STATE OF NEW JERSEY
COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2012

Chris Christie, Governor
Kim Guadagno, Lieutenant Governor

STATE OF NEW JERSEY

COMPREHENSIVE
ANNUAL FINANCIAL REPORT
FISCAL YEAR ENDED JUNE 30, 2012

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lieutenant Governor

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

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FISCAL YEAR ENDED JUNE 30, 2012
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INTRODUCTION

State of New Jersey

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

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P.O. BOX 221
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ANDREW P. SIDAMON-ERISTOFF
State Treasurer

CHARLENE M. HOLZBAUR
Director

January 9, 2013

Governor Chris Christie
Members of the State Legislature
New Jersey Citizens

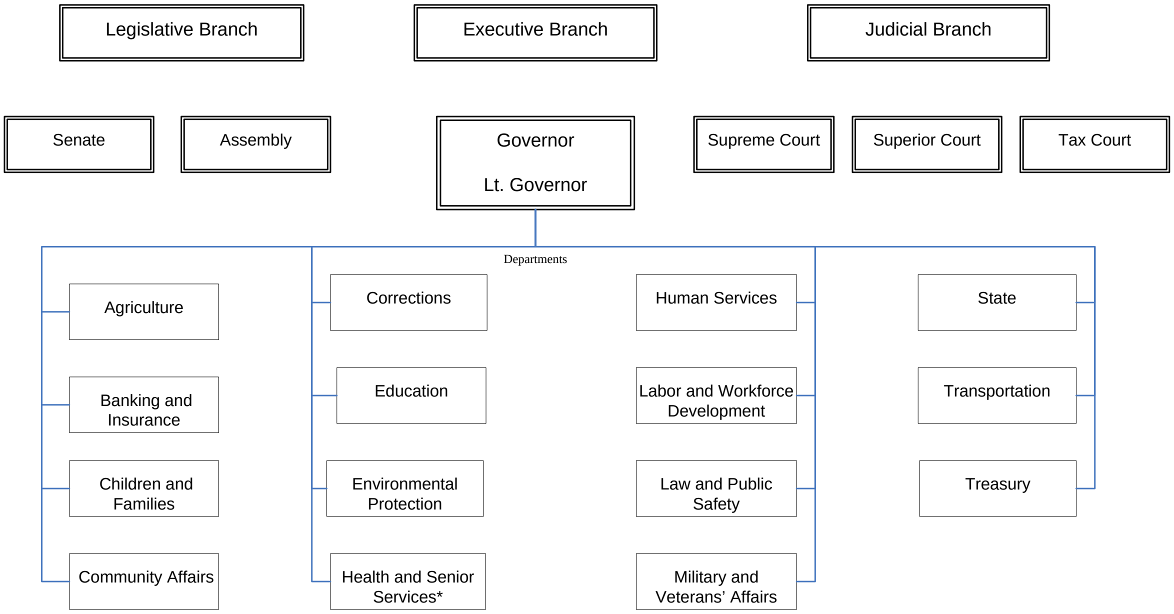
In accordance with the provisions of N.J.S.52:27B-46, it is our pleasure to transmit to you the State of New Jersey's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2012. The Department of the Treasury's Office of Management and Budget prepared this report, and is responsible for the accuracy, completeness, and fairness of all data presented, including all disclosures.

This CAFR 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 (GFOA) of the United States and Canada's Certificate of Achievement for Excellence in Financial Reporting review program.

The State operates in accordance with the standards provided in GASB Statements No. 34 and No. 35. In addition to providing traditional fund financial statements, the objective of this reporting model is to provide a single, unified, transparent picture of the State's fiscal health; thus, this CAFR clearly displays all of the State's revenues, costs, assets, and liabilities. This report also includes a Management's Discussion and Analysis section, which provides users with an objective and easy-to-read analysis of New Jersey's financial performance for the fiscal year ended June 30, 2012. We are confident that the data is accurate in all material respects and presented in a manner designed to set forth fairly the financial position and results of the State's operations, as measured by the fiscal activity of its various funds, and includes all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs.

NEW JERSEY GOVERNMENT

One of the original thirteen colonies, the State of New Jersey was the third state to ratify the United States Constitution in 1787. Adopted on July 2, 1776, New Jersey's original State Constitution subsequently was superseded by the State Constitution of 1844. During the summer of 1947, a constitutional convention met to prepare the current State Constitution, which State voters ratified in the general election held on November 4, 1947. New Jersey's State Constitution continues to be a living document, as State voters passed an amendment creating the position of Lieutenant Governor of New Jersey, effective with the 2009 election. Effective December 8, 2011, it became lawful for the Legislature to authorize wagering on sports events at New Jersey casinos and horse racetracks, excluding events that take place in New Jersey or in which any New Jersey college team participates regardless of where the event takes place. The State Constitution divides the powers of government between three co-equal independent branches: Legislative, Executive, and Judicial.



