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 2004 Annual Report in accordance with the provisions of N.J.S.A. 43:15A-21.

Respectfully submitted,

George B. Babula

GEORGE B. BABULA
Chairperson

Public Employees' Retirement System

2003 BOARD OF TRUSTEES

SIGNIFICANT LEGISLATION

Chapter 108, P.L. 2003

This new law provides for the following:

1. Reduces the pension contributions that local employers must make to the Public Employees' Retirement System of New Jersey (PERS) and the Police and Firemen's Retirement System (PFRS) for four years,
2. Exempts local employer contributions to PERS and PFRS from the local budget cap law for a limited period, and
3. Provides for a prospective increase to the PFRS special retirement benefit upon the pension system attaining a funded level in excess of 104 percent.

1. Pension Contribution Reduction

This law 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 PERS as follows: 20% for payments due in State fiscal year 2005; not more than 40% for payments due in State fiscal year 2006; not more than 60% for payments due in State fiscal year 2007; and not more than 80% for payments due in State fiscal year 2008. Local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the retirement system for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the retirement system as the State Treasurer will determine, but not more than 40% for payments due in State fiscal year 2005, not more than 60% for payments due in State fiscal year 2006, and not more than 80% for payments due in State fiscal year 2007.

2. Budget Cap Exemption

This law provides that, for the respective four-year periods during which local public employers' pension contributions to PERS and PFRS will be reduced, and for the year thereafter when the employers would again be subject to the full contribution requirement, the affected contribution payments shall be exempt from the limits imposed by the local budget "cap" law.

3. Prospective PFRS Special Retirement Benefit Enhancement

This law provides for an increase to the special retirement benefit for members of the Police and Firemen's Retirement System (PFRS) beginning with the fiscal year following the adopted valuation report for the retirement system which indicates a funded level in excess of 104%. PFRS members who have 25 or more years of service are currently eligible for a pension of 65% of final compensation, plus 1% of final compensation multiplied by the number of years of creditable service over 25 but not over 30 (70% maximum). This law will increase that benefit to a pension of 70% of final compensation, plus 1% of final compensation for each year of creditable service over 25 but not over 30 (75% maximum) once the funded level exceeds 104%.

The law also provides for the establishment in PFRS of a benefit enhancement fund to which will be credited an amount of excess valuation assets for the valuation period beginning with the valuation report which indicates a funded level of 104%. The amount of excess valuation assets credited to the benefit enhancement fund will not exceed the present value of the expected additional normal and accrued liability contributions attributable to the increase in the PFRS special retirement benefits payable on behalf of the active PFRS members. No additional excess valuation assets will be credited to the benefit enhancement fund after the maximum amount is attained. The normal and accrued liability contributions for this increase in PFRS benefits for active employees will be paid from the benefit enhancement fund. If fund assets are insufficient to pay those contributions for a valuation period, the retirement system will pay the amount not covered by assets from the benefit enhancement fund.

This law was effective July 1, 2003.

Chapter 127, P.L. 2003

This law provides additional retirement benefits to certain employees of a public agency or instrumentality, other than State agencies or instrumentalities, that elects to provide the benefits, who retire under the Public

Employees' Retirement System (PERS). The governing body of the employer will have one year after the enactment of this law to adopt a resolution. Once a resolution is adopted and effective, employees will have three months to retire. These employers are authorities, boards, commissions, corporations and other agencies and instrumentalities participating in the PERS.

Employees who are at least 50 years of age and have at least 25 years of service credit as of the effective date of retirement will receive an additional three years of service credit. If the member is under age 55 at the time of retirement, the member's retirement allowance will not be reduced. Employees who satisfy age and service requirements and who retire on special veteran's retirement will receive an additional pension in the amount of 3/55 of the compensation upon which the retirement allowance is based.

Employees of employers that offer retirees paid health care benefits coverage who are at least 60 years of age with between 20 and 25 years of service as of the effective date of retirement will receive employer-paid post-retirement health care benefits coverage. Employees of employers that do not offer retirees paid health care benefits coverage who are at least 60 years of age and have at least 20 years of service as of the effective date of retirement will not be eligible for paid health care benefits coverage, but will receive an additional pension payment of $500 per month for the first 24 months after retirement. Employees who are at least 60 years of age with at least 10 but not more than 20 years of service credit as of the effective date of retirement will receive an additional pension of $500 per month for the first 24 months after retirement.

When the needs of an employer require the services of an employee who elects to retire and receive a benefit under this law, the employer, with the approval of the governing body and the consent of the employee, may delay the effective retirement date of the employee for up to one year. The delay authorized under the law does not extend the dates for qualification for benefits.

The cost of the enhanced PERS pension benefits will be funded by employer contributions to the retirement system and paid by the public agency or instrumentality that elects to participate. The additional pension liability shall be paid by each electing entity over a period of 15 years.

An employer may elect to provide these benefits by the adoption of a resolution by its governing body and the filing of a certified copy with the Director of the Division of Pensions and Benefits within three business days. The effective date of the resolution must fall within one year of enactment of this law. An employer may offer these benefits only once. An employer covered by this law must meet with the employee union representatives, whether or not the employer adopts a resolution, within a year of the enactment of this law.

