

NEW JERSEY



COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED JUNE 30, 2006

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**STATE OF NEW JERSEY
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 FISCAL YEAR ENDED JUNE 30, 2006
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State of New Jersey
DEPARTMENT OF THE TREASURY
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JON S. CORZINE
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State Treasurer

January 26, 2007

Governor Jon S. Corzine
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, 2006. 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 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 clearly portray the State's fiscal health. Management's discussion and analysis is included 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, 2006. 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, 2006 is organized in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter and the 2005 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 financial trends, revenue capacity, debt capacity, demographic, economic, and operating information.

HIGHLIGHTS AND INITIATIVES

Fiscal Year 2006

- Following the tragic death of several children due to abuse and neglect, a class action lawsuit was settled by the State in June 2003. The settlement created a Child Welfare Reform Panel whose role was to approve a reform plan and to oversee its implementation over an 18 month period. The plan, titled *A New Beginning: Child Welfare Reform in New Jersey*, was approved on June 9, 2004, and incorporated as part of the settlement. The Fiscal Year 2006 Appropriations Act provided an additional \$55.0 million in State funds to sustain and expand Child Welfare Reform efforts. Some of the implemented reforms are as follows:
 - Organization of Children's Services. All child welfare services have been restructured under the new Department of Children and Families. Within this new organization, the Division of Youth and Family Services, the Division of Child Behavioral Health, the Division of Prevention and Community Partnerships, and the Child Welfare Training Academy have been merged.

- Additional Caseworkers and Support Staff. The Fiscal Year 2006 Appropriations Act provided funding for additional employees that allowed the Division of Youth and Family Services to move towards its goal of achieving caseload to staff ratios of 12 to 1 for protective staff and 15 to 1 for permanency staff.
- The Fiscal Year 2006 Appropriations Act increased State appropriations for several programs that benefited the developmentally disabled. As part of the Department of Human Services Division of Developmental Disabilities' ongoing Community Service Waiting List initiative, funding was made available to place 200 people from the existing Community Services Waiting List and the seven State developmental centers into group homes. This was a 3.0 percent increase over the prior fiscal year, with full year funding totaling \$12.6 million. A new program, Real Life Choices, provides in-home/respite services for people on the Community Services Waiting List and for people living at home with parents and guardians. Real Life Choices reduces the Community Services Waiting List by providing home support for disabled persons and their families as an alternative to residential placements. Each year, the Division of Developmental Disabilities receives approximately 200 requests for immediate, emergency residential placements. The requests include people whose caregivers, usually elderly parents, are no longer able to provide care because of their own medical problems. An additional \$7.0 million was earmarked to meet this anticipated need.

