**New Jersey State Legislature**

**OFFICE OF LEGISLATIVE SERVICES**

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The Honorable James E. McGreevey
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The Honorable John O. Bennett
President of the Senate

The Honorable Richard J. Codey
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The Honorable Albio Sires
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

## INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of New Jersey as of and for the year ended June 30, 2003, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of New Jersey's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of New Jersey as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2003 on our consideration of the State of New Jersey's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis, the budgetary comparison schedules, and the funding progress schedule for all pension trust funds are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of New Jersey's basic financial statements. The Combining Fund Statements - Non-Major Funds, Other Supplementary Information, Schedules of Anticipated and Appropriated Revenue and the Schedule of Appropriations and Expenditures are presented for the purposes of additional analysis and are not a required part of the basic financial statements. These statements and schedules have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The introductory section and the statistical section listed in the table of contents have not been audited by us, and accordingly, we express no opinion on them.

Richard L. Fair
State Auditor
December 1, 2003

RLF:ehk

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following narrative provides an overview and analysis concerning New Jersey State Government's financial performance of its activities for the fiscal year ended June 30, 2003. Readers should consider this information in conjunction with the transmittal letter, which precedes Management's Discussion and Analysis, and the State's financial statements, which follow.

The State of New Jersey is in its second year of accounting and reporting under the standards outlined in the Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. This Comprehensive Annual Financial Report provides significant changes in content and structure. Therefore, a majority of the information provided is not easily comparable to reporting periods prior to the fiscal year ended June 30, 2002. Year-to-year comparisons are provided in this year's Management's Discussion and Analysis. It is the intent of GASB Statement No. 34 to provide meaningful comparisons that will further explain the State's financial position and results of operations.

## FINANCIAL HIGHLIGHTS

### Government-wide

- The primary government's assets total $27.8 billion. Major increases were the result of the inclusion of capital assets, net of depreciation associated with the implementation of GASB Statement No. 34. As of June 30, 2003, assets exceeded liabilities by $3.2 billion. This calculation, commonly known as net assets, represents 11.5 percent of total assets. The State's unrestricted net assets, which represent net assets that have no statutory commitments and are available for discretionary use, totaled a negative $7.9 billion. The negative balance is primarily a result of financing unfunded actuarial liabilities in the State's pension fund systems and uninsured motorist funds, and financing local elementary and high school construction.

- June 30, 2003 Component Unit assets exceeded Component Unit liabilities by $8.8 billion. Total Component Unit assets grew to $34.0 billion.

### Fund Level

- The State's governmental funds reported June 30, 2003 combined ending fund balances of $7.7 billion, an increase of $2.1 billion from the prior fiscal year. Of this amount, $310.8 million represents unreserved fund balances with the remainder reserved for specific, legislated purposes, management reserves, and constitutional dedications. The General Fund's total ending fund balance is $2.3 billion, with $373.0 million unrestricted.

- Proprietary Funds reported June 30, 2003 net assets of $2.2 billion. During the fiscal year, this amount decreased by $695.0 million.

### Long-term Debt

- The State's long-term debt obligations increased 9.5 percent, to $18.8 billion, which includes a net increase in bonded debt of $1.6 billion.

- During the fiscal year, the State issued $3.7 billion in bonds. New money issuances represented $2.1 billion for transportation and education system improvements, while $1.6 billion represented five refunding transactions that provided the State with $74.9 million in net present value savings. During the fiscal year ended June 30, 2003, the State paid $1.4 billion in debt service on its general obligation bonds, revenue bonds, installment obligations, and certificates of participation.

- Non-bonded portions of the State's long-term debt total $2.6 billion. This amount represents a $19.8 million decrease from the prior fiscal year and is mainly attributable to a reduction in compensated absences for sick and vacation.

- As of June 30, 2003 the State has $10.8 billion of legislatively authorized bonding capacity that has not yet been issued. This amount represents a decrease of $2.9 billion from the prior fiscal year. Major components include $7.5 billion for school construction, $1.9 billion for transportation system improvements, $757.4 million for various, voter approved capital items, and $500.0 million for open space preservation.

## OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis serves as an introduction to the State of New Jersey's basic financial statements.

**Basic Financial Statements**

The basic financial statements include Government-wide financial statements and Fund financial statements. Both statements present different views of the State's financial information. The Comprehensive Annual Financial Report includes Notes to the Financial Statements; Required Supplementary Information (Budgetary Schedules) as well as Other Information.

- **Government-wide Financial Statements**
  Government-wide financial statements provide a broad view of the State's operations conforming to private sector accounting standards and provide both short-term and long-term information regarding the State's overall financial position through the fiscal year end. The statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The government-wide financial statements include the following two statements:

  - **The Statement of Net Assets** Shown on page 37, the Statement of Net Assets presents all of the State's assets and liabilities and calculates net assets. Increases or decreases in the State's net assets over time may serve as a useful indicator as to whether or not the State's overall financial position is improving or deteriorating.

  - **The Statement of Activities** Shown on pages 38 and 39, the Statement of Activities presents how the State's net assets changed during Fiscal Year 2003. All changes in net assets are reported when the underlying event occurs giving rise to the change, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods. This statement also presents a comparison between direct expenses and program revenues for each State function.

  Both the Statement of Net Assets and the Statement of Activities have separate sections that report three activities:

    - **Governmental Activities** The majority of State service functions fall into this category, which includes Executive, Legislative, and Judicial Branch operations. Governmental activity functions rely heavily on State taxes and federal grant receipts for funding their respective programs and functions.