The provisions of this law do not apply to employees of a public agency or organization that were eligible to participate in the State early retirement incentive program offered in 2002 pursuant to P.L. 2002, c.23.

This law also provides for the following:

- Partial purchase of pension service credit to qualify.
- The employer shall pay the cost of the actuarial work to determine the additional liability of the retirement systems for the benefits under this act, which shall be included in the initial contribution required from the employer.
- The promulgation of rules and regulations by the Division of Pensions and Benefits deemed necessary for the effective implementation of this act.
- Authorizes public agencies and instrumentalities to issue refunding bonds to retire the present value of the unfunded accrued pension liabilities for early retirement incentive benefits granted by the law.

This law was effective July 14, 2003.

Chapter 128, P.L. 2003

This law provides additional retirement benefits to certain employees of a county, a county college or a municipality that elect to provide the benefits, who retire under the Public Employees' Retirement System (PERS), the Teachers' Pension and Annuity Fund (TPAF) or the Alternate Benefit Program (ABP). The governing body of the employer will have one year after the enactment of this law to adopt a resolution electing to participate in this program. Once a resolution is adopted and effective, employees will have three months to retire. Employers participating in several locally administered county, municipal and school district pension systems may also adopt the provisions of this law.

Employees who are at least 50 years of age and have at least 25 years of service credit as of the effective date of retirement will receive an additional three years of service credit. If a member of PERS or TPAF is under age 55 at the time of retirement, the member's retirement allowance will not be reduced. Employees who satisfy age and service requirements and who retire on a special veteran's retirement will receive an additional pension in the amount of 3/55 of the compensation on which the retirement allowance is based. Participants in ABP will receive an amount equal to 100% of base annual salary at the time of retirement.

Employees who are at least 60 years of age with between 20 and 25 years of service as of the effective date of retirement will receive employer-paid coverage in the New Jersey State Health Benefits Program. The retired employees and their dependents will be eligible for coverage in the program even if the employer does not participate in the program or otherwise provide health care benefits coverage in retirement upon the normal retirement of such employees. Employees who are at least 60 years of age with between 10 and 20 years of service as of the effective date of retirement will receive an additional pension payment of $500 per month for the first 24 months after retirement.

When the needs of an employer require the services of an employee who elects to retire and receive a benefit under this law, the employer, with the approval of the governing body and the consent of the employee, may delay the effective retirement date of the employee for up to one year. The delay authorized under the law does not extend the dates for qualification for benefits.

The cost of the enhanced PERS and TPAF pension benefits will be funded by employer contributions to the retirement systems and paid by the county, county college or municipality who elect to participate. The additional pension liability shall be paid by each electing entity over a period of 15 years. Payments to ABP members shall be made by employers first to the members' annuity contract under the ABP, then to a member's section 403(b) contract, up to the limits allowed by the Internal Revenue Code. Payments in excess of any limits shall be paid directly to the member. The SHBP health care benefits payments for eligible retirees and their dependents will be paid by the employer on a current cost basis. Additionally, an electing county college employer shall be required to pay the SHBP health care premiums for three years following retirement for each employee who retires under this program with 25 or more years of pension service credit and who would otherwise be qualified for State-paid health benefits after retirement.

An employer may elect to provide these benefits by the adoption of a resolution by its governing body and the filing of a certified copy with the Director of the Division of Pensions and Benefits within three business days. The effective date of the resolution must fall within one year of enactment of this law. An employer may offer these benefits only once. An employer covered by this law must meet with the employee union representatives, whether or not the employer adopts a resolution, within a year of the enactment of this law.

The provisions of this law do not apply to employees of a public agency or organization, nor does it apply to members of the Prosecutors Part of PERS.

This law also provides for the following:

- Partial purchase of pension service credit to qualify.
- The employer shall pay the cost of the actuarial work to determine the additional liability of the retirement systems for the benefits under this act, which shall be included in the initial contribution required from the employer.
- The promulgation of rules and regulations by the Division of Pensions and Benefits deemed necessary for the effective implementation of this act.
- The enrollment in the SHBP of those retiring under this act at age 60 with between 20 and 25 years of service within 60 days of retirement.

- Authorizes counties and municipalities to issue refunding bonds to retire the present value of the unfunded accrued pension liabilities for early retirement incentive benefits granted by the law.

This law was effective July 14, 2003.

Chapter 129, P.L. 2003

This law provides additional retirement benefits to certain employees of a local school board, educational services commission or jointure commission that elect to provide the benefits, who retire under the Public Employees' Retirement System (PERS) or the Teachers' Pension and Annuity Fund (TPAF). The governing body of the employer will have one year after the enactment of this law to adopt a resolution electing to participate in this program. Once a resolution is adopted and effective, employees will have two months to retire.

An employee who is at least 50 years of age and has at least 25 years of service credit under PERS or TPAF as of the effective date of retirement will receive an additional three years of service credit. If a member of PERS or TPAF is under age 55 at the time of retirement, the member's retirement allowance will not be reduced. An employee veteran who meets the age and service credit requirements and retires on a special veteran's retirement under PERS or TPAF will receive an additional pension in the amount of 3/55 of the compensation on which the retirement allowance is based.

