

NEW JERSEY



COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2004

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**STATE OF NEW JERSEY
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 FISCAL YEAR ENDED JUNE 30, 2004
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State of New Jersey
DEPARTMENT OF THE TREASURY
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RICHARD J. CODEY
Acting Governor

JOHN E. MCCORMAC, CPA
State Treasurer

December 1, 2004

Acting Governor Richard J. Codey
Members of the State Legislature
New Jersey Citizens

In accordance with the provisions of N.J.S.A. 52:27B-46, we are pleased to transmit to you the New Jersey Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004. The Department of the Treasury's Office of Management and Budget prepared this report and is responsible for data accuracy as well as the completeness and fairness of the presentation, including all disclosures.

This Comprehensive Annual Financial Report, which has earned an unqualified audit opinion from the Office of the State Auditor, presents the financial position and operating results of the State under generally accepted accounting principles (GAAP) applicable to State and Local governments as established by the Governmental Accounting Standards Board (GASB). The State also participates in the Government Finance Officers Association of the United States and Canada's (GFOA) review program for the Certificate of Achievement for Excellence in Financial Reporting.

The State operates in accordance with the standards provided in GASB Statements No. 34 and No. 35. The objectives of this reporting model as reflected in these statements are to provide a clear picture of the government as a single unified entity as well as providing traditional fund based financial statements. All revenues, costs, assets, and liabilities of the State are shown to more clearly portray the State's fiscal health. Management's Discussion and Analysis is included on pages 15 to 28 in order to provide users with an objective and easily readable analysis of New Jersey's financial performance for the fiscal year ended June 30, 2004. We are confident that the data is accurate in all material respects, that it is presented in a manner designed to set forth fairly the financial position and results of the State's operations as measured by the financial activity of its various funds, and that all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs have been included.

The New Jersey Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004 is organized in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter and the 2003 GFOA Certificate of Achievement for Excellence in Financial Reporting. The financial section includes the independent auditor's report on the basic financial statements, management's discussion and analysis, government-wide financial statements, fund financial statements for governmental funds, proprietary funds, fiduciary funds, and component units, together with notes to the basic financial statements as well as additional required supplementary information (Budgetary Schedules), and the other supplementary information (Combining Fund Statements). The statistical section includes the budgetary basis schedules, as well as selected financial and demographic information.

HIGHLIGHTS AND INITIATIVES

Fiscal Year 2004

- Concerns in the Department of Human Services, Division of Youth and Family Services' (DYFS) system of keeping children safe were exposed when the circumstances surrounding the death of a seven-year-old boy was discovered in Newark. In the aftermath, former Governor McGreevey ordered an immediate accounting of all cases where a child had not been located and an open

allegation of abuse existed. As a result, it was determined that numerous allegations remained open and uninvestigated. Former Governor McGreevey also ordered a fact finding process that made a clear cut case for sweeping changes. It was revealed that DYFS' mission was too broad, its delivery system for children was fragmented, its caseworker supervision was inadequate, its workforce was too inexperienced, and that there was a lack of accountability across the whole system. During Fiscal Year 2004, over \$30.0 million was provided for the purpose of reforming and improving the DYFS' information systems and services. Implementation of the Statewide Automated Child Welfare Information System to comprehensively track and monitor cases, the hiring of additional direct care staff, support staff, and Human Services Police officers also occurred. The anticipated result is increased accountability, a revision in management expectations, enhanced recruitment, an expansion and mandate in training, strengthened supervision, and a reduction in caseloads.

- The State took steps to streamline the procedures for the State school construction program, which provides \$8.6 billion to build and renovate schools. In Fiscal Year 2004, \$108.5 million was spent for State debt service and increased aid for recently issued local debt for school construction.
- In Fiscal Year 2004 over \$100.0 million in funding for various homeland security and counter-terrorism initiatives occurred. These funds provided enhanced security for the State's nuclear power plants as well as prompt emergency medical response and additional support for the Office of Counter-Terrorism and State Police efforts to guard New Jersey residents against potential terrorist activities.