    - **Business-type Activities** Certain State operations that are legislatively able to charge fees to external users to recover all or a portion of the cost of the services that are provided are classified as business-type activities. The State Lottery Fund and the Unemployment Compensation Fund are two such examples.

    - **Component Units** Legally separate operations and organizations for which the State has financial accountability are considered component units. The State has 22 authorities, of which the New Jersey Building Authority, the Garden State Preservation Trust, and the New Jersey Transportation Trust Fund Authority are blended into governmental activities, and 12 colleges and universities that are reported as component units. These component units operate as business-type activities and are presented in two categories, major and non-major which is determined, generally, by the relative size of the entity's assets, liabilities, revenues, and expenses when compared to the total of the related component units. A list of the State's component units is shown in Notes 1B – Significant Accounting Policies – Financial Reporting Entity and Note 18 – Component Units in the Notes to the Financial Statements. Audit reports of the individual component units can be obtained from their respective administrative offices.

The Comprehensive Annual Financial Report includes two schedules (shown on pages 42 and 46) that reconcile the amounts reported on the governmental fund financial statements (modified accrual basis of accounting) with government-wide financial statements (accrual basis of accounting). The following summarizes the financial reporting impact of transitioning from a modified accrual basis of accounting to a full accrual basis of accounting:

- Capital assets used in governmental activities are not reported on governmental fund financial statements.

- Certain tax revenues that are not earned, but are available, are reported as revenue on the governmental fund financial statements, but are classified as deferred revenue on the government-wide financial statements.

- Any liability relating to funding certain pension trust funds below the amount required (net pension obligation) is recorded only in the government-wide financial statements.

- Deferred issue costs are capitalized and amortized in the government-wide financial statement, but are reported as expenditures in the governmental fund financial statements.

- Except for the current portion of long-term debt which is reported in the fund financial statements, long-term liabilities, such as capital lease obligations, compensated absences, bonds and notes payable, and others appear as liabilities in the government-wide financial statements only.

- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures on the governmental fund statements.

- Bond and note proceeds result in liabilities on the government-wide financial statements, but are recorded as other financing sources on the governmental fund financial statements.

- Interest expense on long-term debt is recorded in the government-wide financial statements in the period when incurred. In the governmental fund financial statements, interest expense on long-term debt is recorded in the period it is paid.

- Certain other outflows represent either increases or decreases in liabilities on the government-wide financial statements, but are reported as expenditures on the governmental fund financial statements.

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide financial statements and fund financial statements. The notes can be found on pages 62 to 103 of this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003.

- **Fund Financial Statements**

  Fund financial statements begin on page 40. A fund is a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations. The State's fund financial statements reflect financial reporting practices in accordance with this definition. The State entity is divided between funds and component units, with State's funds divided into three categories – governmental, proprietary, and fiduciary.

- **Governmental Funds Financial Statements** Most Direct State Services are financed through governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. The governmental funds financial statements focus on current inflows and outflows of expendable resources and the unexpended balances at the end of a fiscal year that are available for future spending. Governmental fund information helps determine whether or not there was an addition or a reduction in financial resources that can be spent in the near future to finance State programs.

  The State's governmental funds are the General Fund, Debt Service Fund, Special Revenue Funds, and Capital Projects Funds. These funds are reported using the modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- **Proprietary Funds Financial Statements** Proprietary funds are used to account for State business-type activities. Since these funds charge fees to external users, they are known as enterprise funds. Proprietary funds provide the same information as government-wide financial statements and use the accrual basis of accounting.

- **Fiduciary Funds Financial Statements** Fiduciary funds, which include State pension fund systems, are used to account for resources held by the State for the benefit of parties outside of State government. Fiduciary funds are reported using the accrual basis of accounting, in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets as shown on pages 52 to 55. Government-wide financial statements exclude fiduciary fund activity and balances since the assets are legislatively restricted in purpose and do not represent discretionary assets the State can use to fund its operations.

- **Component Units** The government-wide financial statements present information for the component units in a single column of the Statement of Net Assets. The Combining Statement of Net Assets and Changes in Net Assets and the Combining Statement of Cash Flows provides detail for each major component unit and the non-major component units in the aggregate.

- **Notes to the Financial Statements**
  Beginning on page 62, the Notes to the Financial Statements provide additional background information that assist the reader in understanding the data provided in the government-wide financial statements and fund financial statements.

- **Required Supplementary Information**
  The basic financial statements are followed by a section of required supplementary information. This section includes budgetary schedules that reconcile the statutory intent of the program with fund balances in accordance with generally accepted accounting principles at fiscal year's end as well as variances between the final budget and actual results on a budgetary basis. Also there is a Schedule of Funding Progress for all Pension Trust Funds.

- **Other Information**
  Combining financial statements for non-major governmental funds, proprietary funds, fiduciary funds, and non-major component units are shown in this section. They are not reported individually, as with major funds, on the Governmental Fund Financial Statements. The Schedule of Appropriations and Expenditures, shown in this section details the comparison of expenditures at the legal level of control to the final budget. The Schedule of Anticipated Revenue and the Schedule of Appropriated Revenue provide detailed information on major and miscellaneous taxes, fees and other revenues. The Schedule of Anticipated Revenue provides further analysis by showing dollar and percentage variances of actual collections as compared to the original budget certification.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Net Assets

The State's fiscal year ended combined net assets totaled $3.2 billion. Fiscal Year 2003 activities showed a $337.9 million increase in combined net assets, with net assets of governmental activities increasing by $1.0 billion, and business-type activities decreasing by $695.1 million.

