



**STATE OF NEW JERSEY
CONSOLIDATED POLICE AND FIREMEN'S
PENSION FUND**

Financial Statements and Schedules

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 402
301 Carnegie Center
Princeton, NJ 08540-6227

Independent Auditors' Report

The Board of Trustees
State of New Jersey
Consolidated Police and Firemen's Pension Fund:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Consolidated Police and Firemen's Pension Fund (the Fund) as of June 30, 2006 and 2005, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Consolidated Police and Firemen's Pension Fund as of June 30, 2006 and 2005, and the changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis and the supplementary information included in the schedule of funding progress and schedule of employer contributions (Schedules 1 and 2) are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. The 2006 schedule of changes in fiduciary net assets by fund (Schedule 3) is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Fund. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

KPMG LLP

January 25, 2007

**STATE OF NEW JERSEY
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Management's Discussion and Analysis

June 30, 2006 and 2005

Our discussion and analysis of the Consolidated Police and Firemen's Pension Fund (the Fund) financial performance provides an overview of the Fund's financial activities for the fiscal years ended June 30, 2006 and 2005. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2006 - 2005

- Net assets held in trust for pension benefits increased by \$1,583,403 as a result of fiscal year 2006's operations from \$16,630,703 to \$18,214,106.
- Additions for the year were \$15,087,481 which are comprised of contributions of \$14,681,884 and net investment income of \$405,597.
- Deductions for the year were \$13,504,078, which are comprised of benefit payments of \$13,478,301 and administrative expenses of \$25,777.

2005 - 2004

- Net assets held in trust for pension benefits increased by \$1,251,425 as a result of fiscal year 2005's operations from \$15,379,278 to \$16,630,703.
- Additions for the year were \$16,443,601 which are comprised of contributions of \$16,212,252 and net investment income of \$231,349.
- Deductions for the year were \$15,192,176, which are comprised of benefit payments of \$15,137,682 and administrative expenses of \$54,494.

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 Fund and about its activities to help you assess whether the Fund, 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 Fund at the end of the fiscal year. The difference between assets and liabilities represents the Fund's fiduciary net assets. Over time, increases or decreases in the Fund's fiduciary net assets provide one indication of whether the financial health of the Fund 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 Fund'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 Fund is becoming financially stronger or weaker.

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FINANCIAL ANALYSIS

SCHEDULE OF FIDUCIARY NET ASSETS

2006 -2005

	2006	2005	Increase (Decrease)
Assets	\$18,559,367	\$18,057,251	\$502,116
Liabilities	345,261	1,426,548	(1,081,287)
Net Assets	\$18,214,106	\$16,630,703	\$1,583,403

The Fund's assets mainly consist of cash, securities lending collateral, investments, and contributions due from the State. Between fiscal years 2005 and 2006, total assets increased by \$0.5 million or 2.8% due to increase in fair value of investments.

Liabilities mainly consist of pension benefit payments owed to retirees and beneficiaries, and securities lending collateral and rebates payable. Total liabilities decreased by \$1.1 million or 75.8% mainly due to fewer retirees and beneficiaries receiving benefits compared to last year.

Net assets held in trust for pension benefits increased by \$1.6 million or 9.5% primarily because State contributions and investment revenues exceeded benefit payments.

2005 -2004

	2005	2004	Increase (Decrease)
Assets	\$18,057,251	\$16,723,261	\$1,333,990
Liabilities	1,426,548	1,343,983	82,565
Net Assets	\$16,630,703	\$15,379,278	\$1,251,425

Between fiscal years 2004 and 2005, total assets increased by \$1.3 million or 8.0% due to increase in fair value of investments.

Total liabilities increased by 6.1% mainly due to securities lending collateral and rebates payable offset by a reduction in the monthly pension payroll expense. Fewer retirees and beneficiaries are receiving benefits compared to last year.

Net assets held in trust for pension benefits increased by \$1.3 million or 8.1% primarily because State contributions and investment revenues exceeded benefit payments.

ADDITIONS TO FIDUCIARY NET ASSETS

2006 - 2005

	2006	2005	Increase (Decrease)
Employer Contributions	\$14,681,884	\$16,212,252	\$(1,530,368)
Investment & Other	405,597	231,349	174,248
Totals	\$15,087,481	\$16,443,601	\$(1,356,120)

Additions primarily consist of employer contributions and earnings from investment activities. Employer contributions are made mainly by the State to provide funding for pension benefits. Contributions are also received from the Pension Adjustment Fund to cover the cost-of-living adjustments included in benefit payments. The State contributed \$6.4 million toward the unfunded actuarial accrued liability in fiscal year 2006.

