

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS
FINANCIAL STATEMENTS AND SCHEDULES
June 30, 2012 and 2011
(With Independent Auditor's Report Thereon)



CliftonLarsonAllen

Independent Auditor's Report

Office of Legislative Services
Office of the State Auditor
State of New Jersey

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey State Health Benefit Program Funds (the Funds) as of June 30, 2012 and 2011, 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 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 State Health Benefit Program Funds as of June 30, 2012 and 2011, and changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 6 and the schedules of funding progress and employer contributions and related additional actuarial information (schedules 1 and 2) be presented to supplement the basic financial statements, such information although not a part of the basic financial statements is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information, schedules 3 through 8, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The additional information, schedules 3 through 8, has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional information, schedules 3 through 8, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

CliftonLarsonAllen LLP

Mt. Laurel, New Jersey
November 5, 2012

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Management's Discussion and Analysis

June 30, 2012 and 2011

Our discussion and analysis of the financial performance of the State Health Benefit Program Funds – State, Local and Education (the Funds) provides an overview of the Funds' financial activities for the fiscal years ended June 30, 2012 and 2011. Please read it in conjunction with the basic financial statements and financial statement footnotes, which follow this discussion.

Financial Highlights

2012 – 2011

- Net assets held in trust for benefits decreased by \$306,831,901 as a result of fiscal year 2012's operations from \$538,507,589 to \$231,675,688.
- Additions for the year are \$4,967,678,805, which are comprised of member and employer pension contributions of \$4,966,317,505 and investment income of \$1,361,300.
- Deductions for the year are \$5,274,510,706, which are comprised of benefit payments of \$5,266,242,035 and administrative expenses of \$8,268,671.

2011 – 2010

- Net assets held in trust for benefits increased by \$83,494,595 as a result of fiscal year 2011's operations from \$455,012,994 to \$538,507,589.
- Additions for the year are \$4,843,404,735, which are comprised of member and employer pension contributions of \$4,840,627,380 and investment income of \$2,777,355.
- Deductions for the year are \$4,759,910,140, which are comprised of benefit payments of \$4,750,880,105 and administrative expenses of \$9,030,035.

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 Funds and about its 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 Statements of Fiduciary Net Assets show the balances in all of the assets and liabilities of the Funds at the end of the fiscal year. The difference between assets and liabilities represents the Funds' net assets. Over time, increases or decreases in the Funds' net assets provide one indication of whether the financial health of the Funds 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 Funds' 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 Funds are becoming financially stronger or weaker.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Management's Discussion and Analysis

June 30, 2012 and 2011

Financial Analysis

Summary of Fiduciary Net Assets

2012 – 2011

	<u>2012</u>	<u>2011</u>	<u>Increase (decrease)</u>
Assets	\$ 791,674,255	991,996,620	(200,322,365)
Liabilities	<u>559,998,567</u>	<u>453,489,031</u>	<u>106,509,536</u>
Net assets	<u>\$ 231,675,688</u>	<u>538,507,589</u>	<u>(306,831,901)</u>

Assets consist of cash and cash equivalents, investments, and contributions due from members, participating employers and former members who are covered under the rules of the Federal Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). Between fiscal years 2011 and 2012, total assets decreased by \$200.3 million or 20.2%. The decrease in total assets is due to a reduction in the investment holdings in the Cash Management Fund (CMF) of \$130.8 million that were utilized to pay the claims of the funds, a decrease in receivables of \$78.4 million, and an increase in cash of \$8.9 million.

Liabilities consist of outstanding medical and long-term disability claim payments, classified under accounts payable and accrued expenses. Total liabilities increased by \$106.5 million or 23.5% due to an increase in claims payable.

Net assets decreased by \$306.8 million or 56.9%.

Summary of Fiduciary Net Assets

2011 – 2010

	<u>2011</u>	<u>2010</u>	<u>Increase (decrease)</u>
Assets	\$ 991,996,620	923,003,967	68,992,653
Liabilities	<u>453,489,031</u>	<u>467,990,973</u>	<u>(14,501,942)</u>
Net assets	<u>\$ 538,507,589</u>	<u>455,012,994</u>	<u>83,494,595</u>

Assets consist of cash and cash equivalents, investments, and contributions due from members, participating employers and former members who are covered under the rules of the Federal Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). Between fiscal years 2010 and 2011 total assets increased by \$69.0 million or 7.5%. The increase in total assets is due to an increase in the fair value of the balances invested in the Cash Management Fund (CMF) of \$35.3 million and an increase in employer receivables and others of \$35.8 million, offset by a decrease in cash of \$2.1 million.

Liabilities consist of outstanding medical and long-term disability claim payments, classified under accounts payable and accrued expenses. Total liabilities decreased by \$14.5 million or 3.1% due to a decrease in claims payable.