**Net Assets**
**For Fiscal Year Ending June 30**
**(Expressed In Millions)**

| | Governmental Activities | | Business-type Activities | | Total Primary Government | |
|---|---|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** | **2003** | **2002** |
| Current and other noncurrent assets | $ 11,081.8 | $ 8,693.9 | $ 3,761.5 | $ 4,632.5 | $ 14,843.3 | $ 13,326.4 |
| Capital assets, net | 12,960.8 | 12,259.8 | - | - | 12,960.80 | 12,259.8 |
| **Total Assets** | 24,042.6 | 20,953.7 | 3,761.5 | 4,632.5 | 27,804.1 | 25,586.2 |
| Current liabilities | 4,221.6 | 3,806.3 | 501.8 | 606.1 | 4,723.4 | 4,412.4 |
| Noncurrent liabilities | 18,821.4 | 17,184.4 | 1,039.9 | 1,111.5 | 19,861.30 | 18,295.9 |
| **Total Liabilities** | 23,043.0 | 20,990.7 | 1,541.7 | 1,717.6 | 24,584.7 | 22,708.3 |
| Net Assets: | | | | | | |
| Invested in capital assets, net of related debt | 4,907.4 | 4,781.8 | - | - | 4,907.4 | 4,781.8 |
| Restricted | 4,017.0 | 3,453.5 | 2,219.8 | 2,974.6 | 6,236.8 | 6,428.1 |
| Unrestricted | (7,924.9) | (8,272.3) | - | (59.7) | (7,924.9) | (8,332.0) |
| **Total Net Assets** | $ 999.5 | $ (37.0) | $ 2,219.8 | $ 2,914.9 | $ 3,219.3 | $ 2,877.9 |

Invested in capital assets, net of related debt is the largest component of the State's net assets. Capital assets, net of depreciation are used by the State to provide services to citizens; consequently these assets are not available for future spending. Land, land improvements, buildings and improvements, machinery and equipment, infrastructure (roads, bridges and other immovable assets), and construction in progress are shown less any related debt used to acquire these assets that is still outstanding.

### Changes in Net Assets

The State's Fiscal Year 2003 net assets increased by $337.9 million. This amount is a result of the State's decision to sell 100.0 percent of the Tobacco Settlement Receipts. Approximately 45.5 percent of the State's total revenue came from general taxes, while 23.7 percent was derived from operating grants. Charges for services amounted to 20.3 percent of total revenues, while other items such as governmental subsidies and grants, capital grants, interest and investment earnings, and miscellaneous revenues accounted for the remainder. State expenditures cover a range of services. The largest expense, 25.4 percent was for educational, cultural, and intellectual development. Physical and mental health amounted to 22.1 percent of total expenditures, while government direction, management, and control amounted to

13.5 percent. Other major expenditures focused on economic planning, development, and security, public safety and criminal justice, and community development and environmental management. During Fiscal Year 2003, governmental activity expenses exceeded program revenues, resulting in the use of $23.4 billion of general revenues (mostly taxes). Net expenses from business-type activities in Fiscal Year 2003 were lower than revenues by $21.8 million.

The deficit in unrestricted governmental net assets arose primarily as a result of deferring certain tax revenues that were received during Fiscal Year 2003 but not earned until a future time period, recording depreciation expense related to the capital assets, and recording certain liabilities that are required to be included in the government-wide financial statements.