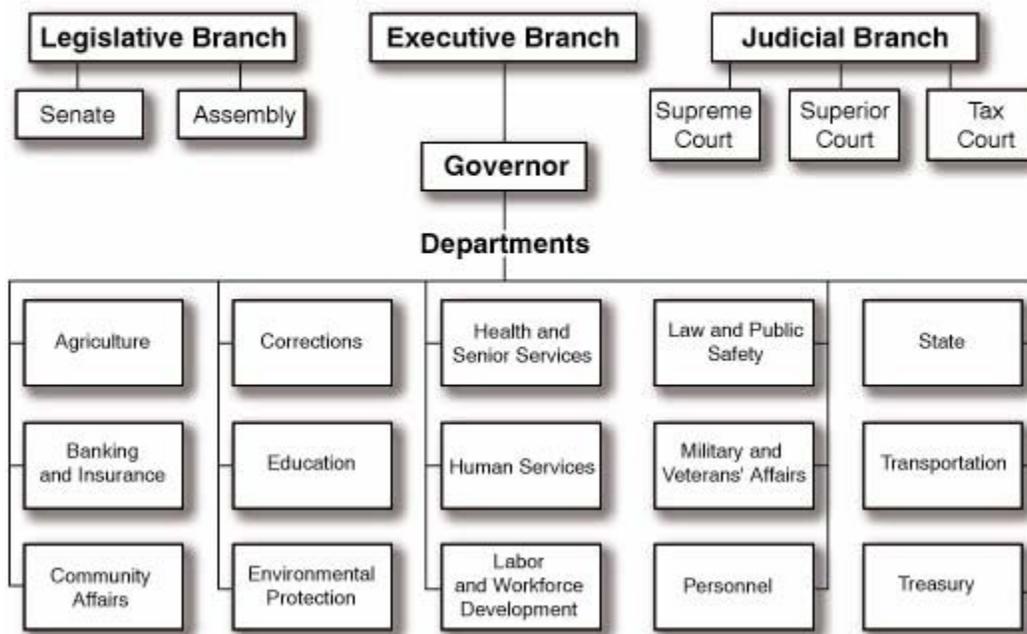
Fiscal Year 2005

- The cornerstone to the Fiscal Year 2005 Appropriations Act is the FAIR (Fair and Immediate Relief) Plan, which provides property tax relief to New Jersey's senior citizens and middle class taxpayers. The three pronged plan calls for immediate relief, spending reforms, and long-term structural changes to New Jersey's property tax system. Immediate relief comes in the form of increased rebate checks. Under the Homestead Rebate Program, the average check for senior citizens will increase to \$1,200, from \$775. Approximately 460,000 senior citizens will receive the \$1,200 maximum. Under the NJSAVER Program, qualified families will receive a rebate of \$800, up from \$250 the prior year. Approximately 1.2 million families are impacted, with another 190,000 families doubling their average rebates to \$500. In order to provide 2.0 million senior citizens and middle class New Jerseyans with property tax relief, an additional 2.6 percent tax on income over \$500,000 was enacted. Spending reforms under the FAIR Plan includes a limit on annual spending increases of municipal governments and school districts operations to 2.5 percent or less. Long-term reforms include the creation of a Citizens Task Force to recommend to the State Legislature the structure and scope of a Constitutional Convention on property tax reform. The Citizens Task Force would return their recommendations in time for the November 2005 ballot.
- Aid to Education continues to be a major component of State spending. The Fiscal Year 2005 Appropriations Act provides \$8.9 billion in school aid, an increase of \$753.3 million over Fiscal Year 2004. Three percent increases in formula aid were provided to non-Abbott school districts. Abbott school districts were provided increases for mandated programs and services as well as increases for the expansion of preschool programs. Fiscal Year 2005 also provides funding for new aid categories, which include \$15.0 million for a new preschool program in non-Abbott school districts; \$12.0 million in additional formula aid for school districts that have experienced unusually high enrollment growth; \$17.0 million to develop and implement strategies for enhanced teaching and learning in low income, non-Abbott school districts; and \$2.5 million in reward and incentive aid for high performing model districts meeting certain administrative efficiency standards. The Fiscal Year 2005 Appropriations Act also includes \$306.0 million for school facilities aid programs.