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Investment income increased by \$0.2 million or 75.3% due to a higher rate of return.

2005 - 2004

	2005	2004	Increase (Decrease)
Employer Contributions	\$16,212,252	\$12,055,073	\$4,157,179
Investment & Other	231,349	152,264	79,085
Totals	\$16,443,601	\$12,207,337	\$4,236,264

The State contributed \$7.0 million toward the unfunded actuarial accrued liability in fiscal year 2005. Contributions were not required from 1997 through 2001 due to Pension Security legislation passed in 1997.

Investment income increased by 51.9% due to a higher rate of return and a smaller unrealized loss on investments than last year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS

2006 - 2005

	2006	2005	Increase (Decrease)
Benefits	\$13,478,301	\$15,137,682	\$(1,659,381)
Administrative Expenses	25,777	54,494	(28,717)
Totals	\$13,504,078	\$15,192,176	\$(1,688,098)

Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries and administrative costs incurred by the Fund. Benefit payments decreased by \$1.7 million or 11.0% due to fewer retirees and beneficiaries. Likewise, administrative expenses decreased by 52.7%.

2005 - 2004

	2005	2004	Increase (Decrease)
Benefits	\$15,137,682	\$16,829,838	\$(1,692,156)
Administrative Expenses	54,494	28,831	25,663
Totals	\$15,192,176	\$16,858,669	\$(1,666,493)

Benefit payments decreased by \$1.7 million or 10.1% due to fewer retirees and beneficiaries. Administrative expenses increased by 89.0% mainly due to the reimbursement to the State General Fund of the Special Project Fund Appropriation utilized for the system reengineering project.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios are 72.9% for fiscal year 2006 and 62.0% for 2005.

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 Fund's finances and to show the Fund'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.

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Statements of Fiduciary Net Assets

June 30, 2006 and 2005

	2006	2005
Assets:		
Cash	\$ 155,455	132,802
Securities Lending Collateral	36,817	158,152
Investments, at fair value:		
Cash Management Fund	15,939,942	14,813,796
Bonds	19,449	88,480
Mortgage Backed Securities	534,869	752,339
Total investments	16,494,260	15,654,615
Receivables:		
Accrued interest	3,858	4,979
Due from Pension Adjustment Fund	620,593	728,842
Other	1,248,384	1,377,861
Total receivables	1,872,835	2,111,682
Total assets	18,559,367	18,057,251
Liabilities:		
Accounts payable and accrued expenses	6,063	25,573
Retirement benefits payable	302,381	1,242,823
Securities lending collateral and rebates payable	36,817	158,152
Total liabilities	345,261	1,426,548
Net Assets:		
Held in trust for pension benefits	\$ 18,214,106	16,630,703

See schedule of funding progress on pages 21-22.
See accompanying notes to financial statements.

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Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Additions:		
Contributions:		
Employers	\$ 6,450,118	7,074,835
Pension adjustment fund	<u>8,231,766</u>	<u>9,137,417</u>
Total contributions	<u>14,681,884</u>	<u>16,212,252</u>
Investment income:		
Net depreciation in fair value of investments	(26,334)	(22,830)
Interest	<u>440,852</u>	<u>262,766</u>
	414,518	239,936
Less: investment expense	<u>8,921</u>	<u>8,587</u>
Net investment income	<u>405,597</u>	<u>231,349</u>
Total additions	<u>15,087,481</u>	<u>16,443,601</u>
Deductions:		
Benefits	13,478,301	15,137,682
Administrative expenses	<u>25,777</u>	<u>54,494</u>
Total deductions	<u>13,504,078</u>	<u>15,192,176</u>
Change in net assets	1,583,403	1,251,425
Net assets - Beginning of year	<u>16,630,703</u>	<u>15,379,278</u>
Net assets - End of year	<u>\$ 18,214,106</u>	<u>16,630,703</u>

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2006 and 2005

(1) DESCRIPTION OF THE FUND

The State of New Jersey Consolidated Police and Firemen's Pension Fund (the Fund; CPFPPF) is a cost-sharing contributory defined benefit plan with a special funding situation which was established as of January 1, 1952, under the provisions of N.J.S.A. 43:16. The Fund is included along with other state-administered pension trust and agency funds in the basic financial statements of the State of New Jersey.