## Statement of Activities
## For Fiscal Year Ending June 30
## (Expressed In Millions)

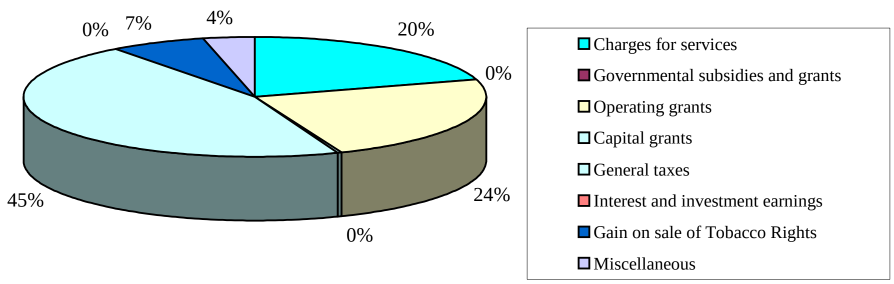
| | Governmental Activities | | Business-type Activities | | Primary Government Total | |
|---|---|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** | **2003** | **2002** |
| **Revenues** | | | | | | |
| Program revenues | | | | | | |
| Charges for services | $ 3,900.7 | $ 3,052.3 | $ 4,706.4 | $ 4,032.0 | $ 8,607.1 | $ 7,084.3 |
| Operating grants | 9,138.9 | 9,233.0 | 897.8 | 847.9 | 10,036.7 | 10,080.9 |
| Capital grants | 30.6 | 23.8 | - | - | 30.6 | 23.8 |
| General revenues | | | | | | |
| General taxes | 19,297.6 | 18,049.8 | - | - | 19,297.6 | 18,049.8 |
| Governmental subsidies and grants | - | - | - | 246.8 | - | 246.8 |
| Interest and investment earnings | 61.1 | 42.8 | - | - | 61.1 | 42.8 |
| Miscellaneous | 1,587.4 | 1,565.2 | - | - | 1,587.4 | 1,565.2 |
| **Total Revenues** | 34,016.3 | 31,966.9 | 5,604.2 | 5,126.7 | 39,620.5 | 37,093.6 |
| **Expenses** | | | | | | |
| Public safety and criminal justice | 2,504.5 | 2,485.0 | - | - | 2,504.5 | 2,485.0 |
| Physical and mental health | 9,305.6 | 8,952.4 | - | - | 9,305.6 | 8,952.4 |
| Educational, cultural, and intellectual development | 10,686.3 | 10,117.8 | - | - | 10,686.3 | 10,117.8 |
| Community development and environmental management | 1,959.0 | 2,207.6 | - | - | 1,959.0 | 2,207.6 |
| Economic planning, development, and security | 4,050.2 | 3,577.1 | - | - | 4,050.2 | 3,577.1 |
| Transportation programs | 1,561.1 | 1,541.6 | - | - | 1,561.1 | 1,541.6 |
| Government direction, management, and control | 5,694.5 | 4,954.9 | - | - | 5,694.5 | 4,954.9 |
| Special government services | 236.3 | 227.2 | - | - | 236.3 | 227.2 |
| Interest expense | 460.0 | 427.1 | - | - | 460.0 | 427.1 |
| State Lottery Fund | - | - | 1,339.0 | 1,304.7 | 1,339.0 | 1,304.7 |
| Unemployment Compensation Fund | - | - | 2,876.3 | 2,497.1 | 2,876.3 | 2,497.1 |
| Other | - | - | 1,367.1 | 1,217.5 | 1,367.1 | 1,217.5 |
| **Total Expenses** | 36,457.5 | 34,490.7 | 5,582.4 | 5,019.3 | 42,039.9 | 39,510.0 |
| Excess (Deficiency) Before Contributions and Transfers | (2,441.2) | (2,523.8) | 21.8 | 107.4 | (2,419.4) | (2,416.4) |
| Transfers | 716.9 | 725.3 | (716.9) | (725.3) | - | - |
| Gain on Sale of Tobacco Rights | 2,757.3 | - | - | - | 2,757.3 | - |
| **Increase (Decrease) In Net Assets** | 1,033.0 | (1,798.5) | (695.1) | (617.9) | 337.9 | (2,416.4) |
| **Net Assets - July 1, 2002** | (33.4) * | 1,761.5 | 2,914.9 | 3,532.8 | 2,881.5 | 5,294.3 |
| **Net Assets - June 30, 2003** | $ 999.6 | $ (37.0) | $ 2,219.8 | $ 2,914.9 | $ 3,219.4 | $ 2,877.9 |

* Net Assets have been restated to reflect a change in accounting classification

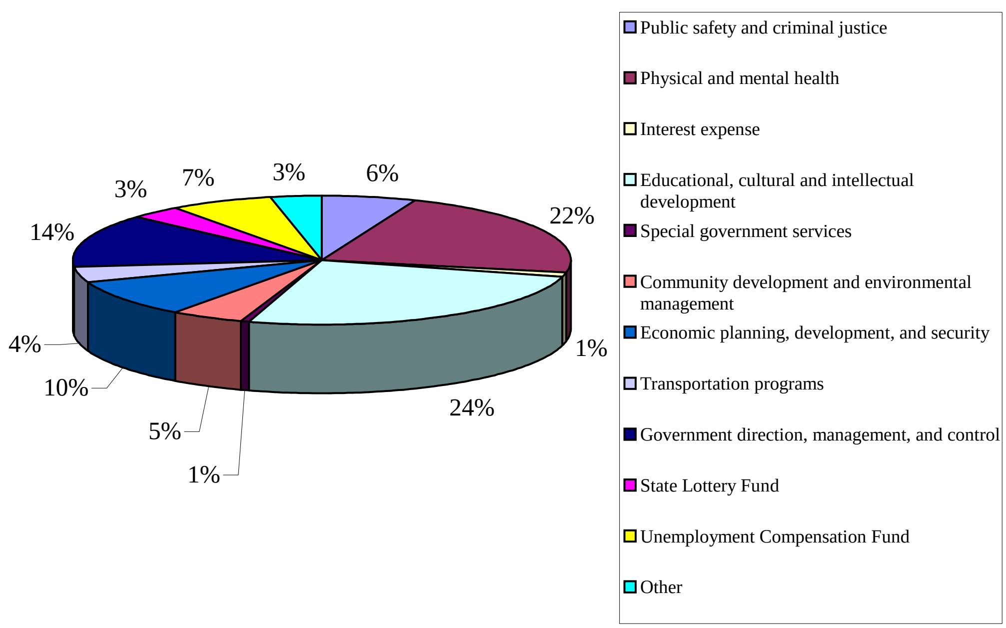
## Governmental Activities – Revenues and Expenditures

The following pie charts depict governmental activities for revenues and expenditures for the fiscal year ended June 30, 2003:

**Revenues – Governmental Activities**
**Fiscal Year Ended June 30, 2003**




**Expenditures – Governmental Activities**
**Fiscal Year Ended June 30, 2003**




Effective January 1, 2002, the State's Corporation Business Tax was restructured to wipe out a myriad of loopholes and tax shelters, restore simplicity, and provided a lower tax rate for small businesses. An alternative minimum assessment was based on corporate sales or gross profits at the payor's option. The minimum assessment was also applied to out-of-state companies that have significant economic presence in New Jersey but currently pay no New Jersey corporate taxes. Loopholes in the Corporation Business Tax are now closed that allowed larger corporations to shelter income and pay only the minimum $200.00 to the State.