An employee who is at least 60 years of age and has at least 20, but less than 25, years of service as of the effective date of retirement will receive full payment of premiums for coverage under the State Health Benefits Program (SHBP) for the retired employee and dependents, but not including survivors, whether or not the employer participates in SHBP with respect to its active employees. An employee who is at least 60 years of age with at least 10, but less than 20, years of service credit will receive an additional pension of $500 per month for the 24 months following retirement.

When the needs of an employer require the services of an employee who elects to receive a benefit under this law, the employer may delay, with the consent of the employee, the effective retirement date of the employee for up to one year. The authorization for a delay in the effective retirement date does not extend the dates for qualification for benefits.

The cost of the enhanced pension benefits will be funded by employer contributions to the retirement systems and paid by the school boards, educational services commissions or jointure commissions who elect to participate. The additional pension liability shall be paid by each electing entity in level payments over a period of 15 years. The SHBP health care benefits payments for eligible retirees and their dependents will be paid by the employer on a current cost basis. Additionally, an electing employer shall be required to pay the SHBP health care premiums for each employee who retires under this program with 25 or mores years of pension service credit for three years following retirement.

An employer may elect to provide these benefits by the adoption of a resolution by its governing body, which is to be effective July 1, and the filing of a certified copy with the Director of the Division of Pensions and Benefits within three business days after its adoption. The effective date of the resolution must fall within 15 months of enactment of this law. An employer may offer these benefits only once. An employer covered by this law must meet with the employee union representatives, whether or not the employer adopts a resolution, within a year of the enactment of this law.

Any employee that was eligible, or could have been if the employer elected, to participate in the State early retirement incentive program offered in 2002 pursuant to P.L. 2002, c.23, is not eligible for the early retirement incentive benefits granted under this law.

This law also provides for the following:

- Partial purchase of pension service credit to qualify.
- The employer shall pay the cost of the actuarial work to determine the additional liability of the retirement systems for the benefits under this act which shall be included in the initial contribution required from the employer.

- The promulgation of rules and regulations by the Division of Pensions and Benefits deemed necessary for the effective implementation of this act.
- Authorizes boards of education to issue refunding bonds to retire the present value of the unfunded accrued pension liabilities for early retirement incentive benefits granted by the law.

This law was effective July 14, 2003.

Chapter 140, P.L. 2003

This law allows an individual nominated and appointed pursuant to Article VII, Section II, paragraph 1 of the New Jersey Constitution to the position of a county prosecutor after January 7, 2002 to receive full credit in the Prosecutors Part of the Public Employees' Retirement (PERS) for non-Prosecutor Part PERS service rendered prior to the date of appointment.

Legislation enacted on January 7, 2002 established a special "Prosecutors Part" within the Public Employees' Retirement System (PERS) to provide higher benefits to persons identified as "prosecutors" under that law (P.L. 2002, c.366). The law defined "prosecutors" to include county prosecutors and assistant prosecutors, and also certain administrators, attorneys and investigators in the Division of Criminal Justice in the Department of Law and Public Safety. A PERS member eligible for retirement as a "prosecutor" is entitled to have "prosecutor" service treated, for pension purposes, under formulas similar to those applicable to Police and Firemen's Retirement System (PFRS).

Chapter 366 provided that all regular PERS service credit established by a "prosecutor" prior to the date of its enactment (January 7, 2002) would be established in the Prosecutors Part without further assessment of cost to the "prosecutor," but only if the member was serving as a "prosecutor" on January 7, 2002. This conversion of service provision does not apply to "prosecutors" appointed after that date. Chapter 140 extends, for duly appointed county prosecutors only, the same no-assessment conversion of regular PERS credit into "prosecutor" credit to pre-appointment PERS service that the county prosecutor established regardless of the county prosecutor's appointment date.

This law was effective August 1, 2003.

Chapter 197, P.L. 2003

This law extends eligibility for certain veterans' benefits to veterans of Operations "Enduring Freedom" and "Iraqi Freedom" who served at least 14 days in the theater of operation of those campaigns and in direct support thereof.

The benefits for which a qualified veteran will become eligible under this law include:

1. For eligible public employees, absolute civil service preference under Title 11A of the New Jersey Statutes;
2. For eligible members of the public employee pension systems, (a) the veteran's retirement allowance under the Teachers' Pension and Annuity Fund (TPAF) or the Public Employees' Retirement System (PERS), and (b) the right to purchase additional pension credit in the Police and Firemen's Retirement System (PFRS), TPAF or PERS; and
3. For homeowners, entitlement to the annual property tax deduction provided for by Article VIII of the New Jersey Constitution ($250 in each tax year) or a property tax exemption if the eligible person has a total and permanent service-incurred disability.

Of the three operations, service that may qualify a person for benefits under the law is as follows:

a. "Enduring Freedom" refers collectively to operations conducted abroad since September 11, 2001, in prosecution of the war against terror, including but not limited to operations conducted in Afghanistan.

b. "Iraqi Freedom" refers to the operations in and around Iraq beginning in March 2003 and still ongoing.

