

STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND
Financial Statements and Schedules
June 30, 2003 and 2002
(With Independent Auditors' Report Thereon)

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

Independent Auditors' Report

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

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Pension Adjustment Fund and Alternate Benefit Program Fund (the Funds) as of June 30, 2003 and 2002, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Funds' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Pension Adjustment Fund and Alternate Benefit Program Fund as of June 30, 2003 and 2002, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures to this information as prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

September 19, 2003

KPMG LLP

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Management's Discussion and Analysis

June 30, 2003 and 2002

Our discussion and analysis of the financial performance the Pension Adjustment Fund and the Alternate Benefit Program Fund (the Funds) provides an overview of the Funds' financial activities for the fiscal year ended June 30, 2003 and 2002. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2003 - 2002

- The Funds' total additions were \$130.4 million mostly consisting of member and employer contributions of \$130 million and investment income of \$0.4 million.
- The Funds' total deductions were \$130.4 million consisting of pension and insurance benefit charges of \$128.4 million and other expenses of \$2 million.

2002 - 2001

- The Funds' total additions were \$124.7 million mostly consisting of member and employer contributions of \$122.3 million and investment income of \$2.4 million.
- The Funds' total deductions were \$124.7 million consisting of pension and insurance benefit charges of \$121.5 million and other expenses of \$3.2 million.

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

This annual report consists of two financial statements: *The Balance Sheet* and *The Statements of Changes in Fiduciary Net Assets*. These financial statements report information about the Funds and about their activities to help you assess whether the Funds, as a whole, have 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 Balance Sheet shows the balances in all of the assets and liabilities of the Funds at the end of the fiscal year. Liabilities include fiduciary net assets held for the State and the local participating employers to cover pension adjustment costs. *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 Funds' fiduciary net assets since the prior year. These two financial statements should be reviewed along with the information contained in the financial statement footnotes to determine whether the Funds is able to meet its financial obligations.

FINANCIAL ANALYSIS

BALANCE SHEET

2003 - 2002

The Funds' assets mainly consist of cash, investments and contributions due from the State and local employers. Between fiscal years 2002 and 2003, total assets increased by \$0.8 million or 3.0% from \$26.6 million to \$27.4 million. This is mainly due to an increase in contributions due from the State to cover pension and life insurance charges in the Alternate Benefit Program Fund.

Liabilities mainly consist of benefits payable to eligible recipients in the Pension Adjustment Fund; pension reimbursements owed by the State of New Jersey to state/county colleges and outstanding life and long-term disability insurance premium charges in the Alternate Benefit Program Fund. Between fiscal year 2002 and 2003,

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
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Management's Discussion and Analysis, Continued

total liabilities increased by \$0.8 million or 3.0% from \$26.6 million to \$27.4 million. The increase in the liabilities is mainly related to the increase in the State's reimbursement liability to state/county colleges for employer share in the Alternate Benefits Program.

2002 - 2001

Between fiscal years 2001 and 2002, total assets increased by \$6.4 million or 31.7% from \$20.2 million to \$26.6 million. This is mainly due to an increase in contributions due from the State to cover life insurance charges in the Alternate Benefit Program Fund.

Between fiscal year 2001 and 2002, total liabilities increased by \$6.4 million or 31.7% from \$20.2 million to \$26.6 million. The increase in the liabilities is also related to the significant increase in the life insurance charges for the Alternate Benefits Program, which is due to an increase in the number of claims filed.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS

2003 - 2002

	2003	2002	Increase (Decrease)
Member Contributions	\$673,034	\$651,432	\$21,602
Employer Contributions	129,345,617	121,669,465	7,676,152
Investment & Other	409,218	2,378,235	(1,969,017)
Totals	\$130,427,869	\$124,699,132	\$5,728,737

For the Alternate Benefits Program Fund, additions primarily consist of member and employer contributions and earnings from investment activities. During the year, employer contributions increased by 8.3% due to higher base salaries. Investment earning decreased by \$1.8 million or 87.5% due to a reduction in the Cash Management Fund rate of return.

For the Pension Adjustment Fund, additions consist of employer contributions and earnings from investment activities. Contributions recognized by the Pension Adjustment Fund decreased over last year due to decrease in number of retirees and beneficiaries. Investment earnings dropped by \$0.1 million or 46.6% due to a reduction in the Cash Management Fund rate of return.

2002 - 2001

	2002	2001	Increase (Decrease)
Member Contributions	\$651,432	\$548,258	\$103,174
Employer Contributions	121,669,465	114,031,453	7,638,012
Investment & Other	2,378,235	1,200,346	1,177,889
Totals	\$124,699,132	\$115,780,057	\$8,919,075

During the year, member and employer contributions increased by 18.8% and 7.5%, respectively, due to higher base salaries and increased membership. Investment earning also increased by \$1.4 million due to a gain on the sale of stock acquired in a demutualization.