In addition, during Fiscal Year 2003, the State established the Tobacco Settlement Financing Corporation, Inc. (TSFC) as a special purpose, local development corporation. The TSFC is an instrumentality of, but separate and apart from, the State of New Jersey. A board consisting of the State Commissioner of Health and Senior Services, the State Treasurer, and one public member appointed by the Governor governs the TSFC. Pursuant to a Purchase and Sale Agreement with the State, the State sold to the TSFC all of its future right, title and interest in the Tobacco Settlement Revenues under the Master Settlement Agreement and the Decree of Final Judgment. The Master Settlement Agreement resolved cigarette smoking related claims, in exchange for certain payments to be made to the settling states, as well as certain tobacco advertising and marketing restrictions, among other things. As of June 30, 2003 the TSFC has issued approximately $3.46 billion of Tobacco Settlement Asset-Backed Bonds in two separate tranches. For Fiscal Year 2003, the State's General Fund received $1.557 billion of bond proceeds and other settlement payments, and another $1.612 billion of bond proceeds and other settlement payments is estimated for Fiscal Year 2004. The remaining funds were used to make a deposit to the Debt Service Reserve Account, pay certain costs of issuance on the bonds, fund capitalized interest, and make a deposit to the Operating Account.

Other significant, Fiscal Year 2003 tax changes included a 70.0 cents per pack increase in the Cigarette Tax.

**Fiscal Year 2004 Revenue**

The State's Fiscal Year 2004 Budget imposes a new, graduated, supplemental fee on realty transfers. The fee is payable to the county in which the deed is recorded. The Realty Transfer Fee does not affect transfers by senior citizens, blind persons, disabled persons, and other transfer of property that is legally defined as low and moderate housing. A portion of the fee is retained by the county to support public health services with the remainder remitted to the State Treasurer for deposit to the State's Extraordinary Aid Account within the General Fund.

The Fiscal Year 2004 Budget inaugurates the State's Hotel/Motel Occupancy Tax. Effective August 1, 2003, the State imposes a 7.0 percent fee. For Fiscal Year 2005 and thereafter, a 5.0 percent fee will be imposed. The legislation establishing the Hotel/Motel Occupancy Tax designates special rate provisions for those municipalities that already impose local taxes or fees on hotel/motel occupancies. In Atlantic City, where there is currently a combined rate of sales and luxury taxes of 12.0 percent, the occupancy rate is 1.0 percent. In the Wildwood area, where there is a combined rate of sales and local taxes of 9.85 percent, the occupancy fee is 3.15 percent. In Newark and Jersey City, where a 6.0 percent local hotel tax is currently collected in addition to the 6.0 percent sales tax, the occupancy fee is 1.0 percent. The Hotel/Motel Occupancy Tax also authorizes all other municipalities to adopt an ordinance to impose a local tax of up to 1.0 percent. The earliest effective date for the local tax is September 1, 2003. For Fiscal Year 2005 and thereafter, the local tax may be imposed at a rate of up to 3.0 percent. The State Hotel/Motel Occupancy Tax is allocated in the following manner; $16.0 million for the New Jersey State Council on the Arts, $2.7 million for the New Jersey Historical Commission, $9.0 million for the New Jersey Commerce and Economic Growth Commission, and $0.5 million for the New Jersey Cultural Trust. The local tax is collected and distributed to the municipality in which the tax is levied.

Effective July 1, 2003, the State's Fiscal Year 2004 Budget imposes a tax on casino licensees on the value of rooms, food, beverages, and entertainment that are given away for free or at a reduced price as a "complimentary." This tax is imposed at a rate of 4.25 percent on those items provided for free. For those complimentary items that are provided at a reduced price, the 4.25 percent tax is calculated on the value of the room, food, beverage or entertainment, reduced by any consideration paid by the customer. Payable by the casino licensees, this tax is in addition to any amount due under the Sales and Use Tax Act on receipts from the sale of food, beverages, room occupancies and entertainment. Other areas impacted in Atlantic City are a casino hotel parking fee which increased to $3.00 from $2.00, a $3.00 per day fee on each hotel room occupied by a guest in a casino hotel, an 8.0 percent gross revenue tax on companies that administer and service multi-progressive casino slot machine systems, and a 7.5 percent tax on the adjusted net income of casino licensees. These newly enacted casino taxes and fees are deposited into the State's Casino Revenue Fund. Appropriations from this fund must be used for reductions in property taxes, utility charges, and other expenses of eligible senior citizens and disabled residents.

In addition, the State's Fiscal Year 2004 Budget increases the Cigarette Tax by 55.0 cents per pack, bringing the total levy to $2.05 per pack of 20 cigarettes. This incremental portion of the Cigarette Tax is statutorily dedicated for health programs each year.

As with the Fiscal Year 2003 Budget, there were no significant, structural changes being made to the State's two other major taxes, the Gross Income Tax and the Sales and Use Tax.

**Business-type Activities**

For the fiscal year ended June 30, 2003, net assets of business-type activities totaled $2.2 billion, a $695.1 million decrease over the prior fiscal year. The major factor contributing to this decrease was an increase in claims and a decrease in revenues in the Unemployment Compensation Fund and excess claims in the Health Benefits Local Employers Program Fund.