In addition to its broadening of veterans' benefit eligibility, this law makes technical changes and updates to descriptions of what constitutes service during the military conflicts of Operation "Restore Hope" in Somalia and

Operations "Joint Endeavor" and "Joint Guard" in the Republic of Bosnia and Herzegovina.

This law was effective December 16, 2003.

Chapter 246, P.L. 2003

This new law is designated the "Domestic Partnership Act." It creates a mechanism, through the establishment of domestic partnerships, for New Jersey to recognize and support adult individuals in this State who share an important personal, emotional and committed relationship with another adult.

The law provides that two persons who desire to become domestic partners may execute and file an Affidavit of Domestic Partnership with the local registrar upon payment of a fee, in an amount to be determined by the Commissioner of Health and Senior Services, if they meet all of the following requirements:

- Both persons share a common residence in this State, or share the same place to live in another jurisdiction and at least one of them is a member of a State-administered retirement system;
- Both persons are otherwise jointly responsible for each other's common welfare as evidenced by joint financial arrangements or joint ownership of real or personal property, which are to be demonstrated by at least one of the following: a joint deed, mortgage agreement or lease; a joint bank account; designation of one of the persons as a primary beneficiary in the other person's will; designation of one of the persons as a primary beneficiary in the other person's life insurance policy or retirement plan; or joint ownership of a motor vehicle;
- Both persons agree to be jointly responsible for each other's basic living expenses during the domestic partnership;
- Neither person is in a marriage recognized by New Jersey law or a member of another domestic partnership;
- Neither person is related to the other by blood or affinity up to and including the fourth degree of consanguinity;
- Both persons are of the same sex and therefore unable to enter into a marriage with each other that is recognized by New Jersey law, or are each 62 years of age or older and not of the same sex;
- Both persons have chosen to share each other's lives in a committed relationship of mutual caring;
- Both persons are at least 18 years of age;
- Both persons file jointly an Affidavit of Domestic Partnership; and
- Neither person has been a partner in a domestic partnership that was terminated less than 180 days prior to the filing of the current Affidavit of Domestic Partnership, except that this prohibition does not apply if one of the partners died; and, in all cases in which a person registered a prior domestic partnership, the domestic partnership must have been terminated in accordance with the provisions of the law.

In the case of domestic partners that are not of the same sex, the domestic partnership will terminate automatically upon the partners' entry into a marriage with each other that is recognized by New Jersey law.

This law accords domestic partners rights and responsibilities that reflect the mutually interdependent and supportive nature of domestic partnership relationships. It provides all domestic partners with:

- statutory protection through the "Law Against Discrimination" (N.J.S.A.10:5-1 et seq.) against various forms of discrimination based on domestic partnership status, including employment, housing and credit discrimination;
- visitation rights for a hospitalized domestic partner and the right to make medical or legal decisions for an incapacitated partner; and
- an additional personal exemption under the "New Jersey Gross Income Tax Act" (N.J.S.A.54A:1-1 et seq.) and an exemption from the New Jersey transfer inheritance tax on the same basis as a spouse.

This law also makes certain health and pension benefits available to dependent domestic partners in the case of domestic partnerships in which both persons are of the same sex and therefore unable to enter into a marriage with each other that is recognized by New Jersey law:

- in the case of State employees, eligibility for dependent coverage under the State Health Benefits Program and dependent benefits under State-administered retirement systems (Public Employees' Retirement System, Police and Firemen's Retirement System, Judicial Retirement System, Teachers' Pension and Annuity Fund, and State Police Retirement System);
- in the case of other public employees, including employees of counties, municipalities and boards of education, eligibility for dependent coverage under the State Health Benefits Program and State-administered retirement systems, if the employer adopts a resolution providing for such coverage; and
- eligibility for dependent coverage under health insurance contracts and policies that commercial health and dental insurers are required to offer to covered persons under the law.

It also provides that two adults who have not filed an Affidavit of Domestic Partnership are to be treated as domestic partners in an emergency medical situation for the purposes of allowing one adult to accompany the other adult who is ill or injured while the latter is being transported to a hospital, or to visit the other adult who is a hospital patient, on the same basis as a member of the latter's immediate family, if both persons, or one of the persons in the event that the other person is legally or medically incapacitated, advise the emergency care provider that the two persons have met the other requirements for establishing a domestic partnership; however, this provision is not to be construed to permit the two adults to be treated as domestic partners for any other purpose prior to their having filed an Affidavit of Domestic Partnership.

Additionally, this law stipulates that, notwithstanding any other provisions of law to the contrary, the following provisions in this law shall not be deemed an unlawful discrimination under the "Law Against Discrimination" (N.J.S.A.10:5-1 et seq.):

- Section 57, which permits an employer that provides a health benefits plan (as defined in N.J.S.A.26:2S 2) to its employees and their dependents to require that an employee contribute a portion or the full amount of the cost of dependent coverage under the plan for the employee's domestic partner, and
- Section 58, which deals with the distinction between same-sex couples and opposite-sex couples over 62 years of age who establish domestic partnerships with respect to health and pension benefits made available to dependent domestic partners under this law.