Contributions recognized by the Pension Adjustment Fund increased slightly over last year. Investment earnings dropped by \$0.2 million or 48.5% since last year due to a reduction in the Cash Management Fund rate of return.

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ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Management's Discussion and Analysis, Continued

**DEDUCTIONS FROM FIDUCIARY NET ASSETS
2003 - 2002**

	2003	2002	Increase (Decrease)
Benefits	\$128,400,036	\$121,542,876	\$6,857,160
Refunds & Amounts Due the General Fund	2,027,833	3,156,256	(1,128,423)
Totals	\$130,427,869	\$124,699,132	\$5,728,737

The increase in benefit payments is mainly due to the increase in the State reimbursement expense to state/county colleges based on 8% of the base salaries of active participants. Also, the increase is related to higher life insurance benefit payments in the Alternate Benefits Program Fund. The number of active and retired claims processed was higher as compared to the prior year.

Refunds and amounts due the general fund primarily represent contributions received from the State of New Jersey in excess of the amount required to cover benefit charges incurred by the Agency Funds. There was a decrease in this expense between 2003 and 2002.

2002 - 2001

	2002	2001	Increase (Decrease)
Benefits	\$121,542,876	\$112,643,962	\$8,898,914
Refunds & Amounts Due the General Fund	3,156,256	3,136,095	20,161
Totals	\$124,699,132	\$115,780,057	\$8,919,075

The increase in benefit payments is mainly due to higher life insurance benefit payments in the Alternate Benefits Program Fund. The number of active and retired claims processed was higher as compared to the prior year. In addition, the State's pension contribution to the Alternate Benefits Program was higher in 2002. The State's contribution is based on 8% of the base salaries of active participants. Salaries were higher in 2002 due to normal salary increases and increased membership.

Refunds and amounts due the general fund primarily represent contributions received from the State of New Jersey in excess of the amount required to cover benefit charges incurred by the Agency Funds. There was an increase in this expense between 2002 and 2001.

RETIREMENT SYSTEM AS A WHOLE

During the year, the Alternate Benefits Program Fund and the Pension Adjustment Fund received sufficient funding to meet their 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 Funds' finances and to show the Funds' 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
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Balance Sheet
Fiduciary Funds - Agency Funds

June 30, 2003

	<u>ALTERNATE BENEFIT PROGRAM FUND</u>	<u>PENSION ADJUSTMENT FUND</u>	<u>TOTAL</u>
Assets:			
Cash and cash equivalents	\$ 344,780	132,124	476,904
Investments, at fair value:			
Cash Management Fund	<u>14,931,117</u>	<u>4,102,651</u>	<u>19,033,768</u>
Total investments	<u>14,931,117</u>	<u>4,102,651</u>	<u>19,033,768</u>
Receivables:			
State related employer contributions	—	2,779,531	2,779,531
Other	28,170	—	28,170
Due from other funds	<u>5,091,548</u>	<u>23,463</u>	<u>5,115,011</u>
Total receivables	<u>5,119,718</u>	<u>2,802,994</u>	<u>7,922,712</u>
Total assets	<u>\$ 20,395,615</u>	<u>7,037,769</u>	<u>27,433,384</u>
Liabilities:			
Accounts payable and accrued expenses	\$ 18,598,669	—	18,598,669
Assets held for local contributing employers	—	3,807,568	3,807,568
Pension adjustment payroll payable	—	991,440	991,440
Due to State of New Jersey	1,796,946	267,427	2,064,373
Due to other funds	<u>—</u>	<u>1,971,334</u>	<u>1,971,334</u>
Total liabilities	<u>\$ 20,395,615</u>	<u>7,037,769</u>	<u>27,433,384</u>

See accompanying notes to the financial statements

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Balance Sheet
Fiduciary Funds - Agency Funds

June 30, 2008

	<u>ALTERNATE BENEFIT PROGRAM FUND</u>	<u>PENSION ADJUSTMENT FUND</u>	<u>TOTAL</u>
Assets:			
Cash and cash equivalents	\$ 334,783	87,701	320,038
Investments, at fair value			
Cash managed investment fund	<u>9,707,179</u>	<u>3,793,778</u>	<u>55,391,101</u>
Total investments	<u>9,707,179</u>	<u>3,793,778</u>	<u>55,391,101</u>
Receivables			
State related employee contributions	—	3,040,349	3,040,349
Other	8,592,311	—	8,592,311
Due from other funds	<u>1,389,994</u>	<u>379,225</u>	<u>1,277,437</u>
Total receivables	<u>55,704,593</u>	<u>3,319,004</u>	<u>54,108,595</u>
Total assets	<u>\$ 51,344,273</u>	<u>9,812,321</u>	<u>82,248,088</u>
Liabilities:			
Accounts payable and accrued expenses	\$ 52,291,009	—	52,291,009
Assets held for local contribution by employees	—	3,744,539	3,744,539
Pension adjustment liability payable	—	5,017,131	5,017,131
Due to State of New Jersey	8,227,242	759,115	3,544,739
Due to other funds	<u>—</u>	<u>5,739,408</u>	<u>5,739,408</u>
Total liabilities	<u>\$ 51,344,273</u>	<u>9,812,321</u>	<u>82,248,088</u>