## FINANCIAL ANALYSIS OF THE STATE'S MAJOR FUNDS

The focus of the State's major governmental funds reported in the fund financial statements is on near term inflows, outflows, and balance of expendable resources, which are essential elements in assessing the State's financing needs and serve as useful measures of the government's net resources available for future spending.

The State's governmental funds reported June 30, 2003 fund balances of $7.7 billion. Of this amount, $310.8 million, or 4.0 percent constituted unreserved fund balances.

**General Fund**

The General Fund is the State's chief operating fund and is the fund into which all State revenues, not otherwise restricted by statute, are deposited. The General Fund's fiscal year ending fund balance totaled $2.3 billion, of which, $1.2 billion represented unreserved fund balances. During Fiscal Year 2003, total fund balance increased by $323.0 million primarily as a result of the State selling all of its future rights in Tobacco Settlement Receipts. By the end of Fiscal Year 2003, net General Fund revenues increased 11.9 percent from the prior fiscal year.

- **General Fund Highlights**
  Lower State revenues reflected New Jersey's economic performance. During Fiscal Year 2003, the State's original budget was adjusted in order to reflect lower revenue collections. The following summarizes major variances between the final budget and the actual amounts (on a budgetary basis):

  - General revenues of $23.3 billion were $2.8 billion lower than the final certifications. Positive variances of $770.4 million from taxes and other revenue were offset by reductions in federal and other grants of $3.2 billion, service and assessments of $252.4 million, and licenses and fees of $102.6 million.

  - Total expenditures were $3.1 billion lower than original appropriations set forth in the budget enacted during June 2002 plus supplemental appropriations during the fiscal year. This amount includes $1.1 billion from physical and mental health, $464.1 million from economic planning, development and security, $442.4 million from community development and environmental management, $388.8 million from public safety and criminal justice, and $303.1 million from government direction, management, and control. Lesser reductions of $240.0 million came from educational, cultural, and intellectual development, $93.4 million came from special government services, and $48.7 million came from transportation programs.

- The Surplus Revenue Fund is an account within the State's General Fund. It is used to account for excess revenues from prior fiscal years that is legislatively reserved for 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. During Fiscal Year 2002, the State released $720.0 million to the General Fund in order to offset lower revenue collections. The Surplus Revenue Fund's undesignated fund balance as of June 30, 2003 is $0.0 million.

**Property Tax Relief Fund**

The Property Tax Relief Fund accounts for revenues from the New Jersey Gross Income Tax. Appropriations from this fund must be used exclusively for the constitutional purpose of reducing or offsetting property taxes.

- **Property Tax Relief Fund Highlights**
  During Fiscal Year 2003, $7.2 billion of property tax relief expenditures were made. The Property Tax Relief Fund's Fiscal Year 2003 ending undesignated fund balance is $0.0 million.

The following table presents a fund balance comparison of the components of the State's ending undesignated fund balance for Fiscal Year 2003 and Fiscal Year 2002:

**Fund Balance Comparison**
**(Expressed In Millions)**

| Fund | Fiscal Year 2003 | Fiscal Year 2002 | Amount |
|---|---|---|---|
| General Fund | $ 373.0 | $ 292.3 | $ 80.7 |
| Surplus Revenue Fund | - | - | - |
| Debt Avoidance and Retirement Fund | - | - | - |
| Property Tax Relief Fund | - | - | - |
| Casino Control Fund | 4.3 | - | 4.3 |
| Casino Revenue Fund | - | - | - |
| **Total** | $ 377.3 | $ 292.3 | $ 85.0 |

The State's governmental funds reported June 30, 2003 fund balances of $7.7 billion. Of this amount, $5.0 billion, or 64.9 percent constituted unreserved fund balances.

**State Lottery Fund**

Monies derived from the sale of State lottery tickets are deposited into this fund. Disbursements are authorized for the payment of prizes to holders of winning lottery tickets and for the administrative expenses of the Division of State Lottery. Available fund balances are transferred to the State's General Fund in support of the amounts annually appropriated for State institutions and for education. The present value of obligations for future installment payments of lottery prizes, which are funded by the purchase of deposit fund contracts, are accounted for in this fund.

In Fiscal Year 2003, gross revenues totaled $2.1 billion, of which 55.4 percent was returned in prizes, 36.2 percent went to State education and institutions, 7.9 percent was paid to sales agents and ticket vendors, and 1.1 percent covered Lottery operational and promotional expenses. As of June 30, 2003, the State Lottery, since its inception, has generated over $32.5 billion in gross revenues, $16.6 billion in prizes, and contributed $13.2 billion to the State.

**Unemployment Compensation Fund**

The Unemployment Compensation Fund accounts for monies deposited from employers and employees contributions for unemployment compensation, amounts credited or advances made by the Federal Government, and amounts received from any other source. After consideration is given to any claim for refund of overpayment of contributions, the Division of Employment Security transfers the remainder to the Treasurer of the United States for credit to the State of New Jersey Unemployment Compensation Fund.

**Component Units**

Combined operating revenues and expenses for the State's component units for Fiscal Year 2003 amounted to $7.6 billion and $10.2 billion respectively. Total operations along with other financing sources and uses contributed to total combined net assets at fiscal year end of $8.8 billion.

The component units received $1.0 billion in State appropriations during Fiscal Year 2003.