* P.L. 2012 c.17 reorganized the Division of Aging from Health and Senior Services to Human Services and renamed the Department of Health and Senior Services to the Department of Health.

Legislative: The State's bicameral Legislative Branch, which consists of a total of 120 members from 40 legislative districts with elections held in odd-numbered years, meets in annual sessions in Trenton, the State's capital. The 40 members of the State Senate are elected to terms of four years, except for the election following a decennial census, in which case the term is for two years. The 80 members of the General Assembly are elected to terms of two years. Neither State Senators nor Assembly Members are subject to term limits. The Office of Legislative Services (OLS) is a nonpartisan agency that provides legislators with legal, fiscal, research, information, and administrative services. Key OLS positions include an executive director, a legislative counsel, the state auditor, a legislative budget and finance officer, a director of central staff, a director of data management, and a director of administration.

Executive: The Office of the Chief Executive, which oversees the entire Executive Branch, consists of the Governor, the Lieutenant Governor, Cabinet-level department heads, and staff who are responsible for carrying out the Governor's constitutional powers and duties. Upon direct election by a plurality of the State's voters, both the Governor and the Lieutenant Governor may serve two successive terms of four years. With the exception of the Secretary of Agriculture, who is chosen by the Board of Agriculture with the Governor's approval, the New Jersey State Constitution grants the Governor the authority to appoint the entire cabinet as well as all Superior Court Judges and county prosecutors, subject to confirmation by the New Jersey Senate. Department heads remain in office until their successors are named and confirmed by the Senate; the only exceptions are the Attorney General and the Secretary of State, who are appointed to serve throughout the Governor's entire term. Although the State Constitution permits a maximum of 20 departments, the State's payroll consisted of approximately 60,500 employees in 15 departments as of January 2012. The Executive Branch also oversees the performance of 566 municipalities and 603 school districts, and the incarceration and rehabilitation of approximately 20,800 prisoners. In addition to reliable transportation and protection for the State's citizenry and environment, the Executive Branch provides social services for one out of every seven New Jersey citizens.

Judicial: New Jersey's Supreme Court consists of a Chief Justice, who is the administrative head of all courts under the State's jurisdiction, as well as six Associate Justices. In addition to Municipal and Tax Courts located throughout the State, there are Superior Courts, with a minimum of two Judges, in each of New Jersey's 21 counties. After nomination by the Governor and subsequent confirmation by the State Senate, all Supreme Court Justices and Superior Court Judges serve initial terms of seven years. Should they be deemed eligible by both the Governor and the State Senate, Supreme Court Justices and Superior Court Judges acquire tenure with retirement at age 70 as mandated by the State Constitution. 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 seven million new cases are filed in New Jersey's courts every year, including six million in Municipal Court and one million in Superior Court. These cases address matters concerning civil, criminal, and family law.

With a total land area of 7,417.3 square miles, New Jersey ranks as the fifth smallest state within the United States of America. An estimated population of 8,821,000 as of July 2011 makes New Jersey the eleventh largest state in population, as well as the most densely populated of all the states with an average of 1,189 people per square mile.

The higher education system in New Jersey includes three public research universities, nine State colleges and universities, 19 community colleges, 14 independent four-year colleges and universities, seven proprietary institutions with degree-granting authority, 12 rabbinical schools and theological seminaries, and two independent two-year religious colleges. Effective July 1, 2013, the "New Jersey Medical and Health Sciences Education Restructuring Act" of 2012 abolishes the University of Medicine and Dentistry of New Jersey (UMDNJ), transfers UMDNJ's various schools and institutes to Rutgers University and Rowan University, respectively, and establishes Rowan University as a public research university. Currently, UMDNJ is classified as a public research university and Rowan University is classified as a State university.

COMPONENT UNITS

In accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, this CAFR for fiscal year ended June 30, 2012 includes the accounts of 21 public authorities and 12 State colleges and universities. 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 18 – Component Units.