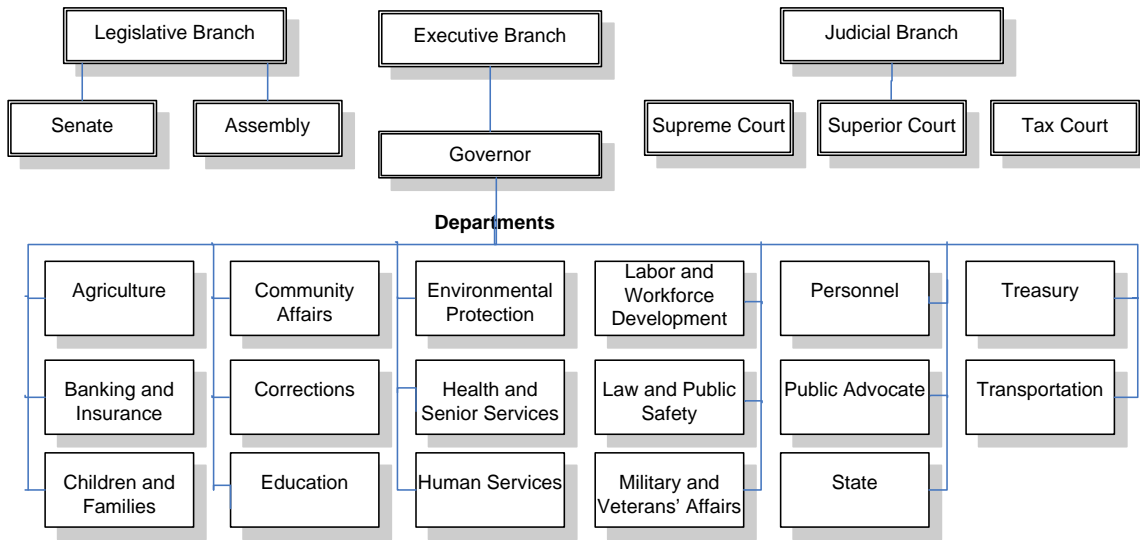
Fiscal Year 2007

- The Fiscal Year 2007 Budget provides for a constitutional ballot measure that enables the State's General Fund to provide for the annual dedication and annual appropriation of an amount equal to the annual revenue derived from a tax rate of 0.5 percent imposed under the New Jersey Sales and Use Tax, exclusively for the purpose of property tax reform, through a special Property Tax Reform Account established in the Property Tax Relief Fund. This measure is expected to provide \$600.0 million in property tax relief. This November, the citizens of New Jersey approved this referendum.
- Although fiscal constraints limit the ability to fully fund pension costs, the Fiscal Year 2007 Appropriations Act accelerates toward full funding and provides a funding increase of \$868.0 million to the State's pension systems. This amount represents more than the State's total combined contribution to the State pension systems from Fiscal Year 1997 through Fiscal Year 2006.
- The Fiscal Year 2007 Budget recognizes that federal funding for special education falls dramatically short. When the Individuals with Disabilities Education Act was first established, the federal government promised to pay 40.0 percent of the national average of per pupil expenditure. However, current federal funding is less than 20.0 percent. The Fiscal Year 2007 Budget provides \$15 million for a grant program for school districts operating or starting up in-district programs for students with autism spectrum disorders. Districts will be able to use these funds for professional development, personnel costs, special education teachers, program coordinators, behavior intervention specialists, parent outreach, transition planning, assistive technology, and similar activities. Also included in the Fiscal Year 2007 Budget is \$4.5 million in new grants funding for planning and start-up costs for districts that seek to develop or enhance their special education programs.
- Recognizing the need for repairs and maintenance, the Fiscal Year 2007 Budget provides \$9 million for capital improvements in State parks, forests, wildlife management areas, and historic sites. The Department of Environmental Protection plans to undertake critical health and safety improvements including demolition of unsafe structures, asbestos removal, and lead abatement. Major projects include restorations of State-owned historic sites, such as Batsto and Atsion Mansions, Rockingham, Waterloo Village, and the historic train sheds at Liberty State Park.

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 17 departments comprising approximately 70,100 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.

The State Senate and the General Assembly comprise New Jersey’s Legislative Branch. 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; each is elected to a two-year term. 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

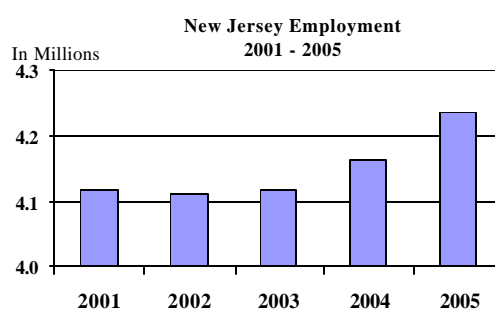
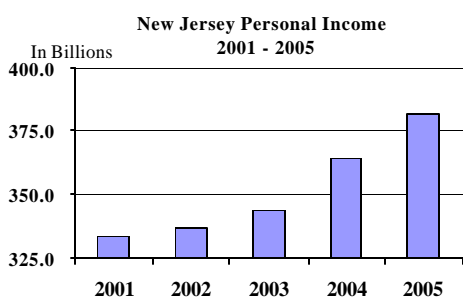
This Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006 includes the accounts of 22 public authorities, and 12 State colleges and universities in accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*. Public authorities are legal, separate entities that are not operating departments of the State. Governing boards are vested with the power to independently manage. 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 19 – Component Units.

NEW JERSEY'S ECONOMIC CONDITION

New Jersey's economy continues to expand in 2006 but at a slower pace than 2005. New Jersey added approximately 116,300 jobs between the bottom of the employment cycle in March 2003 and June 2006. Payroll employment is growing at an average annual rate of 0.9 percent in 2006 after growing at rates of 1.2 percent in 2005, and 0.5 percent in 2004. The level of payroll employment in June 2006, 4.1 million, surpassed the last record level reported in December 2000 for the seventeenth month in a row.

The generally improving labor market conditions have kept the State's jobless rate below 5.0 percent in June 2006 for the twenty-third time since June 2004, after a brief higher reading in April and May (5.1 percent and 5.0 percent, respectively). New Jersey's unemployment rate remains slightly above the national unemployment rate.

According to the United States Bureau of Economic Analysis (release dated June 22, 2006), the preliminary growth rate for New Jersey's personal income of 5.1 percent for the first quarter of 2006 came in above the revised growth rate of 4.3 percent for the fourth quarter of 2005. The average annual growth in personal income for New Jersey is expected to continue to improve at a moderate pace in 2006.



Housing, which has been a robust sector, is expected to cool off in the months ahead with housing permits in 2006 to stay around 25,000 plus units, below the estimated 27,000 plus units for 2005. Vehicle registrations for 2005 were 2.6 percent below 2004 with 2006 vehicle registrations through June remaining at the 2005 level.

New Jersey's and the nation's economy is expected to continue expanding through the rest of 2006 and into 2007. The recently released Beige Book on economic performance dated June 14, 2006 from the United States Federal Reserve Board is slightly less upbeat when compared to previous reports, reflecting an economy in transition that is adjusting to elevated energy prices and higher interest rates. The latest New Jersey economic forecasts from Global Insight, Moody's Economy.com, and Rutgers University project continued economic growth at a moderate pace. All expect a gradual easing in the economic momentum as the housing market slows down.