## CAPITAL ASSET AND DEBT ADMINISTRATION

Administration of the State's capital assets falls under the purview of the Department of the Treasury. Capital assets are recorded under the State's General Fixed Asset System in the New Jersey Office of Management and Budget. The New Jersey Office of Public Finance is responsible for issuing the State's short-term and long-term debt obligations as well as overseeing the State's credit ratings.

Capital Assets are shown in the table below. The State's investment in capital assets, net of accumulated depreciation, totaled $13.0 billion as of June 30, 2003. Depreciation charges for Fiscal Year 2003 totaled $409.5 million.

More detailed information about the State's capital assets is presented in Note 6 – Capital Assets, in the Notes to the Financial Statements.

**Capital Assets (Net of Depreciation)**
**As of June 30**
**(Expressed In Millions)**

| | Total Primary Government | |
|---|---|---|
| | **2003** | **2002** |
| Land | $ 579.5 | $ 530.1 |
| Land Improvements | 24.9 | 27.4 |
| Buildings and Improvements | 1,390.9 | 1,423.3 |
| Equipment | 95.1 | 93.1 |
| Infrastructure | 10,681.3 | 10,019.0 |
| **Sub-Total** | 12,771.7 | 12,092.9 |
| Construction-In-Progress | 189.1 | 166.9 |
| **Total** | $ 12,960.8 | $ 12,259.8 |

**Fiscal Year 2004 Capital Plan**

The State's school construction program is one of the largest capital plans in the country. The Educational Facilities Act established a comprehensive program for the design, renovation, repair and new construction of primary and secondary schools for all local and regional school districts, county special services school districts, county vocational school districts and state-operated school districts, in order to provide the funding mechanism to fulfill the State's constitutional obligation to ensure safe and adequate educational facilities in pubic school districts throughout the State. Under the Educational Facilities Act, the New Jersey School Construction Corporation, a subsidiary of the New Jersey Economic Development Authority, is directed to construct and finance school facilities projects for three categories of school districts: (1) Abbott Districts, (2) districts which are directed by the Commissioner of Education to enter “level II monitoring” upon a finding that they have failed to show sufficient progress toward achieving a certain “thorough and efficient” standard, and (3) districts with a “district aid percentage” equal or greater than 55.0 percent. Any district not described above may elect to have the New Jersey School Construction Corporation undertake the construction of its school facilities project, or may instead elect to do so itself. The Educational Facilities Act currently provides that the aggregate principal amount of bonds, notes or other obligations issued by the New Jersey Economic Development Authority shall not exceed: $100.0 million for the State share of costs for county vocational school district school facilities projects, $6.0 billion for the State share of costs for Abbott District school facilities projects, and $2.5 billion for the State share of costs for school facilities projects in all other districts. As of June 30, 2003 the New Jersey Economic Development Authority has issued $1.1 billion of School Construction Bonds, with school facility project obligations and expenditures as follows:

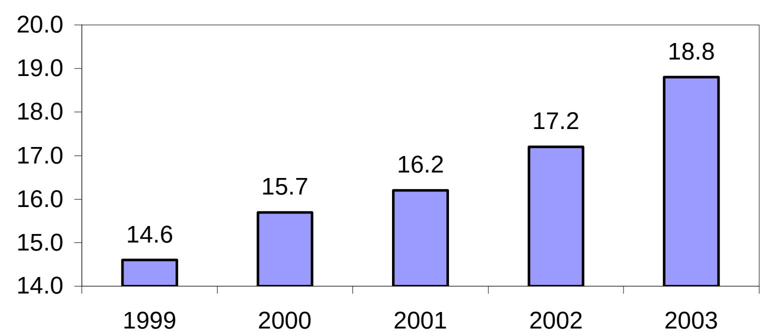
| School Facility Project | Obligations | Expenditures |
| --- | --- | --- |
| Abbott Districts | $ 1,148,086,759 | $ 500,446,831 |
| Non-Abbott Districts | 1,113,846,462 | 320,495,273 |
| Vocation School Districts | 52,026,648 | 17,089,133 |
| General Program Costs | 369,537,358 | 78,571,177 |
| **Total** | $ 2,683,497,227 | $ 916,602,414 |

Exclusive of the State’s school construction program, the State’s Fiscal Year 2004 capital budget authorizes spending of $1.6 billion. Of that amount, the New Jersey Transportation Trust Fund Authority’s spending authorization totals $1.2 billion, with $610.0 million reserved for Department of Transportation projects and $618.2 million reserved for New Jersey Transit projects. The Garden State Preservation Trust is another program funded in the State’s Fiscal Year 2004 Capital Plan. In 1998, voters approved a constitutional amendment that provided $98.0 million in annual funding for the acquisition and development of lands for recreation and conservation purposes, for the preservation of farmland, and for historic preservation. Funding for the Garden State Preservation Trust is expected to continue through Fiscal Year 2009. Other major capital funding includes 4.0 percent constitutional dedication of the State’s Corporation Business Tax to fund hazardous discharge cleanup, underground storage tank improvements, and surface water quality projects.