Net assets increased by \$83.5 million or 18.3%.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Management's Discussion and Analysis

June 30, 2012 and 2011

Summary of Changes to Fiduciary Net Assets

2012 – 2011

	<u>2012</u>	<u>2011</u>	<u>Increase (decrease)</u>
Additions:			
Member contributions	\$ 244,680,394	233,187,835	11,492,559
Employer contributions	4,721,637,111	4,607,439,545	114,197,566
Net investment income	1,361,300	2,777,355	(1,416,055)
Total additions	<u>4,967,678,805</u>	<u>4,843,404,735</u>	<u>124,274,070</u>
Deductions:			
Benefits	5,266,242,035	4,750,880,105	515,361,930
Administrative expenses	8,268,671	9,030,035	(761,364)
Total deductions	<u>5,274,510,706</u>	<u>4,759,910,140</u>	<u>514,600,566</u>
Changes in net assets	<u>\$ (306,831,901)</u>	<u>83,494,595</u>	<u>(390,326,496)</u>

Additions consist of member and employer contributions and earnings from CMF investment activities. Total additions increased by \$124.3 million or 2.6% primarily due to an increase in employer contributions.

Member contributions increased by \$11.5 million or 4.9%. In the SHBP–State, the member contributions increased by \$11.7 million or 8.3%, in SHBP–Local the member contributions increased by \$2.9 million or 7.3% and in SHBP–Education, the member contributions decreased by \$3.1 million or -5.9%. Active employee contribution increased as a result of Chapter 78, P.L. 2011 premium share requirements. In plan year 2012 the active employee group rate for SHBP–State increased by 9.0%, in SHBP–Local the increase was 10.3% and in SHBP–Education, the increase was 10.1%. SHBP membership increases between plan year 2011 and 2012 also contributed to the higher member contributions. However, in the SHBP–Education total member contributions decreased between fiscal year 2011 and fiscal year 2012 due to a reduction in the number of self pay members with adult child coverage as a result of the extension of coverage for qualified adult child under the provisions of the Federal Patient Protection and Affordable Care Act (PPACA).

The SHBP–State employer contributions decreased by \$82.0 million. This is a result of using available reserves to cover claims. For the SHBP–Local, employer contributions increased by \$89.1 million. For the SHBP – Education, employer contributions increased by \$107.0 million. These increases are attributable to rate increases effective January 1, 2011.

Net investment income decreased by \$1.4 million or 51.0% primarily due to the lower investment return in fiscal year 2012 as compared to fiscal year 2011.

Deductions primarily consist of claim charges for the self-insured health and prescription drug, and administrative expenses. During the year, total expenses increased by \$514.6 million or 10.8% due to an increase in claims paid.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Management's Discussion and Analysis

June 30, 2012 and 2011

Summary of Changes to Fiduciary Net Assets

2011 – 2010

	<u>2011</u>	<u>2010</u>	<u>Increase (decrease)</u>
Additions:			
Member contributions	\$ 233,187,835	217,154,537	16,033,298
Employer contributions	4,607,439,545	4,144,906,282	462,533,263
Net investment income	2,777,355	4,269,124	(1,491,769)
Total additions	<u>4,843,404,735</u>	<u>4,366,329,943</u>	<u>477,074,792</u>
Deductions:			
Benefits	4,750,880,105	4,382,156,209	368,723,896
Administrative expenses	9,030,035	13,697,892	(4,667,857)
Total deductions	<u>4,759,910,140</u>	<u>4,395,854,101</u>	<u>364,056,039</u>
Changes in net assets	<u>\$ 83,494,595</u>	<u>(29,524,158)</u>	<u>113,018,753</u>

Additions consist of member and employer contributions and earnings from CMF investment activities. Total additions increased by \$477.1 million or 10.9% primarily due to an increase in employer contribution.

Member contributions increased by \$16.0 million or 7.4%. In the SHBP–State, the increase is due to more active State employees contributing toward their health insurance coverage at 1.5% of salary as a result of contract settlements. Also, on the State side, the increase is due to higher active and retired premium rates for calendar year 2011 as compared to 2010. With regard to the SHBP–Local and SHBP–Education funds, the increase is also due to higher premium rates for calendar year 2011 (SHBP–Local of 11.6%; SHBP–Education of 8.6%).

The SHBP–State employer contributions increased by \$208.1 million. This is due to several factors including higher premium rates between calendar year 2010 and 2011, the State of New Jersey fully funding its obligations to the fund, and an additional \$70.0 million encumbrance that is due to be paid to the fund from the State of New Jersey. For the SHBP–Local, employer contributions increased by \$98.3 million. For the SHBP–Education, employer contributions increased by \$156.1 million. The increases in the SHBP–Local and the SHBP–Education are attributable to rate increases effective January 1, 2011.

Net investment income decreased by \$1.5 million or 34.9% primarily due to depreciation of the CMF.

Deductions primarily consist of claim charges for the self-insured health and prescription drug, and administrative expenses. During the year, total expenses increased by \$364.1 million or 8.3% due to an increase in claims paid.

The change in net assets of \$113.0 million was primarily a result of the increase in member contribution and employer contribution.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Management's Discussion and Analysis

June 30, 2012 and 2011

Overall Financial Condition of the Funds

For the SHBP–Education, total expenses incurred exceeded total revenues recognized by \$185.3 million, reducing the surplus at the beginning of the year from \$369.2 million to \$183.9 million at year-end. This reduction is due in part to retired rates that were set to utilize some of the fund's surplus balance. In addition, on the retired side, available fund balance was used to cover a portion of the State's required premium contributions. Lastly, there was an increase in incurred-but-not-reported claims between fiscal year 2011 and fiscal year 2012, which also contributed to the reduction in the surplus at year-end. For the SHBP–State, total expenses incurred exceeded total revenues recognized by \$116.3 million, reducing the balance from a surplus at the beginning of the year of \$16.2 million to a deficit of \$100.1 million at year end. This is primarily due to the State of New Jersey using available reserves to cover claims payments. For the SHBP–Local, total expenses incurred exceeded total revenues recognized by \$5.2 million, reducing the surplus at the beginning of the year from \$153.1 million to \$147.9 million at year-end which is attributable to higher claims payments.