New Jersey's economy is expected to follow the national trend for the rest of the year, and into 2007. Employment is projected to grow at a 0.9 percent rate in 2006 and at a 0.7 percent rate in 2007. Personal income is expected to grow steadily at a 6.0 percent rate in 2006 and 2007. The housing sector is expected to cool in 2006 to 33,000 units with further slowing in 2007. New motor vehicle registrations are projected to be above the 620,000 units in 2006 and improve in 2007.

Despite the surge in energy prices, inflation is expected to remain under control. Low interest rates have supported spending on housing and other consumer durables in the State. However, should interest rates continue to rise in 2006, it will have a moderating influence on interest-sensitive spending in the economy.

The State and the nation may experience further near-term slow growth and the expected pace of economic expansion may stall if consumers, investors, and businesses become more concerned about energy prices and geopolitical tensions. To a large extent, the future direction of economic expansion nationally and in New Jersey hinges on assumptions of stable energy prices and financial markets, along with supportive monetary and fiscal policies and geopolitical stability. However, the fundamentals of the State's economic health remain stable and the long term prospects for economic growth of the State in 2006 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 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 Governor's responsibility to examine and consider all requests and formulate budget recommendations. The Governor's Budget Message is 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 appropriations 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.

New Jersey's budget process is comprehensive and inclusive, involving every agency in the Executive branch, the Legislature, the Judiciary, and through a series of public hearings, the citizens of the State. It begins in the summer prior to the budget year with preliminary projections of revenues and expenditures, which are the basis for development of budget targets for each branch, department, and agency. Individual agencies are asked to prepare a funding plan or strategy for operating within the established target in the upcoming budget year that includes an analysis of the costs, benefits, and priorities of every program. These plans are the foundation for revenue and spending decisions that are ultimately incorporated into the budget recommendations presented by the Governor and enacted by the Legislature.

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 Director of the Office of Management and Budget's approval. 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. System operations are directed and supervised by the Office of Management and Budget. The State's annual budget is composed 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 fiscal year's end.

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 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. It 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 to be expended during economic downturns and emergency situations. An example of revenue collections outpacing projections occurred during Fiscal Year 2006, when \$271.1 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

Children and Families

In response to a child welfare system that has been in a state of crisis, aggressive reform has required a focus that was not possible under the current Department of Human Services structure. July 1, 2006 marks the creation of the Department of Children and Families that will be initially composed of divisions in the Department of Human Services that focused on child protection, welfare, education and permanency, child behavioral health, and abuse prevention. While building on its accomplishments from the prior year, the Fiscal Year 2007 Budget for the Department of Children and Families totals \$974.8 million. This amount reflects a \$235.6 million increase over the prior year's associated funding under the Department of Human Services. The entire \$235.6 million is dedicated to child welfare services and operations, with no new funding dedicated to costs associated with establishing the new department. A new interim body, the Governor's Task Force on Human Service Restructuring, will be empanelled to evaluate existing resources within State government and to make recommendations for efficiency and alignment of resources to improve services in the areas of child welfare in the Department of Children and Families and for vulnerable residents being served by the Department of Human Services.

Corrections

The Department of Corrections' mission is to ensure that all persons committed to the State's correctional institutions are confined with the level of custody necessary to protect the public, and that they are provided with the care, discipline, training, and treatment needed to prepare them for reintegration into the community. The Fiscal Year 2007 Budget totals \$1.076 billion. The Division of Operations, with a budget of \$861.5 million, is responsible for 14 major institutions. Collectively, county jails, community treatment programs and these facilities, house approximately 27,000 inmates in minimum, medium, and maximum security levels. The Division of Programs and Community Services offers an array of institutional and community-based programs for offenders, including community labor assistance, academic and vocational educational programs, recreational programs, library services, and substance abuse treatment. The State's Parole Board, with a budget of \$98.5 million, promotes the effective and efficient assessment of inmates prior to parole and the efficient supervision of parolees after they have attained parole status. In recent years, the Department has established a Sex Offender Management Unit, and a Satellite-based Monitoring (GPS) of Sex Offenders Pilot Program. The Department has also recently completed collecting DNA samples of all of its offenders, as well as implementing a Community Notification System that alerts citizens in the case of a correctional emergency, such as an escape, fire or evacuation.

Public Advocate

During January 2006, the Department of the Public Advocate was restored as a principal department in the Executive Branch of State government. The Department is mandated to provide consumer protection and advocacy on behalf of the indigent, the elderly, children and other persons unable to protect themselves as individuals of a class. Since January 2006 the Department has been working to reestablish the divisions and functions that existed prior to its abolishment in 1994. This includes the Division of Citizens Relations and the Division of Public Interest Advocacy.

Other similar functions that existed independently or were parts of other State agencies have been consolidated into the Department of the Public Advocate. These include ombudspersons and ratepayer advocate functions. The Fiscal Year 2007 Budget totals \$19.4 million, a \$3.2 million increase over the prior fiscal year.

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.


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 fiscal year ended June 30, 2005. In order to qualify, 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.

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,



Bradley I. Atchew
State Treasurer



Charlene M. Holzbaun
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, 2005

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.



A handwritten signature in black ink, appearing to read "Ronald J. Hawn".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director