needed for the retirement and cost-of-living benefits are transferred from the Contingent Reserve Fund. Annually, interest as determined by the State Treasurer (8.75% for 2003 and 2002) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2003 - $0; 2002 - $0)

The Special Reserve Fund is the fund to which excess interest earnings and gains from sales and maturities of investments are transferred and against which any losses from the sales of securities are charged. The maximum limit on the accumulation of this account is 1% of the market value of the investments allocated to the System, excluding Cash Management Fund investments and bonds allocated to the Contributory Group Insurance Premium Fund which amounted to $183,914,672 and $174,121,903 as of June 30, 2003 and 2002, respectively. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

Contributory Group Insurance Premium Fund (2003 - $183,936,841; 2002 - $167,182,773)

The Contributory Group Insurance Premium Fund represents the accumulation of member group insurance contributions in excess of premiums disbursed to the insurance carrier since the inception of the contributory death benefit program plus reserves held by the insurance carrier. Members are required by statute to participate in the contributory group insurance plan in the first year of membership and may cancel the contributory coverage thereafter. The current contribution rate for active members is 0.5 of 1% of salary, as defined.

Post-Retirement Medical Fund (2003 - $954,217; 2002 - $66,514,431)

The Post-Retirement Medical Fund is credited with employer contributions for post-retirement medical benefits, interest earnings on post-retirement medical reserves, and from which post-retirement medical premiums are paid.

Benefit Enhancement Reserve Fund (2003 - $669,530,604; 2002 - $572,346,105)

The Benefit Enhancement Reserve Fund is a special reserve fund from which required normal contributions to provide benefit increases under Chapter 353, P.L. 2001 and Chapter 133, P.L. 2001 will be charged. The fund was established in 2002 and credited with excess assets equivalent to member contributions for fiscal years 2000 and 2001 by transferring reserves in the Contingent Reserve Fund to the Benefit Enhancement Fund. Additional transfers will be made, as required, to maintain a fund balance equal to the present value of expected additional normal contributions due to the increased benefits. The State will be required to make contributions to the Benefit Enhancement Fund on behalf of State and local employers if excess valuation assets are not available.

(5) 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.

Schedule 1

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' 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)
State						
March 31, 1997	$6,987,217,172	$6,606,707,924	$(380,509,248)	105.8%	$2,714,991,457	(14.0%)
March 31, 1998	7,600,621,930	7,155,035,122	(445,586,808)	106.2%	2,805,791,909	(15.9%)
June 30, 1999	8,879,920,323	7,823,576,056	(1,056,344,267)	113.5%	2,928,470,790	(36.1%)
June 30, 2000	9,743,727,383	8,538,685,222	(1,205,042,161)	114.1%	3,094,280,664	(38.9%)
June 30, 2001	11,123,818,861	9,886,463,368	(1,237,355,493)	112.5%	3,288,383,788	(37.6%)
June 30, 2002	11,073,156,965	10,760,557,483	(312,599,482)	102.9%	3,511,151,199	(8.9%)
Local						
March 31, 1997	10,523,061,499	9,599,816,842	(923,244,657)	109.6%	4,407,751,955	(20.9%)
March 31, 1998	11,486,495,310	10,286,532,879	(1,199,962,431)	111.7%	4,513,357,772	(26.6%)
June 30, 1999	13,171,311,650	11,163,283,877	(2,008,027,773)	118.0%	4,655,241,261	(43.1%)
June 30, 2000	14,380,511,913	12,007,160,806	(2,373,351,107)	119.8%	4,910,962,708	(48.3%)
June 30, 2001	16,625,288,260	13,819,038,491	(2,806,249,769)	120.3%	5,240,338,738	(53.6%)
June 30, 2002	16,503,081,054	14,929,334,103	(1,573,746,951)	110.5%	5,534,322,805	(28.4%)

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' 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, 2002 and 2001 actuarial valuations included the following:

	June 30, 2002	June 30, 2001
Actuarial cost method	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value
Amortization method	Level percent, closed	Level percent, closed
Payroll growth rate for amortization	5.00%	5.00%
Remaining amortization period	39 years for UAAL balance	40 years for UAAL balance
	9 years for asset method change	10 years for asset method change
Actuarial assumptions:		
Interest rate	8.75%	8.75%
Salary range	5.95%	5.95%
Cost-of-living adjustments	2.40%	2.40%