The SHBP and State administered pension statutes impacted by this law can be found in Sections 41 through 46 of the law.

This law was effective on July 10, 2004.

Chapter 263, P.L. 2003

This new law provides for enrollment in the Public Employees' Retirement System of New Jersey (PERS) of eligible employees of any bi-state or multi-state agency in which New Jersey is a participant.

The PERS statutes provide for enrollment in the system of employees of various specified independent agencies and instrumentalities, including several interstate agencies (e.g., the Palisades Interstate Park and Delaware River Basin commissions). This law establishes an enrollment provision covering employees of all interstate agencies and prescribes the terms and conditions applicable to coverage of new enrollees under that provision.

Under this law, the PERS is directed to enroll an eligible officer or employee (other than a police officer or firefighter) of a bi-state or multi-state agency established by an interstate compact to which New Jersey is a party if:

a. the person is a State resident at the time of appointment with the agency, and
b. the governing body of the agency has certified to the retirement system its approval for enrollment in the system of the employee class within which the person is included.

The certification shall be in the manner of a resolution filed with the board of the retirement system in a form prescribed by the Division of Pensions and Benefits. The certification could apply retroactively to individuals commencing service with the agency on or after January 1, 2002. Any individual eligible for membership under such

SIGNIFICANT LEGISLATION

a certification would have the option whether or not to be enrolled. They would have 90 days to enroll after becoming eligible.

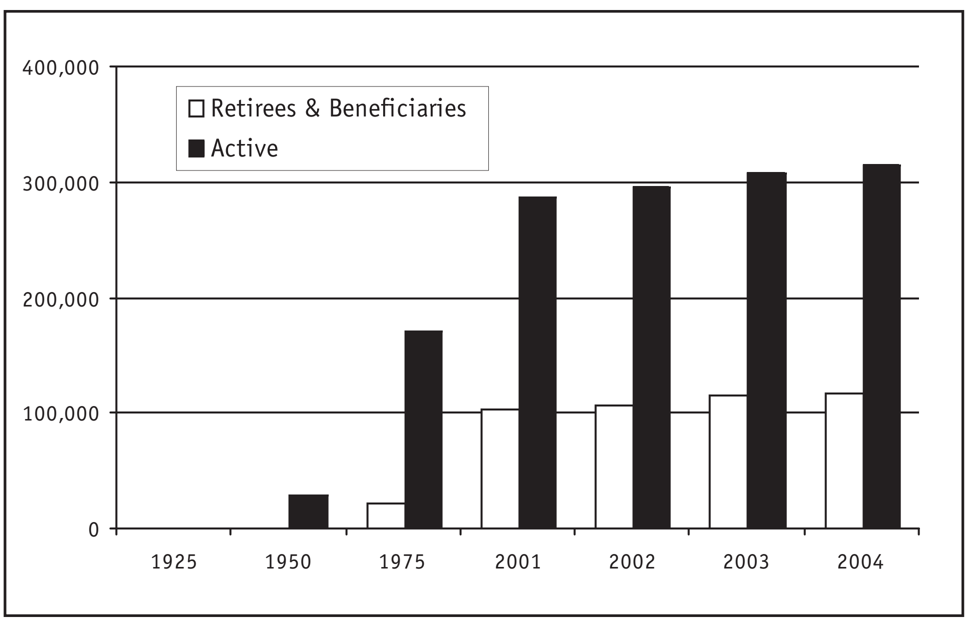
Once enrolled, the employee would receive credit for service with the agency rendered prior to enrollment if either the agency or the employee pays the full purchase cost to the retirement system at the time of enrollment. An employee who was a member of the retirement system on the date continuous service with the agency began and who has not withdrawn the employee contributions from the system shall participate in the retirement system under the former membership. The interstate agency would for all purposes of the PERS be deemed an employer, and its eligible employees would be subject to the same membership, contribution and benefit provisions of the retirement system, and to certain general provisions of law covering members of all State-established pension funds, as are applicable to State employees.

Additionally, an officer or employee of a bi-state or multi-state agency who is eligible for PERS membership under this law may purchase pension credit for service previously rendered with a bi-state or multi-state agency prior to becoming a PERS member if the initial appointment or employment with the agency occurred on or after January 1, 2002. Such a purchase will be similar to an out-of-state purchase.

This law was effective January 14, 2004.

MEMBERSHIP

- As of June 30, 2004, the active membership of the System totaled 314,673 This includes 94,066 State employees and 220,607 employees from 1,660 participating local employers. Total inactive membership as of June 30, 2004 was 49,203.
- There were 118,114 retirees and beneficiaries receiving annual pensions totaling $1,506,081,057. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act)*.
- Beneficiaries of 705 active and 4,141 retired members received lump sum death benefits in the amount of $97,104,220.
- The System's assets totaled $23,191,446,226 at the close of the fiscal year 2004.