NEW JERSEY GOVERNMENT

The Executive Branch is headed by the Office of the Chief Executive which includes the Governor and staff that assist in the execution of the Governor’s constitutional powers and duties. The Governor is the State’s chief operating officer, and assists in directing and coordinating the activities of the various State departments. These duties include the implementation of new laws and activities, as well as ongoing responsibilities associated with existing laws, and other essential aspects of governing. The Office of the Chief Executive is active in the review and formulation of proposals of law that are ultimately submitted to the State Legislature. Staff assists in the development of public policy affecting the citizens of the State, and in the implementation of the State’s fiscal plan once it is adopted.

ORGANIZATION OF NEW JERSEY STATE GOVERNMENT



The Executive Branch consists of 15 departments comprising approximately 66,000 employees. The maximum number of departments permitted by the State Constitution is 20. Each department is headed by a single executive; four also have boards with policy-making and oversight responsibilities. Department heads and board members are appointed by the Governor with the advice and consent of the Senate, except for the Secretary of Agriculture, who is chosen by the Board of Agriculture with the approval of the Governor. Department heads continue in office until successors are named and confirmed by the Senate, with the exception of the Attorney General and the Secretary of State, who are appointed to serve during the Governor’s term. The Executive Branch oversees the performance of 566 municipalities and 611 school districts, and the incarceration and rehabilitation of approximately 27,000 prisoners. The Executive Branch also provides social services for one out of eight New Jersey citizens, reliable transportation, and protection for the State’s citizenry and environment.

New Jersey’s Legislative Branch consists of the State Senate and the General Assembly. There are 40 legislative districts with elections being held in odd-numbered years. There are 40 members of the State Senate. State Senators are elected to terms of four years, except for the election following a decennial census, in which case the term is for two years. There are 80 members of the General Assembly. Assemblymen are elected to two-year terms. The Office of Legislative Services is a nonpartisan agency

that provides legislators with legal, fiscal, research, information, and administrative services. It is organized with an executive director, a legislative counsel, the state auditor, a director of central staff, a director of data management, and a director of administration.

The Judicial Branch consists of the Supreme Court, the Appellate Division of the Superior Court, and the Tax Court. Judges are nominated by the Governor and must be confirmed by the Senate. Terms are for seven years. For purposes of judicial administration, the State is divided into 15 vicinages, each consisting of a single county or a combination of counties. The Administrative Office of the Courts provides support services. Approximately 7.0 million new cases are filed in New Jersey's courts every year, including 6.0 million in Municipal Court and 1.0 million in Superior Court. These cases address matters concerning civil, criminal, and family law.

COMPONENT UNITS

This Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004 includes the accounts of 22 public authorities, and 12 State colleges and universities in accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*. Public authorities are legally separate entities that are not operating departments of the State. Governing boards are vested with the power to independently manage these component units. Each component unit is established for a specific purpose for the benefit of the State's citizenry. GASB Statement No. 14 provides that the State's financial statements should emphasize the primary government and permit financial statement users to distinguish between the primary government and its component units. As a result, the transmittal letter, management's discussion and analysis, and the financial statements focus on the primary government of the State and its activities, although information pertaining to the component units is presented. For additional information, please see Note 18 – Component Units on page 87.

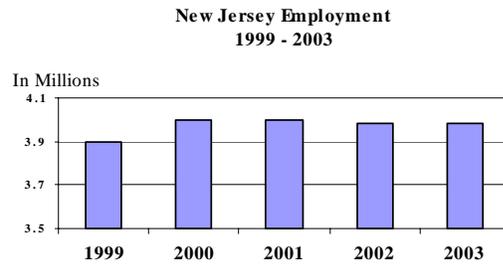
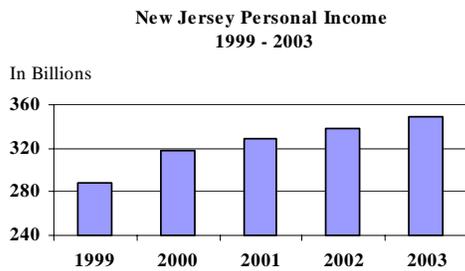
NEW JERSEY'S ECONOMIC CONDITION