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

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Employer Contributions

YEAR ENDED JUNE 30,	ANNUAL REQUIRED CONTRIBUTION	EMPLOYER CONTRIBUTIONS[1]	PERCENTAGE CONTRIBUTED
State			
1997	$134,878,582	$241,106,642[2]	178.8%
1998	78,833,287	—	0.0%
1999	86,945,810	—	0.0%
2000	103,033,425	—	0.0%
2001	85,078,620	—	0.0%
2002	88,911,187	—	0.0%
2003	44,636,619	—	0.0%
Local			
1997	142,672,255	67,476,771	47.3%
1998	84,639,988	19,034,673	22.5%
1999	111,886,040	19,599,153	17.5%
2000	112,800,127	20,541,177	18.2%
2001	88,717,727	21,670,774	24.4%
2002	77,254,063	16,174,534	20.9%
2003	—	16,987,033	N/A

Notes to Schedule

(1) Excludes post-retirement medical contributions (State only) and contributions received from other State of New Jersey retirement systems for certain members who transferred their eligible prior service credit to the Public Employees' Retirement System. The local employer contribution from 1998 to 2003 consists of required contributions under the early retirement incentive programs.

In accordance with Chapter 115, P.L. 1997, available excess valuation assets were used to fund, in full or in part, the required contributions of the State and local employers.

(2) For the year ended June 30, 1997, the state portion of 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.

Schedule 3

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2003

	MEMBERS' ANNUITY SAVINGS AND ACCUMULATIVE INTEREST FUND	CONTINGENT RESERVE FUND	RETIREMENT RESERVE FUND	SPECIAL RESERVE FUND	CONTRIBUTORY GROUP INSURANCE PREMIUM FUND	POST-RETIREMENT MEDICAL FUND	BENEFIT ENHANCEMENT FUND	OTHER	TOTAL
Additions:									
Contributions:									
Members	$ 311,106,320	—	—	—	43,793,936	—	—	—	354,900,256
Employers	—	899,789	—	—	—	69,917,899	—	—	70,817,688
Other	—	—	—	—	—	—	—	4,614	4,614
Total contributions	311,106,320	899,789	—	—	43,793,936	69,917,899	—	4,614	425,722,558
Distribution of net investment income	508,176,891	(780,145,747)	944,232,103	—	7,882,585	914,573	36,903,261	—	717,963,666
Total additions	819,283,211	(779,245,958)	944,232,103	—	51,676,521	70,832,472	36,903,261	4,614	1,143,686,224
Deductions:									
Benefit payments	—	61,392,310	1,414,895,246	—	34,922,453	136,392,686	—	4,614	1,647,607,309
Refunds of contributions	63,625,541	3,628,140	—	—	—	—	—	—	67,253,681
Administrative expenses	—	19,581,136	—	—	—	—	—	—	19,581,136
Total deductions	63,625,541	84,601,586	1,414,895,246	—	34,922,453	136,392,686	—	4,614	1,734,442,126
Net increase (decrease) before transfers among reserves	755,657,670	(863,847,544)	(470,663,143)	—	16,754,068	(65,560,214)	36,903,261	—	(590,755,902)
Transfers among reserves:									
Retirements	(646,520,709)	(1,564,350,884)	2,210,871,593	—	—	—	—	—	—
Other	12,689,387	(425,432,795)	352,462,170	—	—	—	60,281,238	—	—
Net increase (decrease)	121,826,348	(2,853,631,223)	2,092,670,620	—	16,754,068	(65,560,214)	97,184,499	—	(590,755,902)
Net assets held in trust for pension and post-retirement medical benefits:									
Beginning of year	6,124,856,638	3,991,477,386	10,629,869,683	—	167,182,773	66,514,431	572,346,105	—	21,552,247,016
End of year	$ 6,246,682,986	1,137,846,163	12,722,540,303	—	183,936,841	954,217	669,530,604	—	20,961,491,114

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