For the State Health Benefit Program Funds for fiscal year 2012, based on the current actuarial valuation dated July 1, 2011, the State had a \$18.0 billion unfunded actuarial accrued liability for other post-employment benefits (OPEB) under Governmental Accounting Standards Board (GASB) Statement No. 43 for the SHBP–State active and retired members and \$30.9 billion for the SHBP–Education employees and retirees that become the obligation of the State of New Jersey upon retirement. In comparison, based on the prior year actuarial valuation, the State had a \$21.1 billion unfunded actuarial accrued liability for the SHBP–State active and retired members and \$38.2 billion for the SHBP–Education employees and retirees. The reduction in the overall unfunded actuarial accrued liability is mainly attributable to the changed method of prescription drug integration from the Retiree Drug Subsidy to the Employer Group Waiver Program and Chapter 78, P.L. 2011 that increased contribution requirements for some future retirees. The SHBP–Local fiscal year 2012 unfunded actuarial accrued liability for OPEB based on the same actuarial valuation, was \$11.1 billion, and for the prior year actuarial valuation, the liability was \$12.1 billion.

Contacting System Financial Management

The financial report is designed to provide our members, beneficiaries, investors and creditors 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
STATE HEALTH BENEFIT PROGRAM FUNDS**

Statement of Fiduciary Net Assets

June 30, 2012

	State Health Benefit Program Fund State	State Health Benefit Program Fund Local	State Health Benefit Program Fund Education
	<u> </u>	<u> </u>	<u> </u>
Assets:			
Cash and cash equivalents	\$ 382,903	3,170,749	7,634,917
Investments, at fair value:			
Cash Management Fund	94,067,107	191,706,595	384,879,343
Total investments	<u>94,067,107</u>	<u>191,706,595</u>	<u>384,879,343</u>
Receivables:			
Contributions:			
Members	(2,011,030)	(2,501,870)	(1,940,161)
Employers	8,273,382	65,782,035	38,782,620
Other	969,629	1,116,142	1,361,894
Total receivables	<u>7,231,981</u>	<u>64,396,307</u>	<u>38,204,353</u>
Total assets	<u>101,681,991</u>	<u>259,273,651</u>	<u>430,718,613</u>
Liabilities:			
Accounts payable and accrued expenses	<u>201,825,466</u>	<u>111,346,483</u>	<u>246,826,618</u>
Total liabilities	<u>201,825,466</u>	<u>111,346,483</u>	<u>246,826,618</u>
Net assets (deficit):			
Held in trust for health benefits	<u>\$ (100,143,475)</u>	<u>147,927,168</u>	<u>183,891,995</u>

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Statement of Fiduciary Net Assets

June 30, 2011

	State Health Benefit Program Fund State	State Health Benefit Program Fund Local	State Health Benefit Program Fund Education
	<u> </u>	<u> </u>	<u> </u>
Assets:			
Cash and cash equivalents	\$ 515,221	1,216,944	528,391
Investments, at fair value:			
Cash Management Fund	<u>100,860,457</u>	<u>181,134,803</u>	<u>519,476,514</u>
Total investments	<u>100,860,457</u>	<u>181,134,803</u>	<u>519,476,514</u>
Receivables:			
Contributions:			
Members	501,409	558,682	101,356
Employers	84,112,971	58,321,364	42,729,823
Other	<u>490,202</u>	<u>687,604</u>	<u>760,879</u>
Total receivables	<u>85,104,582</u>	<u>59,567,650</u>	<u>43,592,058</u>
Total assets	<u>186,480,260</u>	<u>241,919,397</u>	<u>563,596,963</u>
Liabilities:			
Accounts payable and accrued expenses	<u>170,307,691</u>	<u>88,772,664</u>	<u>194,408,676</u>
Total liabilities	<u>170,307,691</u>	<u>88,772,664</u>	<u>194,408,676</u>
Net assets:			
Held in trust for health benefits	<u>\$ 16,172,569</u>	<u>153,146,733</u>	<u>369,188,287</u>

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2012

	State Health Benefit Program Fund State	State Health Benefit Program Fund Local	State Health Benefit Program Fund Education
Additions:			
Contributions:			
Members	\$ 152,051,630	43,109,391	49,519,373
Employers	1,691,931,065	932,727,716	2,096,978,330
Total contributions	1,843,982,695	975,837,107	2,146,497,703
Investment income:			
Net depreciation in fair value of investments	(23,086)	(20,975)	(67,295)
Interest	209,428	391,077	872,151
Net investment income	186,342	370,102	804,856
Total additions	1,844,169,037	976,207,209	2,147,302,559
Deductions:			
Benefits	1,957,384,329	979,913,607	2,328,944,099
Administrative expenses	3,100,752	1,513,167	3,654,752
Total deductions	1,960,485,081	981,426,774	2,332,598,851
Net decrease	(116,316,044)	(5,219,565)	(185,296,292)
Net assets (deficit) held in trust for health benefits:			
Beginning of year	16,172,569	153,146,733	369,188,287
End of year	\$ (100,143,475)	147,927,168	183,891,995