See accompanying notes to the financial statements

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND**

Statements of Changes in Fiduciary Net Assets

Years Ended June 30, 2003 and 2002

	2003	2002
Additions:		
Contributions:		
Members	\$ 673,034	651,432
Employers	116,889,694	107,895,693
Total contributions	117,562,728	108,547,125
Investment income:		
Net appreciation (depreciation) in fair value of investments	(10,150)	14,564
Interest	272,151	2,087,807
Total investment income	262,001	2,102,371
Total additions	117,824,729	110,649,496
Deductions:		
Benefits	116,036,015	107,969,987
Refunds of contributions and due General Fund	1,788,714	2,679,509
Total deductions	\$ 117,824,729	110,649,496

See accompanying notes to the financial statements

**STATE OF NEW JERSEY
PENSION ADJUSTMENT FUND**

Statements of Changes in Fiduciary Net Assets

Years Ended June 30, 2003 and 2002

	2003	2002
Additions:		
Contributions:		
Employers	\$ 12,455,923	13,773,772
Total contributions	12,455,923	13,773,772
Investment income:		
Net appreciation (depreciation) in fair value of investments	(7,462)	8,262
Interest	154,679	267,602
Total investment income	147,217	275,864
Total additions	12,603,140	14,049,636
Deductions:		
Benefits	12,364,021	13,572,889
Refunds of contributions and due General Fund	239,119	476,747
Total deductions	\$ 12,603,140	14,049,636

See accompanying notes to the financial statements

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements

June 30, 2003 and 2002

(1) DESCRIPTION OF THE FUNDS

Agency funds:

Pension Adjustment Fund
Alternate Benefit Program Fund

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

The State of New Jersey Alternate Benefit Program Fund (ABP) was established by legislation in 1965 through 1968 for full-time faculty members of public institutions of higher education. It was later expended to include certain administrative and professional titles.

The financial statements of the Funds are included along with other state-administered pension trust funds in the basic financial statements of the State of New Jersey.

(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 Funds are accounted for using an economic resources measurement focus. The Funds that focus 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 Funds. 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 Funds conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans" and No. 26, "Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans." Plan assets are recorded at fair value. Employer contributions are recognized when payable to the Funds. Benefits and refunds are recognized when payable in accordance with the terms of the Funds.

Financial Reporting Model:

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

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

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

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

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements, Continued

Investment Valuation:

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

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

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

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

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

Administrative Expenses:

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

Benefit Provisions:

Benefit Provisions - PAF

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

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

Legislation passed in 2001 (Chapter 4, P.L. 2001) provides increased benefits to certain members of the Consolidated Police and Firemen's Pension Fund who retired prior to December 29, 1989 with at least 25 years of creditable service. The benefit increase was effective November 1, 2001. 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.

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

Vesting and Benefit Provisions - ABP

The Alternate Benefit Program provides retirement benefits, disability benefits, and group life insurance benefits to eligible participants. Retirement benefits are payable upon separation from service with no age or service requirements. However, distributions under age 55 are limited to employee contributions and accumulations. The remaining employer's contributions and earnings are available for distribution upon attaining age 55. Participants are immediately vested if the participant has an existing retirement account containing employer and employee contributions based on employment in public education, or is an active or vested member of a federal or state retirement system.

**STATE OF NEW JERSEY
ALTERNATE BENEFIT PROGRAM FUND
PENSION ADJUSTMENT FUND**

Notes to Financial Statements, Continued

Cash and Cash Equivalents

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

Based upon aggregate collateral levels maintained for all state bank accounts as a whole, substantially all cash balances maintained in financial institutions as of June 30, 2003, which include funding for the July 1, 2003 retirement payroll, are designated Category 3.

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

(3) CONTRIBUTIONS

Contribution Requirements - PAF

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

Contribution Requirements - ABP

Members contribute a mandatory 5% of base or contractual salary that is tax deferred under the 414(h) provisions of the Internal Revenue code. Members are also permitted to make voluntary federal tax-deferred contributions under Internal Revenue Code Section 403(b). The State of New Jersey pays the employer contribution for all State and county employees participating in the plan. The employer contribution is based on 8% of base or contractual salary. The State of New Jersey is also responsible for the cost of noncontributory life insurance coverage and long term disability coverage for its plan members.

(4) INCOME TAX STATUS

The Alternate Benefit Program Fund is a qualified plan as described in Section 403(b) of the Internal Revenue Code.