MEMBERSHIP ACTIVITY

During fiscal year 2004, 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** - 29,181 new members were enrolled in PERS during fiscal year 2004.
- **LOANS** - 76,872 loans were issued to members. The total loans receivable as of June 30, 2004 is $432,512,607.
- **WITHDRAWALS** - there were 6,160 withdrawals during fiscal year 2004.
- **RETIREMENT** - 6,603 members retired under the following retirement types:

TYPE OF RETIREMENT	
Service	4,352
Early	430
Deferred	353
Ordinary Disability	1,059
Accidental Disability	50
Veteran	359
TOTAL	6,603

OPTION SELECTION	
Maximum	3,288
Option 1	597
Option 2	185
Option 3	55
Option 4	5
Option A	1,030
Option B	346
Option C	662
Option D	432
Other	3
TOTAL	6,603

KPMG LLP
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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, 2004 and 2003, 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, 2004 and 2003, 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 basic 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were 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 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 24, 2004

KPMG LLP

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis
June 30, 2004 and 2003

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, 2004 and 2003. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2004 - 2003

- Net assets held in trust for pension and post-retirement medical benefits increased by $2,071,861,293 as a result of this year's operations from $20,961,491,114 to $23,033,352,407.
- Additions for the year were $3,927,964,270, which are comprised of member and employer pension contributions of $1,149,321,013 and investment income of $2,778,643,257.
- Deductions for the year were $1,856,102,977, which are comprised of benefit and refund payments of $1,837,483,395 and administrative expenses of $18,619,582.
- The System utilized net assets (excess assets above the required funding level) to meet the employers' portion of normal pension contribution requirements in part.

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.

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

2004 - 2003

	2004	2003	Increase (Decrease)
Assets	$23,191,446,226	$21,103,328,107	$2,088,118,119
Liabilities	158,093,819	141,836,993	16,256,826
Net Assets (Deficit)	$23,033,352,407	$20,961,491,114	$2,071,861,293

The System's assets mainly consist of cash, investments and contributions due from members and participating employers. Between fiscal years 2003 and 2004, total assets increased by $2.1 billion or 9.9%. The total assets increased due to an increase in contributions receivable from members and employers and also overall increase in fair value of investments. Employer contribution receivables include contribution receivables from local employers for appropriations due April 1, 2005 based on Chapter 108, P.L. 2003, which provided 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 to 20% for payments due in State fiscal year 2005. Employer contribution receivables are also including State appropriation, based on Chapter 23, P.L. 2002, which permitted early retirement incentive benefits to State employees who meet specified age and service requirements and who retire within a specified time period. Last year employer contribution receivables decreased partly due to Chapter 42, P.L. 2002, which permitted local government units to issue refunding bonds to retire an unfunded accrued liability resulting from early retirement benefits.

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 increased by $16.3 million or 11.5% over last year. This is mainly due to an increase in benefits payable to retirees and beneficiaries, partly related to the State Early Retirement Incentive (Chapter 23, P.L. 2002).

Net assets held in trust for pension and post-retirement medical benefits increased by $2.1 billion or 9.9%.

2003 - 2002

	2003	2002	Increase (Decrease)
Assets	$21,103,328,107	$21,698,860,050	$(595,531,943)
Liabilities	141,836,993	146,613,034	(4,776,041)
Net Assets (Deficit)	$20,961,491,114	$21,552,247,016	$(590,755,902)

Between fiscal years 2002 and 2003, total assets decreased by $595.5 million or 2.7%. The total assets decreased because pension benefit payments to retirees and beneficiaries exceeded the revenues received by the System.

Total liabilities decreased by $4.8 million or 3.3% over last year. 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 $590.8 million or 2.8%.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS
2004 - 2003

	2004	2003	Increase (Decrease)
Member Contributions	$374,864,048	$354,900,256	$19,963,792
Employer Contributions & Other	774,456,965	70,817,688	703,639,277
Investment	2,778,643,257	717,968,280	2,060,674,977
Totals	$3,927,964,270	$1,143,686,224	$2,784,278,046

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions rose by $20.0 million or 5.6% due to increased membership.

Employer contributions rose by $703.6 million or 994.0% over last year. The State made a contribution of $168.7 million for fiscal year 2004 post-retirement medical (PRM). Also, employer contributions include $42.4 million from local employers for appropriation due April 1, 2005, based on Chapter 108, P.L. 2003, and $561.1 million from State appropriation, based on Chapter 23, P.L. 2002.

For fiscal year 2004, the 68% 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 2004 based on Pension Security legislation passed in 1997.

Investment & other revenues increased by $2.1 billion or 287.0% due to an increase in earnings and net appreciation in fair value of investments.

The total investment gain for all pension funds was estimated to be 14.2% compared to 3.3% gain in the prior year.