The Fund's designated purpose is to provide retirement, death and disability benefits to its members. Membership in the Fund is limited to county and municipal police and firemen who were appointed prior to July 1, 1944. There are no active vested members and 841 pensioners and beneficiaries are receiving benefits as of June 30, 2005, the date of the most recent actuarial valuation. As of June 30, 2004, there were no active members and 948 pensioners and beneficiaries receiving benefits. The Fund's Board of Trustees is primarily responsible for its administration.

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

Vesting and Benefit Provisions:

The vesting and benefit provisions are set by N.J.S.A. 43:16. The Fund provides retirement as well as death and disability benefits to any active member after 25 years of service. A member may retire at age 60 after 25 years of service. Retirement is mandatory at age 65, except for chiefs of police, who may retire at age 70. Benefits are generally determined to be 60% of final salary, as defined, plus 1% for each creditable year of service, as defined, in excess of 25 years, but not to exceed 30 years. Members are always fully vested in their own contributions.

Chapter 4, P.L. 2001 provided increased benefits to certain members who retired prior to December 29, 1989 with at least 25 years of creditable service. The maximum amount of the increase was 5% of the retiree's final compensation. For those with 30 or more years of service, the total pension benefit increased from 65% to 70% of final compensation.

(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 Fund is accounted for using an economic resources measurement focus.

The accrual basis of accounting is used for measuring financial position and changes in fiduciary net assets of the Fund. 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 Fund conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans." Employer contributions are recognized when payable to the Fund. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

Valuation of Investments:

Investments are reported at fair value as follows:

- U.S. Government and Agency, Foreign and Corporate obligations – prices quoted by a major dealer in such securities.
- Common Stock and Equity Funds, Foreign Equity Securities, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.

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- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund – closing bid price on the last day of trading during the period as determined by the Transfer Agent.
- Alternative investments (private equity, real assets and absolute return strategy funds) – estimated fair value provided by the investment manager and reviewed by management. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the value that would be used if a ready market for such investments existed. Accordingly, the realized value received upon the sale of the asset may differ from the fair value.

Investment Transactions:

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

Unit Transactions:

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

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

Securities Lending:

Common Funds A, B and D and several of the directly-held pension plan portfolios participate in securities lending programs, whereby securities are loaned to brokers or to other borrowers and, in return, the pension funds have rights to the collateral received. All of the securities held in Common Funds A, B and D, and certain securities held directly by the pension plans, are eligible for the securities lending program. Collateral received may consist of cash, letters of credit, or government securities having a market value equal to or exceeding 102% (U.S. dollar denominated) or 105% (non-U.S. dollar denominated) of the value of the loaned securities at the time the loan is made. For Common Funds A and B, in the event that the market value of the collateral falls below 101% of the market value of all the outstanding loaned securities to an individual borrower, additional collateral shall be transferred by the borrower to the respective funds no later than the close of the next business day so that the market value of such additional collateral, when added to the market value of the other collateral, shall equal 102% of the market value of the loaned securities. For Common Fund D, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% of the market value of the outstanding loaned securities to an individual borrower, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. As of June 30, 2006 and 2005, the Common Funds have no aggregate credit risk exposure to brokers because the collateral amount held by the Common Funds exceeded the market value of the securities on loan.

The contracts with the Common Funds' custodian banks require them to indemnify the Common Funds if the brokers fail to return the securities or fail to pay the Common Funds for income distributions on the securities while they are on loan. The custodian bank for Common Fund D also indemnifies Common Funds for any loss of principal or interest on the invested collateral. For any losses on the investment collateral in Common Funds

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A or B or other pension plan portfolios, the lending fee paid to the lending agent shall be reduced by 25% of the amount of such loss, up to an amount not to exceed 75% of the previous six months' securities lending fees. The securities loans can be terminated by notification by either the borrower or the Common Funds. The term to maturity of the securities loans is generally matched with the term to maturity of the investment of the cash collateral.

Administrative Expenses:

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

(3) INVESTMENTS

The Fund is invested in bonds and mortgage backed securities which represent 0.04% and 0.07% of the investment total of the pension funds as of June 30, 2006 and 2005, respectively.