See accompanying notes to financial statements.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2011

	State Health Benefit Program Fund State	State Health Benefit Program Fund Local	State Health Benefit Program Fund Education
Additions:			
Contributions:			
Members	\$ 140,345,415	40,187,922	52,654,498
Employers	1,773,900,683	843,600,488	1,989,938,374
Total contributions	1,914,246,098	883,788,410	2,042,592,872
Investment income:			
Net appreciation in fair value of investments	27,744	24,576	75,086
Interest	307,234	607,529	1,735,186
Net investment income	334,978	632,105	1,810,272
Total additions	1,914,581,076	884,420,515	2,044,403,144
Deductions:			
Benefits	1,805,522,732	880,203,684	2,065,153,689
Administrative expenses	3,612,014	1,806,007	3,612,014
Total deductions	1,809,134,746	882,009,691	2,068,765,703
Net increase (decrease)	105,446,330	2,410,824	(24,362,559)
Net assets (deficit) held in trust for health benefits:			
Beginning of year	(89,273,761)	150,735,909	393,550,846
End of year	\$ 16,172,569	153,146,733	369,188,287

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Notes to Financial Statements

June 30, 2012 and 2011

(1) Description of the Funds

The State Health Benefit Program Fund (SHBP)–State, SHBP–Local and SHBP–Education (the Funds) are included along with other state-administered trust funds in the basic financial statements of the State of New Jersey.

The Prescription Drug Program (PEP) of each respective SHBP are combined and reported as a trust fund with the respective SHBP–State, SHBP–Local, and SHBP–Education. The SHBP–State is classified as a single-employer plan. The SHBP–Local and SHBP–Education are classified as cost-sharing multiple-employer plans.

(2) Summary of Significant Accounting Policies

The financial statements of the funds have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Reporting Entity

The financial statements include the SHBP – State, Local and Education, which are administered by the Division of Pensions and Benefits (the Division) over which operating controls are with the individual funds governing Boards and/or the State of New Jersey. The financial statements of the funds are included in the financial statements of the State of New Jersey; however, the accompanying financial statements are intended to present solely the funds listed above which are administered by the Division and not the State of New Jersey as a whole.

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All funds are 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 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 GASB Statement No. 43, *Financial Reporting for Post-Employment Benefits Other than Pension Plans*.

Membership

Membership (active and retired participants) in the Funds consisted of the following as of June 30, 2012 and 2011 based on the internal database:

	2012			
	State	Local	Education	Total
Health Benefits Program Fund ⁽¹⁾	143,099	68,457	188,831	400,387
Prescription Drug Program Fund ⁽¹⁾	142,616	56,380	138,747	337,743

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Notes to Financial Statements

June 30, 2012 and 2011

	2011			
	State	Local	Education	Total
Health Benefits Program Fund ⁽²⁾	142,873	66,540	184,603	394,016
Prescription Drug Program Fund ⁽²⁾	142,377	54,643	136,833	333,853

⁽¹⁾The health benefit program had a total of 1,103 state, local, and education participating employers and contributing entities for fiscal year 2012.

⁽²⁾The health benefit program had a total of 1,068 state, local, and education participating employers and contributing entities for fiscal year 2011.

Valuation of Investments

Cash Management Fund units are stated at fair value using the closing bid price on the last day of trading during the period as determined by the Transfer Agent.

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, Department of the Treasury, 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.

Investments

The Funds' investments as of June 30, 2012, consist of an interest in the Cash Management Funds. The Cash Management Fund is not evidenced by securities that exist in physical or book entry form held by the Funds, and it is unrated.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Notes to Financial Statements

June 30, 2012 and 2011

Significant New Legislation

Chapter 78, P.L. 2011 sets new health benefit contribution amounts towards the cost of employee coverage, effective October 2011. The percentage rate of contribution is determined based on the employee's annual salary and the selected level of coverage. The increased employee contributions will be phased in over a 4-year period for those employed prior to Chapter 78's effective date with a minimum contribution required to be at least 1.5% of salary.

Administrative Expenses

Administrative expenses are paid by the Funds to the State of New Jersey, Department of the Treasury and are included in the accompanying financial statements.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates.

Funded Status and Funding Progress

The required supplementary information regarding the funded status and funding progress of the Funds for the OPEB includes actuarial valuations which involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. These amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the probability of future events.

The required schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial calculations reflect a long-term perspective and are based on the benefits provided under State statutes in effect at the time of each valuation and also consider the pattern of the sharing of costs between the employer and members at that point in time. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and members in the future.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Notes to Financial Statements

June 30, 2012 and 2011

Actuarial Methods and Assumptions

In the July 1, 2011 and 2010 actuarial valuations, the projected unit credit was used as the actuarial cost method. The actuarial assumptions included 4.50% for investment rate of return.