2003 - 2002

	2003	2002	Increase (Decrease)
Member Contributions	$354,900,256	$340,363,504	$14,536,752
Employer Contributions & Other	70,822,302	1,208,577	69,613,725
Investment	717,963,666	(1,889,813,125)	2,607,776,791
Totals	$1,143,686,224	$(1,548,241,044)	$2,691,927,268

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 2004. The total investment gain for all pension funds was estimated to be 3.3% compared to 9.0% loss in the prior year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS
2004 - 2003

	2004	2003	Increase (Decrease)
Benefits	$1,771,806,236	$1,647,607,309	$124,198,927
Refunds & Adjustments	65,677,159	67,253,681	(1,576,522)
Administrative Expenses	18,619,582	19,581,136	(961,554)
Totals	$1,856,102,977	$1,734,442,126	$121,660,851

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 $124.2 million or 7.5% partly due to an increase in number of retirees based on the State Early Retirement Incentive (Chapter 23, P.L. 2002). The number of refunds processed has decreased compared to last year due to fewer terminations. Administrative expenses have decreased by $1.0 million or 4.9% mainly due to a decrease in salaries and wages cost over the last year.

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

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.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 97.9% for fiscal year 2004 and 107.3% for 2003 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, 2004 and 2003

	2004			2003		
	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Assets:						
Investments, at fair value:						
Cash Management Fund	$ 257,591,562	13,273	257,604,835	546,045,650	25,564	546,071,214
Bonds	274,126,748	14,126	274,140,874	267,594,519	12,528	267,607,047
Common Pension Fund A	10,938,341,699	563,647	10,938,905,346	9,647,348,735	451,657	9,647,800,392
Common Pension Fund B	5,927,626,792	305,447	5,927,932,239	6,189,402,157	289,768	6,189,691,925
Common Pension Fund D	4,340,735,626	223,676	4,340,959,302	3,388,626,257	158,644	3,388,784,901
Mortgage Backed Securities	156,840,502	8,082	156,848,584	342,951,140	16,056	342,967,196
Total investments	21,895,262,929	1,128,251	21,896,391,180	20,381,968,458	954,217	20,382,922,675
Receivables:						
Contributions:						
Members	58,986,918	—	58,986,918	54,743,195	—	54,743,195
Employers	691,223,689	—	691,223,689	100,372,530	—	100,372,530
Accrued interest and dividends	109,715,145	—	109,715,145	119,243,689	—	119,243,689
Members' loans	432,512,607	—	432,512,607	444,068,570	—	444,068,570
Other	2,616,687	—	2,616,687	1,977,448	—	1,977,448
Total receivables	1,295,055,046	—	1,295,055,046	720,405,432	—	720,405,432
Total assets	23,190,317,975	1,128,251	23,191,446,226	21,102,373,890	954,217	21,103,328,107
Liabilities:						
Accounts payable and accrued expenses	24,042,413	—	24,042,413	19,679,321	—	19,679,321
Retirement benefits payable	124,006,633	—	124,006,633	116,673,568	—	116,673,568
NCGI premiums payable	5,693,432	—	5,693,432	5,120,098	—	5,120,098
Cash overdraft	4,351,341	—	4,351,341	364,006	—	364,006
Total liabilities	158,093,819	—	158,093,819	141,836,993	—	141,836,993
Net Assets:						
Held in trust for pension benefit	$ 23,032,224,156	1,128,251	23,033,352,407	20,960,536,897	954,217	20,961,491,114

See schedule of funding progress on page 27.
See accompanying notes to financial statements.

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2004 and 2003

	2004			2003		
	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Additions:						
Contributions:						
Members	$ 374,864,048	—	374,864,048	354,900,256	—	354,900,256
Employers	605,793,071	168,659,302	774,452,373	899,789	69,917,899	70,817,688
Other	4,592	—	4,592	4,614	—	4,614
Total contributions	980,661,711	168,659,302	1,149,321,013	355,804,659	69,917,899	425,722,558
Investment income:						
Net appreciation (depreciation) in fair value of investments	2,098,276,346	135,690	2,098,412,036	37,060,277	914,573	37,974,850
Interest	499,713,132	—	499,713,132	523,444,265	—	523,444,265
Dividends	184,665,089	—	184,665,089	161,204,573		161,204,573
	2,782,654,567	135,690	2,782,790,257	721,709,115	914,573	722,623,688
Less: investment expense	4,147,000	—	4,147,000	4,660,022	—	4,660,022
Net investment income	2,778,507,567	135,690	2,778,643,257	717,049,093	914,573	717,963,666
Total additions	3,759,169,278	168,794,992	3,927,964,270	1,072,853,752	70,832,472	1,143,686,224
Deductions:						
Benefits	1,603,185,278	168,620,958	1,771,806,236	1,511,214,623	136,392,686	1,647,607,309
Withdrawals	65,677,159	—	65,677,159	67,253,681	—	67,253,681
Administrative expenses	18,619,582	—	18,619,582	19,581,136	—	19,581,136
Total deductions	1,687,482,019	168,620,958	1,856,102,977	1,598,049,440	136,392,686	1,734,442,126
Change in net asets	2,071,687,259	174,034	2,071,861,293	(525,195,688)	(65,560,214)	(590,755,902)
Net assets - Beginning of year	20,960,536,897	954,217	20,961,491,114	21,485,732,585	66,514,431	21,552,247,016
Net assets - End of year	$ 23,032,224,156	1,128,251	23,033,352,407	20,960,536,897	954,217	20,961,491,114

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, 2003 and June 30, 2002, the dates of the most recent actuarial valuations, participating employers consisted of the following:

	2003	2002
State of New Jersey	1	1
County agencies	65	66
Municipalities	576	578
School districts	560	561
Other public agencies	459	466
Total	1,661	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, provided 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 paid 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.