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

	<u>2006</u>	<u>2005</u>
Domestic equities	\$ 36,206,866,148	34,782,276,119
International equities	12,953,297,531	11,232,483,997
Domestic fixed income	16,949,855,296	16,521,446,786
International fixed income	1,187,184,887	2,201,826,936
Domestic floating rate securities	77,882,139	77,922,181
Police and Fireman's mortgages	965,008,210	896,706,544
Private equity	236,208,692	—
Real estate	81,345,789	—
Absolute return strategy funds	260,707,666	—
Net forward foreign exchange contracts	(15,138,794)	51,900
	<u>\$ 68,903,217,564</u>	<u>65,712,714,463</u>

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

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

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is evaluated by nationally recognized statistical rating agencies such as Moody's Investors Service, Inc. (Moody's) or Standard & Poor's Corporation (S&P). Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. There are no restrictions in the

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amount that can be invested in United States treasury and government agency obligations. Council regulations require minimum credit ratings for certain categories of fixed income obligations held directly by the pension funds and limit the amount that can be invested in any one issuer or issue as follows:

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

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For securities in the fixed income portfolio, the following tables disclose aggregate market value, by major credit quality rating category at June 30, 2006 and 2005:

June 30, 2006 (000's)	Moody's Rating				
	Aaa	Aa	A	Baa	Ba
United States Treasury Notes	\$ 3,516,004	—	—	—	—
United States Treasury Bills	389,716	—	—	—	—
United States Treasury TIPS	790,555	—	—	—	—
United States Treasury Bonds	1,984,003	—	—	—	—
United States Treasury Strips	37,219	—	—	—	—
Title XI Merchant Marine Notes	3,615	—	—	—	—
Federal Agricultural Mortgage Corp. Notes	95,763	—	—	—	—
Federal Farm Credit Bank Bonds	50,270	—	—	—	—
Federal Home Loan Bank Bonds	466,312	—	—	—	—
Federal Home Loan Bank Discounted Notes	89,894	—	—	—	—
Federal Home Loan Mortgage Corp. Notes	341,897	—	—	—	—
Federal National Mortgage Association Notes	226,193	—	—	—	—
Resolution Funding Corp. Obligations	6,397	—	—	—	—
Floating Rate Notes	25,023	20,020	9,999	22,841	—
Corporate Obligations	509,357	674,474	2,172,927	1,545,710	—
Real Estate Investment Trust Obligations	—	—	—	93,436	—
Finance Company Debt	217,653	623,016	626,864	9,097	55,587
Supranational Obligations	75,512	—	—	—	—
International Bonds and Notes	208,740	99,215	19,539	—	—
Foreign Government Obligations	470,461	313,716	—	—	—
Remic/FHLMC	731,131	—	—	—	—
Remic/FNMA	67,108	—	—	—	—
Remic/GNMA	17,650	—	—	—	—
GNMA Mortgage Backed Certificates	78,051	—	—	—	—
FHLM Mortgage Backed Certificates	598,915	—	—	—	—
FNMA Mortgage Backed Certificates	620,790	—	—	—	—
Asset Backed Obligations	178,119	—	—	—	—
Private Export Obligations	55,971	—	—	—	—
Exchange Traded Securities	—	—	51,735	—	—
	\$ 11,852,319	1,730,441	2,881,064	1,671,084	55,587

The table does not include certain corporate obligations totaling \$24,426,500 which have an S&P rating of A and do not have a Moody's rating. The Police and Firemen's Mortgages and the Cash Management fund are unrated.

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June 30, 2005 (000's)	Moody's Rating			
	Aaa	Aa	A	Baa
United States Treasury Notes	\$ 1,813,358	—	—	—
United States Treasury TIPS	598,125	—	—	—
United States Treasury Bonds	2,193,224	—	—	—
United States Treasury Strips	42,326	—	—	—
Title XI Merchant Marine Notes	3,956	—	—	—
Federal Agricultural Mortgage Corp. Notes	—	101,698	—	—
Federal Farm Credit Bank Bonds	102,225	—	—	—
Federal Home Loan Bank Bonds	521,527	—	—	—
Federal Home Loan Bank Discounted Notes	4,244	—	—	—
Federal Home Loan Mortgage Corp. Notes	265,077	26,953	—	—
Federal National Mortgage Association Notes	698,324	26,078	—	—
Resolution Funding Corp. Obligations	7,337	—	—	—
Floating Rate Notes	25,026	19,983	9,999	22,914
Corporate Obligations	645,239	594,643	2,722,186	1,310,398
Real Estate Investment Trust Obligations	—	—	—	99,301
Finance Company Debt	285,528	963,800	757,113	132,094
Supranational Obligations	122,496	—	—	—
International Bonds and Notes	420,419	—	—	—
Foreign Government Obligations	1,293,765	283,284	58,319	—
Remic/FHLMC	638,865	—	—	—
Remic/FNMA	73,982	—	—	—
Remic/GNMA	17,993	—	—	—
GNMA Mortgage Backed Certificates	112,091	—	—	—
FHLM Mortgage Backed Certificates	774,802	—	—	—
FNMA Mortgage Backed Certificates	645,810	—	—	—
Asset Backed Obligations	252,973	—	—	—
Private Export Obligations	34,127	—	—	—
Exchange Traded Securities	—	—	56,050	—
	\$ 11,592,839	2,016,439	3,603,667	1,564,707