	<u>SHBP–State</u>		<u>SHBP–Local</u>		<u>SHBP–Education</u>	
	July 1, 2011	July 1, 2010	July 1, 2011	July 1, 2010	July 1, 2011	July 1, 2010
Actuarial valuation date	July 1, 2011	July 1, 2010	July 1, 2011	July 1, 2010	July 1, 2011	July 1, 2010
Actuarial value of assets	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Actuarial accrued liability	18,077,800,000	21,090,400,000	11,127,000,000	12,089,800,000	30,871,900,000	38,191,500,000
Unfunded actuarial accrued liability	18,077,800,000	21,090,400,000	11,127,000,000	12,089,800,000	30,871,900,000	38,191,500,000
Funded ratio	—	—	—	—	—	—
Covered payroll	\$ 7,491,835,889	\$ 7,424,794,315	\$ 2,831,000,000	\$ 2,844,100,000	\$ 12,794,864,111	\$ 13,445,205,685
Unfunded actuarial accrued liability as a percentage of covered payroll	241.3%	284.1%	393.0%	425.1%	241.3%	284.1%
Actuarial cost method	Projected unit credit					
Amortization method	Level dollar, open	Level percent, open	Level dollar, open	Level percent, open	Level dollar, open	Level percent, open
Remaining amortization period	30 years					
Actuarial assumptions:						
Interest rate	4.50% (assuming no prefunding)					
Salary range	N/A	N/A	N/A	N/A	N/A	N/A
Cost-of-living adjustments	N/A	N/A	N/A	N/A	N/A	N/A

For medical benefits, the healthcare cost trend rate assumption initially is at 8.0% or 9.0% (depending on the medical plan) and decreases to a 5.0% long-term trend rate for all medical benefits after six or eight years. For prescription drug benefits, the initial healthcare cost trend rate assumption is 9.0% or 9.5% (depending on the retirement status), decreasing to a 5.0% long-term trend rate after eight or nine years. For Medicare Part B reimbursement, the healthcare cost trend rate assumption is 5.0% throughout eleven years.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Notes to Financial Statements

June 30, 2012 and 2011

(3) Contributions

Contribution Requirements – SHBP–State (including PDP–State)

Contributions to pay for the health premiums of participating employees in the SHBP–State are collected from the State of New Jersey, active and retired members, and former active and retired members who have elected to participate under the rules of COBRA. The State of New Jersey provides contributions for State employees through State appropriations. These appropriations are generally distributed to the SHBP on a monthly basis. Active and retired member contributions are generally received on a monthly basis. Certain State employees share in the cost of their premiums, as provided by Chapter 8, P.L. 1996.

Under the provisions of Chapter 8, P.L. 1996, the SHBP implemented premium sharing for employees covered under the State component of the program. Chapter 8 authorizes the State to negotiate premium sharing in the collective bargaining agreements governing employment of State employees. Premium sharing also applies to retired group coverage for employees who attain 25 years of creditable pension service after July 1, 1997 or who retire on a disability retirement after that same date. Those employees not represented by any bargaining unit premium share in accordance with rules established by the State Health Benefits Commission.

Contributions to pay for the premiums of participating employees in the PDP are collected from the State of New Jersey, and former active and retired members who have elected to participate under the rules of COBRA. The State of New Jersey provides contributions for State employees through State appropriations. These appropriations are distributed to the PDP on a monthly basis.

The State of New Jersey 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 (PRM) benefits have been funded on a pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial basis.

The State made a contribution of \$1.7 billion, including administrative revenue of \$3.8 million, for fiscal year 2012. The State made a contribution of \$1.7 billion, including administrative revenue of \$4.0 million, for fiscal year 2011.

Chapter 103, P.L. 2007 implemented changes to SHBP and established an employee contribution of 1.5% of the employee's base salary for State employees, effective July 1, 2007.

Chapter 2, P.L. 2010, effective May 21, 2010, requires a minimum contribution of 1.5% of base salary toward the cost of health care benefits coverage by all active public employees. Employees of the State, local governments, and board of educations who become a member of a State or locally-administered retirement system on or after the law's effective date would be required to pay in retirement 1.5% of their pension benefit toward the cost of health care coverage under the SHBP.

Chapter 78, P.L. 2011, effective June 28, 2011, established new employee contribution requirements towards the cost of employer provided health benefit coverage. Employees are required to contribute a certain percentage of the cost of coverage. The rate of contribution is determined based on the employee's annual salary and the selected level of coverage. The increased employee contributions will be phased in over a 4-year period for those employed prior to Chapter 78's effective date with a minimum contribution

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Notes to Financial Statements

June 30, 2012 and 2011

required to be at least 1.5% of salary. For those employed on or after June 28, 2011, the 4-year phase-in does not apply, and contributions based on the full percentage rate of contribution are required. Under Chapter 78, certain future retirees eligible for employer-paid health care coverage at retirement are also required to pay a percentage of the cost of their medical coverage determined on the basis of their annual retirement benefit.

Contribution Requirements – SHBP–Local (including PDP–Local)

Contributions to pay for the health premiums of participating employees in the SHBP–Local are collected from the State of New Jersey, participating local employers, active members, and retired members. Local employer payments and active and retired member contributions are generally received on a monthly basis.

Local group employees are not affected by the premium sharing provisions of Chapter 8, P.L. 1996.

Contributions to pay for the premiums of participating employees in the PDP are collected from participating local employers, and former active and retired members who have elected to participate under the rules of COBRA. Local employer payments as well as COBRA contributions are also received on a monthly basis.

Local employers participating in the SHBP–Local made a contribution of \$932.7 million, including administrative revenue of \$2.0 million, for fiscal year 2012. Local employers participating in the SHBP–Local made a contribution of \$843.6 million, including administrative revenue of \$2.0 million for fiscal year 2011.