Executive Order No. 122, signed on July 23, 2004, was established to direct the Board of Directors for each State Authority to create an Audit Committee whose members are to assist in the oversight of the financial reporting and audit processes of the Authority. Each member of the Audit Committee is independent of the Authority, with at least one member having a background in accounting or related financial expertise. The Audit Committee must assist the Board in retaining an independent auditor to conduct an audit. The auditor selection process must be based on public, competitive bidding principles and shall take place no less than once every five years. In order to ensure the independence of the auditor selection process, an evaluation committee shall be established by the Board to conduct the solicitation and evaluation of eligible auditors. The auditor selected shall report directly to the Audit Committee or the Board. At no time shall the auditor report to any staff member of the Authority. At least twice a year, the Audit Committee shall hold a private meeting with the auditor. In carrying out these duties, the Audit Committee shall proactively assist the Board in overseeing the integrity and quality of the Authority's financial statements, the Authority's compliance with legal, regulatory, and ethical requirements, the auditor's performance and ability to perform, and the performance of the Authority's own internal audit and internal control functions.

NEW JERSEY'S ECONOMIC CONDITION

The State and nation have continued their recovery, but growth has been erratic. Job gains in the State were brisk in the first half of 2012 but employment was little-changed from the spring through October. Nonetheless, in each month through October, payroll employment in New Jersey has been higher than in the same month of 2011. However, the State still needs to gain approximately 200,000 jobs to regain the 2008 peak in employment. In an environment of moderate job growth, and some gains in the labor force, the State unemployment rate moved up to 9.9 percent in August before edging down to 9.7 percent in October, still well above the national rate of 7.9 percent. Personal income of state residents continued to show more marked strength than employment. In the first half of 2012 personal income grew at an annual rate of 7.2 percent in the first quarter and 3.1 percent in the second quarter. The level of personal income has set a new record high in each of the last six quarters.

The economic outlook for the nation remains uncertain, with continuing questions about the near-term and longer-term outlooks for federal tax and spending policy. The possibility of fiscal consolidation—a combination of tax reforms and/or increases and spending cuts—raises risks of some reduction in the near-term growth of demand, though such a policy may improve the longer-term prospects for the national economy and in so doing will improve the attractiveness of the United States as a place to invest and expand business. The implementation of the Affordable Care Act and the changes in financial regulation and supervision sanctioned by the Dodd-Frank Act adds to the near-term uncertainty, though it is now highly unlikely that either statute will be repealed or substantially modified. Limited revenue growth has continued to put downward pressure on public sector spending and employment by states and municipalities. Europe has slipped into recession, which will work to reduce foreign demand for U.S. products while increasing competition for U.S. producers. At the same time, consumer confidence appears to be higher, spending on big-ticket items such as automobiles has strengthened, and there are signs that homebuilding and sales are reviving and housing prices are stabilizing or moving up. The same national forces are apparent in New Jersey. In our case, the aftermath of Superstorm Sandy has raised some additional challenges for the State; some areas of the State, most notably shore communities and businesses, will continue to cope with losses of infrastructure, though there will also be some stimulus to activity as the rebuilding process goes forward. Looking forward, it is likely that the national expansion will continue at a pace comparable to that seen in recent years, with moderate gains in employment and some ongoing reduction in the unemployment rate. Recent actions and announcements by the Federal Reserve indicate further commitments to keep interest rates exceptionally low for a prolonged time; this policy will likely be retained even if there is a change in Federal Reserve leadership in early 2014.

The prospects are that New Jersey's housing sector will improve. Through September, housing permits were on a path to show a substantial increase from 2011, though the dislocations resulting from Superstorm Sandy creates a great deal of near-term uncertainty in this area. Home resales also showed considerable gains in the first half of 2012. It is likely that these trends will continue, with the possibility that the aftermath of the storm will provide some additional impetus to this sector. Motor vehicle sales continue to recover, with purchases of new vehicles through September more than 7.0 percent higher than in the same period of 2011.

For 2012 as a whole, New Jersey payroll employment is projected to average about 1.1 percent higher than in 2011 and grow around 1.3 percent in 2013. The unemployment rate is expected to average 9.5 percent in 2012 and 9.1 percent in 2013. Personal income is expected to grow around 3.2 percent in 2012 and 3.9 percent in 2013.

As unemployment stays high and capacity utilization remains low, underlying inflation is expected to be low and is not likely to be a serious concern until after spending and employment growth move higher. Enhanced availability of credit, continued improvement in financial market stability, and gains in consumer and business confidence continue to be critical factors necessary for a more pronounced economic turnaround in the nation and in New Jersey.