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

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

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The following table summarizes the maturities (or, in the case of Remics, Police and Firemen's Mortgages and mortgage-backed securities, the expected average life) of the fixed income portfolio at June 30, 2006 and 2005:

June 30, 2006 (000's)	Total Market Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
United States Treasury Notes	\$ 3,516,004	747,277	796,007	1,972,720	—
United States Treasury Bills	389,716	389,716	—	—	—
United States Treasury TIPS	790,555	—	60,532	580,319	149,704
United States Treasury Bonds	1,984,003	—	—	215,305	1,768,698
United States Treasury Strips	37,219	—	—	—	37,219
Title XI Merchant Marine Notes	3,615	—	—	—	3,615
Federal Agricultural Mortgage Corp. Notes	95,763	—	95,763	—	—
Federal Farm Credit Bank Bonds	50,270	—	50,270	—	—
Federal Home Loan Bank Bonds	466,312	175,074	268,104	23,134	—
Federal Home Loan Bank Discounted Notes	89,894	—	—	—	89,894
Federal Home Loan Mortgage Corp. Notes	341,897	322,470	—	19,427	—
Federal National Mortgage Association Notes	226,193	129,785	96,408	—	—
Resolution Funding Corp. Obligations	6,397	—	—	—	6,397
Floating Rate Notes	77,883	35,021	32,863	9,999	—
Corporate Obligations	4,926,894	712,831	1,267,070	1,126,601	1,820,392
Real Estate Investment Trust Obligations	93,436	—	42,914	50,522	—
Finance Company Debt	1,532,217	380,558	741,111	273,382	137,166
Supranational Obligations	75,512	—	—	—	75,512
International Bonds and Notes	327,494	124,499	145,353	18,137	39,505
Foreign Government Obligations	784,177	22,393	459,160	193,953	108,671
Remic/FHLMC	731,131	3,383	—	39,299	688,449
Remic/FNMA	67,108	1,321	—	17,827	47,960
Remic/GNMA	17,650	—	—	—	17,650
Police and Firemen's Mortgages	965,008	—	—	—	965,008
GNMA Mortgage Backed Certificates	78,051	12	637	—	77,402
FHLM Mortgage Backed Certificates	598,915	—	148	3,698	595,069
FNMA Mortgage Backed Certificates	620,790	149	9,291	21,177	590,173
Asset Backed Obligations	178,119	—	118,906	59,213	—
Private Export Obligations	55,971	—	11,887	44,084	—
	<u>\$ 19,128,194</u>	<u>3,044,489</u>	<u>4,196,424</u>	<u>4,668,797</u>	<u>7,218,484</u>

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June 30, 2006 and 2005

June 30, 2005 (000's)	Total Market Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
Fixed Income Investment Type	Market Value	Less than 1	1-5	6-10	More than 10
United States Treasury Notes	\$ 1,813,358	111,930	795,152	906,276	—
United States Treasury TIPS	598,125	—	—	517,312	80,813
United States Treasury Bonds	2,193,224	—	—	—	2,193,224
United States Treasury Strips	42,326	—	—	—	42,326
Title XI Merchant Marine Notes	3,956	—	—	—	3,956
Federal Agricultural Mortgage Corp. Notes	101,698	—	101,698	—	—
Federal Farm Credit Bank Bonds	102,225	49,578	52,647	—	—
Federal Home Loan Bank Bonds	521,527	49,610	471,917	—	—
Federal Home Loan Bank Discounted Notes	4,244	—	—	—	4,244
Federal Home Loan Mortgage Corp. Notes	292,030	—	174,938	117,092	—
Federal National Mortgage Association Notes	724,402	226,752	315,835	26,078	155,737
Resolution Funding Corp. Obligations	7,337	—	—	—	7,337
Floating Rate Notes	77,922	—	67,923	9,999	—
Corporate Obligations	5,272,466	492,077	1,632,208	1,509,472	1,638,709
Real Estate Investment Trust Obligations	99,301	—	19,836	79,465	—
Finance Company Debt	2,138,535	405,222	1,021,737	576,593	134,983
Supranational Obligations	122,496	25,227	—	—	97,269
International Bonds and Notes	420,419	54,846	300,229	19,865	45,479
Foreign Government Obligations	1,654,211	45,065	632,606	567,437	409,103
Remic/FHLMC	638,865	—	9,872	20,959	608,034
Remic/FNMA	73,982	196	4,734	18,358	50,694
Remic/GNMA	17,993	—	—	—	17,993
Police and Firemen's Mortgages	896,707	—	—	—	896,707
GNMA Mortgage Backed Certificates	112,091	41	1,479	—	110,571
FHLM Mortgage Backed Certificates	774,802	—	265	4,999	769,538
FNMA Mortgage Backed Certificates	645,810	—	7,343	29,116	609,351
Asset Backed Obligations	252,973	—	153,828	34,509	64,636
Private Export Obligations	34,127	—	12,289	21,838	—
Convertible Zero Coupon Bonds	4,701	—	—	4,701	—
	\$ 19,641,853	1,460,544	5,776,536	4,464,069	7,940,704