State of New Jersey contribution to the SHBP–Local is to fund the cost of medical premiums after retirement for qualified retirees in the PFRS pension fund. In accordance with Chapter 62, P.L. 1994, PRM benefits have been funded on a pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial basis.

Chapter 2, P.L. 2010, effective May 21, 2010, requires a minimum contribution of 1.5% of base salary toward the cost of health care benefits coverage by all active public employees. Employees of the State, local governments, and board of educations who become a member of a State or locally-administered retirement system on or after the law's effective date would be required to pay in retirement 1.5% of their pension benefit toward the cost of health care coverage under the SHBP.

Chapter 78, P.L. 2011, effective June 28, 2011, established new employee contribution requirements towards the cost of employer provided health benefit coverage. Employees are required to contribute a certain percentage of the cost of coverage. The rate of contribution is determined based on the employee's annual salary and the selected level of coverage. The increased employee contributions will be phased in over a 4-year period for those employed prior to Chapter 78's effective date with a minimum contribution required to be at least 1.5% of salary. For those employed on or after June 28, 2011, the 4-year phase-in does not apply, and contributions based on the full percentage rate of contribution are required. Under Chapter 78, certain future retirees eligible for employer-paid health care coverage at retirement are also required to pay a percentage of the cost of their medical coverage determined on the basis of their annual retirement benefit.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Notes to Financial Statements

June 30, 2012 and 2011

Contribution Requirements – SHBP–Education (including PDP–Education)

Contributions to pay for the health premiums of participating employees in the SHBP–Education are collected from the State of New Jersey, participating local employers, active members and retired members. Local employer payments and active and retired member contributions are generally received on a monthly basis.

Local group employees are not affected by the premium sharing provisions of Chapter 8, P.L. 1996.

Contributions to pay for the premiums of participating employees in the PDP are collected from participating local employers, and former active and retired members who have elected to participate under the rules of COBRA. Local employer payments as well as COBRA contributions are also received on a monthly basis.

Local employers participating in the SHBP–Education made a contribution of \$2.1 billion, including administrative revenue of \$4.8 million, for fiscal year 2012. Local employers participating in the SHBP–Education made a contribution of \$2.0 billion, including administrative revenue of \$4.7 million for fiscal year 2011.

State of New Jersey contribution to the SHBP–Education is to fund the cost of medical premiums after retirement for qualified retirees in the Public Employees’ Retirement System (PERS), Teachers’ Pension and Annuity Fund (TPAF), and Alternate Benefit Program (ABP) pension fund. In accordance with Chapter 62, P.L. 1994, PRM benefits have been funded on a pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial basis.

Chapter 2, P.L. 2010, effective May 21, 2010, requires a minimum contribution of 1.5% of base salary toward the cost of health care benefits coverage by all active public employees. Employees of the State, local governments, and board of educations who become a member of a State or locally-administered retirement system on or after the law’s effective date would be required to pay in retirement 1.5% of their pension benefit toward the cost of health care coverage under the SHBP.

Chapter 78, P.L. 2011, effective June 28, 2011, established new employee contribution requirements towards the cost of employer provided health benefit coverage. Employees are required to contribute a certain percentage of the cost of coverage. The rate of contribution is determined based on the employee’s annual salary and the selected level of coverage. The increased employee contributions will be phased in over a 4-year period for those employed prior to Chapter 78’s effective date with a minimum contribution required to be at least 1.5% of salary. For those employed on or after June 28, 2011, the 4-year phase-in does not apply, and contributions based on the full percentage rate of contribution are required. Under Chapter 78, certain future retirees eligible for employer-paid health care coverage at retirement are also required to pay a percentage of the cost of their medical coverage determined on the basis of their annual retirement benefit.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Notes to Financial Statements

June 30, 2012 and 2011

(4) Vesting and Benefits

Vesting and Benefit Provisions – SHBP–State (including PDP–State)

The Program provides medical coverage to qualified active and retired participants. Under Chapter 136, P.L. 1977, the State of New Jersey pays for the health insurance coverage of all enrolled retired State employees (regardless of age) whose pensions are based upon 25 years or more of credited service or a disability retirement regardless of years of service. Retirees who are not eligible for employer paid health coverage at retirement can continue in the Program by paying the cost of the insurance for themselves and their covered dependents. The PDP was established in December 1974, under N.J.S.A. 52:14–17.29 to provide coverage to employees and their eligible dependents for drugs which under federal or State law may be dispensed only upon a prescription written by a physician. State employees are eligible for PDP coverage after 60 days of employment.

Vesting and Benefit Provisions – SHBP–Local (including PDP–Local)

The Program provides medical coverage to qualified local active and retired participants. Partially funded benefits are also provided to local police officers and firefighters who retire with 25 years of service (or on disability) from an employer who does not provide coverage under the provision of Chapter 330, P.L. 1997. Also, local employees are eligible for the PDP coverage after 60 days of employment.