BUDGET AND ACCOUNTING

Legal Level of Control

The State's annual Appropriations Act includes the General Fund, as well as certain Special Revenue Funds (Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief). The departments maintain legal control at the appropriation line item level and exercise budgetary control by individual appropriations and allocations within annual 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. Revisions to the annual Appropriations Act, reflecting program changes or interdepartmental transfers of an administrative nature, may be effected during the budget year with certain Executive and Legislative Branch approvals. Language, located in the "General Provisions" section of the State's annual Appropriations Act, enables management to amend a department's budget with approval by 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

The Office of Management and Budget directs and supervises a central accounting system, which maintains all accounting records for the various State departments. The State's annual budget provides individual appropriations to departments for specific programs and purposes, while component units maintain separate accounting systems.

To ensure expenditures do not exceed appropriations and allocations, the State employs encumbrance accounting. 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 guarantee 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 the evaluation of costs and benefits requires managerial estimates and judgments. All internal control evaluations occur within this framework.

RELEVANT FINANCIAL POLICIES

The New Jersey State Constitution, which mandates an annual balanced budget, directs, 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. Accordingly, 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.

Created as a "rainy day fund," the Surplus Revenue Fund is part of the General Fund's resources and fund balance, and accounts for excess revenues from prior fiscal years that are reserved legislatively 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. Such an example occurred during Fiscal Year 2009 when, in response to the national recession, the State drained its entire Surplus Revenue Fund to help balance its budget. As of June 30, 2012, this Fund continued to have a zero balance.

The State employs a budgetary basis of accounting for all of its annual fiscal transactions. The budgetary basis differs from the GAAP basis, which is used to present fund financial statements, in that the former: 1) recognizes encumbrances as expenditures, 2) recognizes all federal revenues related to such encumbrances, and 3) reflects only current fiscal year transactions. The GAAP basis also requires that certain grants and other financial assistance be recorded as revenues and/or expenditures.

FINANCIAL TRENDS

Revenue History

Although State-budgeted Fiscal Year 2012 revenue collections of $29.1 billion were almost $3.5 billion less than those collected in pre-recession Fiscal Year 2008, there was a measurable improvement of $426.8 million when compared to Fiscal Year 2011 revenue collections. In comparison to Fiscal Year 2008, Gross Income Tax collections in Fiscal Year 2012 were almost $1.5 billion less; however, they also showed a marked increase of $511.4 million in comparison to Fiscal Year 2011. With the current Fiscal Year 2013 estimate projected to be $31.7 billion, the State's economic recovery trend remains optimistic. The Statistical Section provides a ten-year history of State-budgeted revenue collections.

Pension and Other Postemployment Benefits (OPEB) Obligations

Pursuant to P.L. 2010, c.1, the State resumed making contributions to the pension plans on a phased-in basis over a seven-year period beginning in Fiscal Year 2012. Previously, the State had not fully funded its various pension plans for several years, and its post-retirement medical program is funded on a pay-as-you-go basis. This continued underfunding, coupled with the on-going investment decline and increased number of retirees receiving distributions, has led to the State's current net pension obligation of $12.8 billion and a net OPEB obligation of $16.8 billion as of June 30, 2012. The total unfunded actuarial accrued liability (UAAL) for State and local pension plans was $41.7 billion as of June 30, 2011, or an increase of $5.4 billion from June 30, 2010. The increase in the UAAL is mainly attributable to expected actuarial losses including the investment return of 2.52% being lower than the assumed rate of return of 7.95% and the state's pension contribution of $1/7^{th}$ of the actuarially required amount being less than the full actuarially required amount. This increase would have been larger except for the impact of P.L. 2011, c. 78 which suspended additional cost of living adjustment (COLA) increases for current and future retirees. The total State and local OPEB unfunded actuarial accrued liability at June 30, 2011 was $60.1 billion, or a decrease of $11.3 billion from the prior year. For updated information, Fiscal Year 2011 actuarial reports can be accessed via: http://www.state.nj.us/treasury/pensions/actuarial-rpts.shtml.

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. Private sector public accounting firms have been used for the audits of 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 various State agencies.

Additional information regarding the State's financial status, including prior year budgets, appropriations acts, and financial reports, is available on the State's web site (http://www.state.nj.us/treasury/omb/).

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 CAFR for the fiscal year ended June 30, 2011. In order to qualify for this certificate, a governmental entity must publish an easily readable and efficiently organized comprehensive annual financial report, of which the contents 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 express our grateful appreciation to the many dedicated professionals in the Office of Management and Budget and the Office of the State Auditor, whose work made possible the preparation of this report. We believe 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,

Andrew P. Sidamon-Eristoff
State Treasurer

Charlene M. Holzbaur
Director, Office of Management and Budget

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, 2011

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.

President

Executive Director

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