Through calendar year 2004, New Jersey's economy continued to expand and its recovery is showing signs of momentum. The State outperformed the nation in terms of job creation at a faster pace over last year. New Jersey added 101,700 jobs between the bottom of the employment cycle in March 2003 and September 2004. Payroll employment increased over 1.4 percent during the first nine months through September 2004 after declining slightly by 0.1 percent last year. Jobs in September 2004 grew at a 1.7 percent average annual rate over a year ago, continuing the positive year over year growth trend for the fifteenth consecutive month since July 2003, surpassing the pre-recession level.

Payroll employment increased by over 1.6 percent in the third quarter of 2004, a solid increase compared to the 0.4 percent growth in the same quarter a year ago, and maintained the momentum in job growth that started to pick up since the first quarter of 2004. Overall, the State added 60,300 jobs between January and September 2004. Employment gains were primarily spread across the service providing sectors with particularly strong growth in professional and business services (12,700 jobs), education and health services (9,500 jobs), and trade, transportation, and utilities (8,100 jobs). The total government (14,600 jobs) and construction (3,700 jobs) sectors also showed strong gains.

The generally improving labor market conditions have kept the State's jobless rate below 5.0 percent for the third straight month since July 2004. New Jersey's unemployment rate dropped to 4.8 percent in September 2004, well below the corresponding rate of 5.4 percent for the nation.

The preliminary 2004 second quarter growth rate for New Jersey's personal income of 4.7 percent improved over the revised first quarter 2004 growth rate of 4.1 percent. October 2004 economic forecasts project slight moderation in the third quarter followed by an improving personal income growth scenario in the fourth quarter and into 2005. Despite the slight increase in the inflation rate (around 3.0 percent) the growth momentum in the labor market conditions will benefit consumers and businesses. In addition, low interest rates continue to support spending on housing and other consumer durables in the State.



The housing sector continues to be robust during 2004 with new housing starts estimated to stay around 33,000 units or more for the year, slightly above the 2003 level. New vehicle registrations for the nine months through September 2004 were 3.5 percent above the level in 2003.

New Jersey and the nation are expected to have a solid year with economic momentum heading into calendar year 2005. In the December Beige Book, the United States Federal Reserve was upbeat reporting broad economic expansion across the nation. The fundamentals of the State's economic health remain stable and the long run prospects for economic growth of the State in calendar year 2005 and beyond are favorable.

The Statistical Section contains various demographic and economic tables for New Jersey.

BUDGET AND ACCOUNTING

Budget Process

The State Constitution, as well as certain statutes, governs the State's budget and appropriation process. Each department, board, commission, office or other agency of the State begins the budget process by filing with the Director of the Office of Management and Budget (the "Director") a request for appropriation or permission to spend, specifying all expenditures proposed to be made by such spending agency during the following fiscal year. The Director then examines each request and determines the necessity or advisability of the appropriation request. After review and examination, the Director submits the requests, together with findings, comments, and recommendations, to the Governor. It is the responsibility of the Governor to examine and consider all requests and formulate budget recommendations. The Governor's Budget Message is then transmitted on the fourth Tuesday in February, unless otherwise provided through legislation.

During the course of the fiscal year, the Governor may take steps to reduce State expenditures if it appears that revenues have fallen below those originally anticipated. The Governor, with approval from the State Legislature, may enact supplemental appropriations after the adoption of the annual Appropriations Act, should there be sufficient revenues on hand or anticipated, as certified by the Governor, to meet such appropriation.

Over the past two decades, New Jersey's budget process has evolved into a strategic planning initiative in which the budget is directly related to the program objectives of governmental activities. Costs and benefits of each agency's programs are weighed and justified at various alternative funding levels.