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Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The pension funds invest in global markets. The pension funds can invest in securities of companies incorporated in one of thirty countries approved by the Council. The market value of international preferred and common stocks and issues convertible into common stocks, when combined with the market value of international government and agency obligations, cannot exceed 22% of the market value of the pension funds. Not more than 5% of the value of the assets held by Common Fund D can be invested in companies incorporated in emerging market countries, and not more than 5% of the market value of the emerging market securities can be invested in any one corporation. Council regulations permit the pension funds to enter into foreign exchange contracts for the purpose of hedging the international portfolio. The pension funds held forward contracts totaling approximately \$1.9 billion and \$650 million at June 30, 2006 and 2005, respectively. Common Fund D had the following foreign currency exposure (expressed in U.S. dollars and 000's):

June 30, 2006			Foreign
Currency	Total		Government
Currency	Market Value	Equities	Obligations
Australian dollar	\$ 387,324	387,324	—
Canadian dollar	635,640	635,640	—
Danish krone	198,388	198,388	—
Euro	4,789,852	4,286,765	503,087
Hong Kong dollar	130,126	130,126	—
Japanese yen	3,039,675	3,039,675	—
Mexican peso	46,306	46,306	—
New Zealand dollar	18,426	18,426	—
Norwegian krone	269,692	269,692	—
Pound sterling	1,712,822	1,637,310	75,512
Singapore dollar	98,276	98,276	—
South Korean won	121,267	121,267	—
Swedish krona	760,561	682,104	78,457
Swiss franc	1,263,174	1,263,174	—
	<u>\$ 13,471,529</u>	<u>12,814,473</u>	<u>657,056</u>

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Notes to Financial Statements

June 30, 2006 and 2005

June 30, 2005			Foreign
Currency	Total		Government
	Market Value	Equities	Obligations
Australian dollar	\$ 401,419	272,432	128,987
Canadian dollar	587,693	502,887	84,806
Danish krone	148,396	148,396	—
Euro	4,447,970	3,646,096	801,874
Hong Kong dollar	167,809	167,809	—
Japanese yen	2,218,395	2,213,694	4,701
Mexican peso	40,732	40,732	—
New Zealand dollar	72,766	32,929	39,837
Norwegian krone	198,279	91,284	106,995
Pound sterling	2,181,965	1,957,489	224,476
Singapore dollar	75,678	75,678	—
South Korean won	141,633	141,633	—
Swedish krona	735,391	628,136	107,255
Swiss franc	1,017,524	1,017,524	—
	<u>\$ 12,435,650</u>	<u>10,936,719</u>	<u>1,498,931</u>

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

The pension funds' interests in alternative investments may contain elements of credit, currency and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition. Council regulations require that not more than 13 percent of the market value of the pension funds can be invested in alternative investments, with the individual categories of real assets, private equity and absolute return strategy investments limited to 5 percent, 7 percent and 5 percent of the market value, respectively. Not more than 5 percent of the market value of Common Fund E may be committed to any one partnership or investment, without the prior written approval of the Council. Common Fund E cannot own more than 25 percent of any individual investment. The investments in Common Fund E cannot comprise more than 20 percent of any one investment manager's total assets.