Vesting and Benefit Provisions – SHBP–Education (including PDP–Education)

The Program provides medical coverage to qualified local education active and retired participants. Members of the TPAF who retire from a board of education or county college with 25 years of service or on a disability retirement receive free post-retirement medical coverage. Under the provisions of Chapter 126, P.L. 1992, the Program also provides free coverage to members of the PERS and ABP who retire from a board of education or county college with 25 years of service or on a disability retirement if the member's employer does not provide this coverage. Certain local participating employers also provide post-retirement medical coverage to their employees. Retirees who are not eligible for employer paid health coverage at retirement can continue in the Program if their employer participates in this program or, if they are participating in the health benefits plan of their former employer and are enrolled in Medicare Parts A and B, by paying the cost of the insurance for themselves and their covered dependents. Also, education employees are eligible for the PDP coverage after 60 days of employment.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Notes to Financial Statements

June 30, 2012 and 2011

(5) Funds

The Funds maintain the following legally required funds as follows:

Reserve Fund – SHBP–State (including PDP–State) (2012 – \$-100,143,475-; 2011 – \$16,172,569)

The State used available reserves to cover claims payments this fiscal year, resulting in a negative fund balance at year-end.

Reserve Fund – SHBP–Local (including PDP–Local) (2012 – \$147,927,168; 2011 – \$153,146,733)

The net assets of the SHBP–Local are available to pay claims of future periods. These reserves are maintained by the fund to stabilize rates and to meet unexpected increase in claims.

Reserve Fund – SHBP–Education (including PDP–Education) (2012 – \$183,891,995; 2011 – \$369,188,287)

The net assets of the SHBP–Education are available to pay claims of future periods. These reserves are maintained by the fund to stabilize rates and to meet unexpected increase in claims.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Required Supplementary Information

Schedule of Funding Progress

(Unaudited – See accompanying independent auditor’s report)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (b)	Unfunded actuarial accrued liability (b – a)	Funded ratio (a / b)	Covered payroll * (c)	Unfunded actuarial accrued liability as a percentage of covered payroll * ((b – a) / c)	
State Health Benefit Program — State							
July 1, 2007	\$	—	18,417,000,000	18,417,000,000	—%	N/A	N/A
July 1, 2008		—	19,850,900,000	19,850,900,000	—	\$ 7,163,803,681	277.1%
July 1, 2009		—	20,461,400,000	20,461,400,000	—	7,493,198,538	273.1%
July 1, 2010		—	21,090,400,000	21,090,400,000	—	7,424,794,315	284.1
July 1, 2011		—	18,077,800,000	18,077,800,000	—	7,491,835,889	241.3
State Health Benefit Program — Local							
July 1, 2007	\$	—	9,096,600,000	9,096,600,000	—%	N/A	N/A
July 1, 2008		—	8,840,500,000	8,840,500,000	—	\$ 2,411,700,000	366.6%
July 1, 2009		—	10,010,400,000	10,010,400,000	—	2,607,200,000	384.0%
July 1, 2010		—	12,089,800,000	12,089,800,000	—	2,844,100,000	425.1
July 1, 2011		—	11,127,000,000	11,127,000,000	—	2,831,000,000	393.0
State Health Benefit Program — Education							
July 1, 2007	\$	—	32,232,500,000	32,232,500,000	—%	N/A	N/A
July 1, 2008		—	36,062,600,000	36,062,600,000	—	\$ 13,016,396,319	277.1%
July 1, 2009		—	36,321,100,000	36,321,100,000	—	13,301,201,462	273.1%
July 1, 2010		—	38,191,500,000	38,191,500,000	—	13,445,205,685	284.1
July 1, 2011		—	30,871,900,000	30,871,900,000	—	12,794,864,111	241.3

* Required disclosure at adoption of standard. Covered payroll not available for the initial analysis.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Required Supplementary Information

Schedule of Funding Progress – Additional Actuarial Information

(Unaudited – See accompanying independent auditor’s report)

Significant actuarial methods and assumptions used in the most recent 2011 and 2010 actuarial valuations include the following:

	<u>July 1, 2011</u>	<u>July 1, 2010</u>
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method	Level dollar, open	Level percent, open
Remaining amortization period	30 years	30 years
Actuarial assumptions:		
Interest rate	4.50% (assuming no prefunding)	4.50% (assuming no prefunding)
Salary range	N/A	N/A
Cost-of-living adjustments	N/A	N/A

July 1, 2011

For medical benefits, the healthcare cost trend rate assumption initially is at 8.0% or 9.0% (depending on the medical plan) and decreases to a 5.0% long-term trend rate for all medical benefits after six or eight years. For prescription drug benefits, the initial healthcare cost trend rate assumption is 9.0% or 9.5% (depending on the retirement status), decreasing to a 5.0% long-term trend rate after eight or nine years. For Medicare Part B reimbursement, the healthcare cost trend rate assumption is 5.0% throughout eleven years.

July 1, 2010

For medical benefits, the healthcare cost trend rate assumption initially is at 8.0% or 9.0% (depending on the medical plan) and decreases to a 5.0% long-term trend rate for all medical benefits after six or eight years. For prescription drug benefits, the initial healthcare cost trend rate assumption is 10.0%, decreasing to a 5.0% long-term trend rate after ten years. For Medicare Part B reimbursement, the healthcare cost trend rate assumption is 5.0% throughout eleven years.

**STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS**

Required Supplementary Information

Schedule of Employer Contributions

(Unaudited – See accompanying independent auditor’s report)

	Annual required contribution⁽¹⁾	Employer contributions	Percentage contributed
State Health Benefit Program — State			
Year ended July 1, 2008	\$ 1,554,300,000	391,448,000	25.2%
Year ended July 1, 2009	1,651,900,000	424,341,000	25.7
Year ended July 1, 2010	1,676,000,000	476,394,000	28.4
Year ended July 1, 2011	1,714,500,000	511,846,000	29.9
Year ended July 1, 2012	1,802,200,000	505,481,000	28.0
State Health Benefit Program — Local			
Year ended July 1, 2008	\$ 748,100,000	179,900,000	24.0%
Year ended July 1, 2009	713,900,000	169,600,000	23.8
Year ended July 1, 2010	802,100,000	209,100,000	26.1
Year ended July 1, 2011	976,900,000	251,100,000	25.7
Year ended July 1, 2012	1,098,200,000	274,800,000	25.0
State Health Benefit Program — Education			
Year ended July 1, 2008	\$ 2,692,700,000	678,152,000	25.2%
Year ended July 1, 2009	2,969,700,000	762,859,000	25.7
Year ended July 1, 2010	2,992,500,000	850,606,000	28.4
Year ended July 1, 2011	3,125,400,000	933,054,000	29.9
Year ended July 1, 2012	3,115,800,000	873,919,000	28.0

Notes to schedule:

- (1) The annual required contribution reflects a 30-year, 4.0% annual increasing amortization of the unfunded actuarial accrued liability based on expected benefit payments plus retiree drug subsidy for the applicable fiscal year-end.

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Combining Schedule of Fiduciary Net Assets Information

State Health Benefit Program Fund - Local

June 30, 2012

	Health Benefit Program Fund Local	Prescription Drug Program Fund Local	Total State Health Benefit Program Fund Local
	<u> </u>	<u> </u>	<u> </u>
Assets:			
Cash	\$ 2,825,535	345,214	3,170,749
Investments, at fair value:			
Cash Management Fund	<u>133,532,972</u>	<u>58,173,623</u>	<u>191,706,595</u>
Total investments	<u>133,532,972</u>	<u>58,173,623</u>	<u>191,706,595</u>
Receivables:			
Contributions:			
Members	(1,649,730)	(852,140)	(2,501,870)
Employers	55,011,526	10,770,509	65,782,035
Other	<u>48,141</u>	<u>1,068,001</u>	<u>1,116,142</u>
Total receivables	<u>53,409,937</u>	<u>10,986,370</u>	<u>64,396,307</u>
Total assets	<u>189,768,444</u>	<u>69,505,207</u>	<u>259,273,651</u>
Liabilities:			
Accounts payable and accrued expenses	<u>103,557,483</u>	<u>7,789,000</u>	<u>111,346,483</u>
Total liabilities	<u>103,557,483</u>	<u>7,789,000</u>	<u>111,346,483</u>
Net assets held in trust for health benefits	<u>\$ 86,210,961</u>	<u>61,716,207</u>	<u>147,927,168</u>

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Combining Schedule of Changes in Fiduciary Net Assets Information

State Health Benefit Program Fund - Local

June 30, 2012

	Health Benefit Program Fund Local	Prescription Drug Program Fund Local	Total State Health Benefit Program Fund Local
	<u> </u>	<u> </u>	<u> </u>
Additions:			
Contributions:			
Members	\$ 27,847,395	15,261,996	43,109,391
Employers	740,601,399	192,126,317	932,727,716
Total contributions	<u>768,448,794</u>	<u>207,388,313</u>	<u>975,837,107</u>
Investment income:			
Net depreciation in fair value of investments	(19,404)	(1,571)	(20,975)
Interest	328,160	62,917	391,077
Net investment income	<u>308,756</u>	<u>61,346</u>	<u>370,102</u>
Total additions	<u>768,757,550</u>	<u>207,449,659</u>	<u>976,207,209</u>
Deductions:			
Benefits	789,855,345	190,058,262	979,913,607
Administrative expenses	1,513,167	—	1,513,167
Total deductions	<u>791,368,512</u>	<u>190,058,262</u>	<u>981,426,774</u>
Net increase (decrease)	(22,610,962)	17,391,397	(5,219,565)
Net assets held in trust for health benefits:			
Beginning of year	108,821,923	44,324,810	153,146,733
End of year	<u>\$ 86,210,961</u>	<u>61,716,207</u>	<u>147,927,168</u>

STATE OF NEW JERSEY
STATE HEALTH BENEFIT PROGRAM FUNDS

Combining Schedule of Fiduciary Net Assets Information

State Health Benefit Program Fund - Education

June 30, 2012

	Health Benefit Program Fund Education	Prescription Drug Program Fund Education	Total State Health Benefit Program Fund Education
Assets:			
Cash	\$ 7,172,204	462,713	7,634,917
Investments, at fair value:			
Cash Management Fund	298,938,216	85,941,127	384,879,343
Total investments	298,938,216	85,941,127	384,879,343
Receivables:			
Contributions:			
Members	(977,838)	(962,323)	(1,940,161)
Employers	34,588,276	4,194,344	38,782,620
Other	41,101	1,320,793	1,361,894
Total receivables	33,651,539	4,552,814	38,204,353
Total assets	339,761,959	90,956,654	430,718,613
Liabilities:			
Accounts payable and accrued expenses	227,803,618	19,023,000	246,826,618
Total liabilities	227,803,618	19,023,000	246,826,618
Net assets held in trust for health benefits	\$ 111,958,341	71,933,654	183,891,995