Legal Level of Control

The State's Annual Appropriations Act includes the General Fund and certain Special Revenue Funds (Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief Funds). Legal control is maintained within the departments at the appropriation line item level. Budgetary control is exercised at the department level by individual appropriations and allocations within appropriations to various programs and major expenditure objects. Program classifications represent a lower level, operating program function, consisting of closely related activities with identifiable objectives or goals. During the budget

year, revisions to the Annual Appropriations Act reflecting program changes or interdepartmental transfers of an administrative nature may be effected with certain Executive and Legislative Branch approvals. Under the “General Provisions” section of the State’s Annual Appropriations Act, management may amend the budget within a department with the approval of the Director of the Office of Management and Budget. Under specific conditions, additional approval by the Office of Legislative Services is required. Only the State Legislature, however, may transfer appropriations between departments.

Accounting Systems

For the various State departments, accounting records are maintained by a central accounting system. The system operations are directed and supervised by the Office of Management and Budget. The State’s annual budget is comprised of individual appropriations to departments for specific programs and purposes. Component units maintain separate accounting systems.

Encumbrance accounting is employed to ensure that expenditures do not exceed appropriations and allocations. Purchase orders, contracts, and other commitments involving monetary expenditures are encumbrances. Any unencumbered and unexpended non-continuing appropriations lapse at the end of the fiscal year.

Consideration as to the adequacy of internal controls is paramount in developing and maintaining the State’s accounting system. Internal accounting controls are designed to provide reasonable assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, and that financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from its use, and that the evaluation of costs and benefits require managerial estimates and judgments. All internal control evaluations occur within this framework.

RELEVANT FINANCIAL POLICIES

The State Constitution mandates a balanced budget. It provides, in part, that no money shall be drawn from the State Treasury but for appropriations made by law and that no law appropriating money for any State purpose shall be enacted if the appropriations contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of the revenue on hand and anticipated to be available to meet such appropriations during such fiscal period, as certified by the Governor. During the course of the fiscal year, the State may have to make several revenue and expenditure adjustments to ensure a positive fund balance. The State has had a balanced budget in every fiscal year since the adoption of the State Constitution in 1947.

As part of the General Fund’s resources and fund balance, the Surplus Revenue Fund was created as a rainy day fund. The Surplus Revenue Fund is used to account for excess revenues from prior fiscal years that are legislatively reserved and may be used to support current year’s appropriations in the event that anticipated revenues in the General Fund are estimated to be less than those certified by the Governor upon approval of the annual Appropriations Act. The Surplus Revenue Fund was designed to build fund balance during economic upswings, and expended during economic downturns and emergency situations. An example of revenue collections outpacing projections occurred during Fiscal Year 2004, when \$282.4 million was deposited into the Surplus Revenue Fund. An example of an emergency situation that resulted in tapping the Surplus Revenue Fund occurred in Fiscal Year 2000 when the State needed \$26.9 million in emergency disaster relief funds to aid flood victims of Hurricane Floyd.

The State’s budgetary basis of accounting differs from that utilized to present fund financial statements in conformance with GAAP. The main differences between the budgetary basis and the GAAP basis used to present fund financial statements, are that under the budgetary basis encumbrances are recognized as expenditures, the federal revenue related to such encumbrances is also recognized, and the budgetary basis reflects transactions only for the current fiscal year. In addition, under the GAAP basis in the fund financial statements, certain grants and other financial assistance are required to be recorded as revenues and expenditures.

FINANCIAL TRENDS

Education

State aid for elementary and secondary education continues to be one of the largest components of the State budget at almost one third of the Fiscal Year 2005 State appropriations. State funding for Education has historically been a struggle, especially in times of limited resources. The cost of compliance with State Supreme Court mandates for funding the poorest school districts, known as Abbott districts, forces the direction of a large portion of those resources, reducing the amount available for distribution to non-Abbott school districts. Having one of the highest per pupil spending amounts in the country and high reliance on property taxes for the local support adds to the pressure to increase the level of State support. Federal legislation such as the No Child Left Behind Act and the Individuals with Disabilities Education Act have placed additional requirements on districts that result in spending increases beyond the federal funding provided for the programs. The State periodically reviews its funding formulas to balance the competing needs as best possible.