Net appreciation or depreciation in fair value of investments includes net realized gains and the change in net unrealized gains and losses on investments for the fiscal years ended June 30, 2006 and 2005. The net realized gain from investment transactions amounted to \$3,946,824,420 and the net increase in unrealized gains on investments amounted to \$567,526,008 for the year ended June 30, 2006. The net realized gain from investment transactions amounted to \$2,729,925,208 and the net increase in unrealized gains on investments amounted to \$935,762,205 for the year ended June 30, 2005.

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Notes to Financial Statements

June 30, 2006 and 2005

(4) SECURITIES LENDING COLLATERAL

The Fund's share in the securities lending program is 0.0003% and 0.001% of the total market value of the collateral as of June 30, 2006 and 2005, respectively.

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

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

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

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June 30, 2006 and 2005

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

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

For securities exposed to credit risk in the collateral portfolio, the following tables disclose aggregate market value, by major credit quality rating category at June 30, 2006 and 2005. In those cases where an issuer and/or security have both a long-term and short-term rating, the short-term rating is disclosed.

June 30, 2006
(000's)

	Moody's Rating				
	Aaa	Aa	A	P1	Not rated
Corporate Obligations	\$ 699,376	3,602,027	1,611,461	—	—
Commercial Paper	—	—	—	3,683,532	—
Certificates of Deposit	1,957,748	—	—	—	—
Repurchase Agreements	—	—	—	—	1,609,375
Guaranteed Investment Contracts	—	450,000	—	—	—
Money Market Funds	253,861	—	—	—	101,392
Collateralized Notes	—	135,924	—	—	—
Cash	—	—	—	—	147
	<u>\$ 2,910,985</u>	<u>4,187,951</u>	<u>1,611,461</u>	<u>3,683,532</u>	<u>1,710,914</u>

June 30, 2005
(000's)

	Moody's Rating				S&P Rating (1)
	Aaa	Aa	A	P1	A
Corporate Obligations	\$ 440,053	3,748,203	2,052,074	—	—
Commercial Paper	—	—	—	2,373,183	—
Certificates of Deposit	—	1,357,406	—	—	97,900
Repurchase Agreements	—	—	—	—	—
Guaranteed Investment Contracts	—	150,000	200,000	—	—
Money Market Funds	103,815	—	—	—	—
Collateralized Notes	10,000	—	—	—	—
	<u>\$ 553,868</u>	<u>5,255,609</u>	<u>2,252,074</u>	<u>2,373,183</u>	<u>97,900</u>

(1) Moody's rating not available

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June 30, 2006 and 2005

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

The following tables summarize the maturities of the collateral portfolio at June 30, 2006 and 2005.

June 30, 2006 (000's)	Total Market Value	Maturities	
		Less than one year	One year to 25 months
Corporate Obligations	\$ 5,912,864	2,301,117	3,611,747
Commercial Paper	3,683,531	3,683,531	—
Certificates of Deposit	1,957,748	1,957,748	—
Repurchase Agreements	1,609,375	1,609,375	—
Guaranteed Investment Contracts	450,000	350,000	100,000
Money Market Funds	355,253	355,253	—
Collateralized Notes	135,924	—	135,924
	<u>\$ 14,104,695</u>	<u>10,257,024</u>	<u>3,847,671</u>

June 30, 2005 (000's)	Total Market Value	Maturities	
		Less than one year	One year to 25 months
Corporate Obligations	\$ 6,240,331	4,753,161	1,487,170
Commercial Paper	2,373,183	2,373,183	—
Certificates of Deposit	1,455,306	1,455,306	—
Repurchase Agreements	1,588,984	1,588,984	—
Guaranteed Investment Contracts	350,000	250,000	100,000
Money Market Funds	104,889	104,889	—
Collateralized Notes	10,000	10,000	—
	<u>\$ 12,122,693</u>	<u>10,535,523</u>	<u>1,587,170</u>

As of June 30, 2006, the pension funds had received cash collateral of \$14,115,678,308 for outstanding loaned investment securities having market values of \$13,824,349,093. As of June 30, 2005, the pension funds had received cash collateral of \$12,166,888,240 for outstanding loaned investment securities having market values of \$11,780,098,612. In addition, as of June 30, 2006, the pension funds loaned investment securities having market values of \$1,471,340, against which it had received non-cash collateral with a current value of \$1,494,859, which is not reflected in the accompanying financial statements. As of June 30, 2005, the pension funds loaned investment securities having market values of \$38,245,996, against which it had received non-cash collateral with a current value of \$39,118,460, which is not reflected in the accompanying financial statements.