Membership:

Membership in the System consisted of the following at June 30, 2003 and 2002, the dates of the most recent actuarial valuations:

2003	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries receiving benefits currently and terminated employees entitled to benefits but not yet receiving them	116,545	18,805
Active members:		
Vested	152,259	9,221
Non-vested	142,888	78,358
Total active members	295,147	87,579
Total	411,692	106,384

2002	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries receiving benefits currently and terminated 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

(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." Employer contributions are recognized when payable to the System. Benefits and refunds are recognized when payable in accordance with the terms of the System.

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, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, requires disclosure of the level of custodial 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, 2004 and 2003, 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 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 new 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 statements of changes in fiduciary net assets.

Cash and Cash Equivalents:

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, also requires that deposits held in financial institutions be categorized to indicate the level of custodial 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, 2004 and 2003, which include funding for the July 1, 2004 and 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, and the rate for State employees will return to the normal rate of 5% effective July 1, 2004 per statute since there are no longer surplus assets 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) and the rate for the Workers' Compensation Judges Part of the PERS (Chapter 259, P.L. 2001) will remain unchanged at 7.5% and 5% of base salary, respectively. However, the rate for local employees will return to the normal rate of 5% effective January 1, 2005. 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 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 2004, the 68% 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 2004. 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 $168.66 million for fiscal year 2004 post-retirement medical (PRM). 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.

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) provided 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 paid only 20% of the normal and accrued liability pension cost by using the BEF.

(4) FUNDS

This System maintains the following legally required funds:

Members' Annuity Savings and Accumulative Interest Fund (2004 - $6,689,917,734; 2003 - $6,246,682,986)

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 (2004 - $1,394,613,547; 2003 - $1,137,846,163)

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

Retirement Reserve Fund (2004 - $13,887,326,848; 2003 - $12,722,540,303)

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 interest, are transferred to the Retirement Reserve Fund from the Members' Annuity Savings 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 2004 and 2003) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2004 - $217,021,510; 2003 - $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 $194.24 million and $183.91 million as of June 30, 2004 and 2003, respectively. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

Contributory Group Insurance Premium Fund (2004 - $194,869,806; 2003 - $183,936,841)

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 (2004 - $1,128,251; 2003 - $954,217)

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 (2004 - $648,474,711; 2003 - $669,530,604)

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%)
June 30, 2003	10,829,953,189	11,942,299,170	1,112,345,981	90.7%	3,576,118,300	31.1%
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%)
June 30, 2003	16,406,284,200	15,887,012,746	(519,271,454)	103.3%	5,811,726,702	(8.9%)

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, 2003 and 2002 actuarial valuations included the following:

	June 30, 2003	June 30, 2002
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
Remaining amortization period	38 years for UAAL balance	39 years for UAAL balance
	8 years for asset method change	9 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%
2004	50,365,892	—	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
2004	—	20,882,718	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 2004 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, 2004

	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	$ 328,511,925	—	—	—	46,352,123	—	—	—	374,864,048
Employers	—	605,793,071	—	—	—	168,659,302	—	—	774,452,373
Other	—	—	—	—	—	—	—	4,592	4,592
Total contributions	328,511,925	605,793,071	—	—	46,352,123	168,659,302	—	4,592	1,149,321,013
Distribution of net investment income	507,268,629	850,705,536	1,150,797,444	217,021,510	538,322	135,690	52,176,126	—	2,778,643,257
Total additions	835,780,554	1,456,498,607	1,150,797,444	217,021,510	46,890,445	168,794,992	52,176,126	4,592	3,927,964,270
Deductions:									
Benefit payments	—	61,146,740	1,506,076,466	—	35,957,480	168,620,958	—	4,592	1,771,806,236
Refunds of contributions	58,125,451	7,551,708	—	—	—	—	—	—	65,677,159
Administrative expenses	—	18,619,582	—	—	—	—	—	—	18,619,582
Total deductions	58,125,451	87,318,030	1,506,076,466	—	35,957,480	168,620,958	—	4,592	1,856,102,977
Net increase (decrease) before transfers among reserves	777,655,103	1,369,180,577	(355,279,022)	217,021,510	10,932,965	174,034	52,176,126	—	2,071,861,293
Transfers among reserves:									
Retirements	(338,655,644)	(768,469,645)	1,107,125,289	—	—	—	—	—	—
Other	4,235,289	(343,943,548)	412,940,278	—	—	—	(73,232,019)	—	—
Net increase (decrease)	443,234,748	256,767,384	1,164,786,545	217,021,510	10,932,965	174,034	(21,055,893)	—	2,071,861,293
Net assets held in trust for pension and post-retirement medical benefits:									
Beginning 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
End of year	$ 6,689,917,734	1,394,613,547	13,887,326,848	217,021,510	194,869,806	1,128,251	648,474,711	—	23,033,352,407

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