Transportation

Stable funding for public transportation occurred in 1984 with the passage of the New Jersey Transportation Trust Fund Authority. Prior to the enactment, funding was provided through various intermittent general obligation bond acts that were subject to voter approval. Funded from sources such as the Motor Fuels Tax, the Petroleum Products Gross Receipts Tax, a portion of the Sales and Use Tax, and bond proceeds, the New Jersey Transportation Trust Fund Authority has provided the New Jersey Department of Transportation and New Jersey Transit Corporation with a combined capital program that has grown from \$249.0 million in Fiscal Year 1985 to \$1,292.6 million in Fiscal Year 2005. Stable State and federal funding has allowed the New Jersey Transit Corporation to invest in such notable projects as the Secaucus Transfer, Newark Airport Station, Montclair Connection, MidTown Direct, and the Newark Elizabeth Rail Link. These projects are in addition to the purchase of rolling stock needed to upgrade the bus and rail fleet of vehicles. For Fiscal Year 2005, the New Jersey Transportation Trust Fund Authority has funded the New Jersey Department of Transportation's "Fix-it-First" approach that addresses bridges, pavement, and projects which support urban and suburban redevelopment, and protection of environmental values. The New Jersey Department of Transportation's program focuses on innovative strategies to promote safety, while providing a balanced, economical, effective attack on highway congestion.

Open Space Preservation

One of State Government's responsibilities is the conservation of the State's natural resources. Open space preservation began in 1961 under the Department of Environmental Protection's Green Acres program. Farmland preservation, through the Department of Agriculture's State Agriculture Development Committee, began in 1983. The Garden State Preservation Trust was created in Calendar Year 1999 to provide funding for the Department of Environmental Protection, the State Agriculture Development Committee, and the New Jersey Historic Trust for the preservation of open space, farmland, and historic properties. Through the annual \$98.0 million constitutional dedication from the State's Sales and Use Tax, the Garden State Preservation Trust has preserved approximately 40,000 acres per year since its inception. This amount represents a 111.1 percent increase from earlier funding efforts that concentrated on voter approved general obligation bond acts. A total of 551,358 acres have been preserved for open space, while a total of 129,310 acres have been preserved for farmland purposes.

AUDIT INFORMATION

The principal auditor of the State's reporting entity is the Office of the State Auditor, which resides in the legislative branch of State government. The State Auditor's examination was conducted in accordance with generally accepted auditing standards and its opinion precedes the Basic Financial Statements. Outside public accounting firms have been used for the audits for separately issued component units and college and university financial statements. In addition, the Office of the State Auditor conducts periodic financial and expanded scope audits of the various State agencies. This audit received an unqualified opinion on the Basic Financial Statements contained in this Comprehensive Annual Financial Report.

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The GFOA awarded the Certificate of Achievement for Excellence in Financial Reporting to the State of New Jersey for its Comprehensive Annual Financial Report for the year ended June 30, 2003.

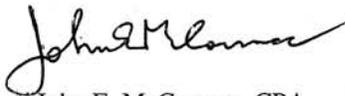
In order to qualify for the Certificate of Achievement, a governmental entity must publish an easily readable and efficiently organized comprehensive annual financial report, the contents of which conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

The State of New Jersey has received this award every year since 1993. It is our belief that this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004 continues this tradition and conforms to the GFOA's Certificate of Achievement Program requirements.

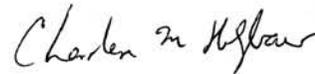
ACKNOWLEDGEMENTS

Finally, we would like to express our appreciation to the many dedicated professionals in the Office of Management and Budget and the Office of the State Auditor whose efforts made possible the preparation of this report. We believe that their combined efforts have produced a report that will provide a means for government, the financial community, decision makers, and concerned citizens to better understand and evaluate the State's financial condition.

Sincerely,



John E. McCormac, CPA
State Treasurer



Charlene M. Holzbaur
State Comptroller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of New Jersey

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Nancy L. Ziehl

President

Jeffrey R. Enen

Executive Director