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Notes to Financial Statements

June 30, 2006 and 2005

(5) CONTRIBUTIONS

The contribution policy is set by N.J.S.A. 43:16 and requires contributions by active members and the State of New Jersey. Plan member and employer contributions may be amended by State of New Jersey legislation. Contributions by active members were based on 7% of their salary. The State of New Jersey, the only contributing employer of the Fund, is required to contribute at an actuarially determined rate.

The State made a contribution of \$6.40 million to satisfy the actuarially accrued liability in fiscal year 2006.

(6) FUNDS

The Fund maintains the following legally required fund:

Pension Reserve Fund (2006 - \$18,214,106; 2005 - \$16,630,703)

The Pension Reserve Fund is credited with all active member and State of New Jersey contributions and investment income.

(7) INCOME TAX STATUS

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

**STATE OF NEW JERSEY
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Required Supplementary Information (Unaudited)

Schedule of Funding Progress

ACTUARIAL VALUATION DATE	ACTUARIAL VALUE OF ASSETS (a)	ACTUARIAL ACCRUED LIABILITY (b)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY (b - a)	FUNDED RATIO (a / b)	COVERED PAYROLL (c)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY AS A PERCENTAGE OF COVERED PAYROLL (b - a) / c)
June 30, 1997	\$70,420,937	\$66,004,245	\$(4,416,692)	106.7%	N/A	N/A
June 30, 1998	62,205,001	59,272,789	(2,932,212)	104.9%	N/A	N/A
June 30, 1999	54,018,660	52,226,208	(1,792,452)	103.4%	N/A	N/A
June 30, 2000	46,078,644	46,544,429	465,785	99.0%	N/A	N/A
June 30, 2001	38,656,261	41,658,355	3,002,094	92.8%	N/A	N/A
June 30, 2002	31,842,796	36,350,384	4,507,588	87.6%	N/A	N/A
June 30, 2003	27,623,585	41,396,376	13,772,791	66.7%	N/A	N/A
June 30, 2004	21,735,396	35,052,202	13,316,806	62.0%	N/A	N/A
June 30, 2005	21,886,445	30,031,591	8,145,146	72.9%	N/A	N/A

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Required Supplementary Information (Unaudited)

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2005 and 2004 actuarial valuations included the following:

	June 30, 2005	June 30, 2004
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 dollar, closed	Level dollar, closed
Remaining amortization period	1 year	1 year
Actuarial assumptions:		
Interest rate	2.00%	2.00%

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Required Supplementary Information (Unaudited)

Schedule of Employer Contributions

YEAR ENDED JUNE 30,	ANNUAL REQUIRED CONTRIBUTION	EMPLOYER CONTRIBUTIONS⁽¹⁾	PERCENTAGE CONTRIBUTED
1997	\$10,580,991	\$43,995,746 ⁽²⁾	415.8%
1998	—	—	N/A
1999	—	—	N/A
2000	—	—	N/A
2001	—	—	N/A
2002	550,864	506,541	92.0%
2003	3,550,445	2,713,914	76.4%
2004	5,330,714	1,950,425	36.6%
2005	14,329,212	7,046,000	49.2%
2006	13,854,805	6,396,222	46.2%

Notes to Schedule

- (1) Excludes contributions from local employers to cover administrative expenses of the Fund.
- (2) For the year ended June 30, 1997, the employer contributions exceeded the annual required contributions as a result of legislation that was enacted (Chapter 114, P.L. 1997), authorizing the New Jersey Economic Development Authority to issue bonds, notes or other obligations for the purpose of financing, in full or in part, the State of New Jersey's portion of the unfunded accrued liability under the State of New Jersey retirement systems.

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Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2006

	PENSION RESERVE FUND	PENSION ADJUSTMENT PASS THROUGH	TOTAL
Additions:			
Contributions:			
Employers	\$ 6,450,118	—	6,450,118
Pension Adjustment Fund	—	8,231,766	8,231,766
Total contributions	6,450,118	8,231,766	14,681,884
Distribution of net investment income	405,597	—	405,597
Total additions	6,855,715	8,231,766	15,087,481
Deductions:			
Benefits	5,246,535	8,231,766	13,478,301
Administrative expenses	25,777	—	25,777
Total deductions	5,272,312	8,231,766	13,504,078
Net increase	1,583,403	—	1,583,403
Net assets held in trust for pension benefits:			
Beginning of year	16,630,703	—	16,630,703
End of year	\$ 18,214,106	—	18,214,106