**Debt Administration**

As of June 30, 2003, New Jersey’s outstanding long-term debt totaled $18.8 billion. This amount represents a $1.6 billion increase over the prior fiscal year. In addition the State has $10.8 billion of legislatively authorized bonding capacity that has not yet been issued. The authorized bonding capacity was decreased by $2.9 billion during Fiscal Year 2003. The State’s long-term debt for the past five fiscal years is shown below:

**Long-Term Debt**
**Fiscal Year 1999 to Fiscal Year 2003**
**(Expressed in Billions)**



The State's long-term debt can be broken into bonded and non-bonded categories. Bonded categories include General Obligation Bonds, Revenue Bonds, Installment Obligations, Certificates of Participation, Unamortized Premium, and Unamortized Deferral on Refunding. Non-bonded categories include Capital Leases, Loans Payable, Accumulated Sick and Vacation Payable, Net Pension Obligation, and Other. A description of each category is as follows:

- **General Obligation Bonds** The State is empowered by voters to authorize, issue, and incur debt subject to certain constitutional restrictions. General obligation bond acts are both legislatively and voter-approved and are backed by the State's full faith and credit. Examples of capital projects financed by State General Obligation Bonds include correctional facilities, psychiatric institutions, dams, reservoirs, and transportation projects. As of June 30, 2003 the State had $3.3 billion of State General Obligation Bonds outstanding with another $757.4 million of bonding authorization remaining from various State General Obligation Bond Acts.

- **Revenue Bonds** This debt classification represents bond issuances whose segment of debt service is derived solely from legally restricted revenues. Revenue bonds include debt issued by the New Jersey Building Authority for the purpose of erecting office structures to support State operations, the Garden State Preservation Trust for the purpose of acquiring land to preserve for open space, and the New Jersey Transportation Trust Fund Authority for the purpose of constructing various transportation and transit related projects. As of June 30, 2003 the State had $6.2 billion of Revenue Bonds outstanding with another $2.4 billion of bonding authorization remaining for funding for Garden State Preservation Trust and New Jersey Transportation Trust Fund Authority programs.

- **Installment Obligations** This debt classification represents obligations whose debt service is subject to and dependent upon the State Legislature making future appropriations from time to time. Installment obligations include debt issued to help fund the State's school construction program, and fund colleges and universities for the installation of dormitory fire suppression equipment. The State's Installment Obligation Bonds outstanding as of June 30, 2003 total $6.3 billion. Total authorized but unissued Installment Obligation Bonds equal $7.6 billion as of June 30, 2003.

- **Certificates of Participation** Certificates of Participation are debt issuances used primarily to finance State equipment needs under the State's master lease program. Currently, the State uses a line of credit as its preferred financing method for equipment. The State's Certificates of Participation outstanding as of June 30, 2003 equal $81.7 million.

- **Unamortized Premium (Net)** During Fiscal Year 2003, unamortized premium totaled $365.2 million, a $171.2 million increase from the prior fiscal year's end. This increase is mainly attributed to the State issuing $1.6 billion of refunding bonds in five distinct transactions. GASB Statement No. 34 requires the premium to be deferred and amortized over the life of the refunding bonds.

- **Unamortized Deferral on Refunding** Unamortized Deferral on Refunding shows the actual gain or loss on refunding transactions under GASB Statement No. 23. Gains are shown as an asset and amortized over the shorter of the life of the refunding bonds or the bonds that were refunded. As of June 30, 2003 the State has issued seven refunding bonds to be amortized over 25.9 years. GASB Statement No. 23 defines a gain/loss as the total outstanding amount of the old bonds minus the new refunding bonds issued minus the cost of issuance on the new refunding bonds. The refunding bonds, applicable to GASB Statement No. 23 interpretation, have a total loss of $211.9 million.

- **Capital Leases** Capital Leases represent long-term contractual obligations that the State has entered into for the purpose of utilizing office space for State operations and program usage. Total Capital Leases outstanding as of June 30, 2003 equal $542.7 million.

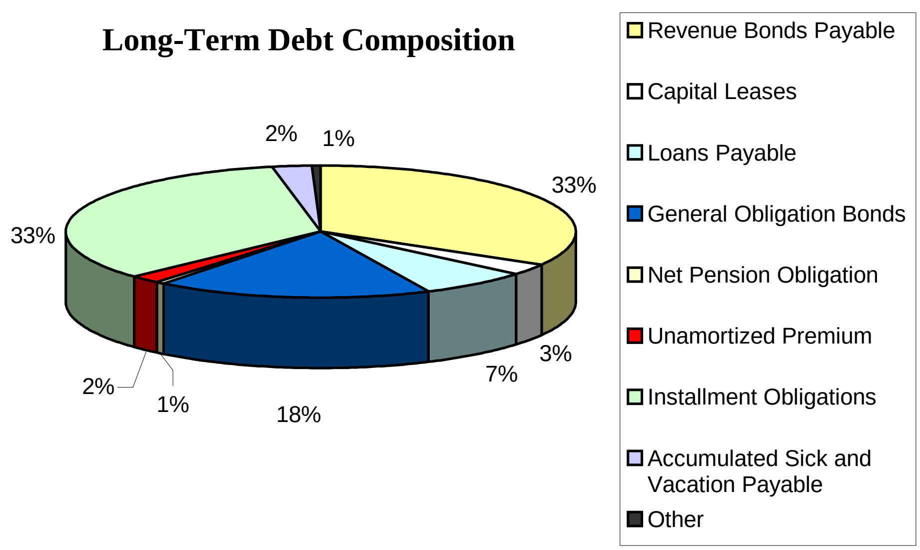
- **Loans Payable** Loans Payable represent amounts received by the New Jersey Automobile Insurance Guaranty Fund, from the New Jersey Property-Liability Insurance Guaranty Association (PLIGA). The loans were made in an effort to depopulate the New Jersey Automobile Insurance Guaranty Fund and to help satisfy its unfunded liability. PLIGA loans of $1.3 billion remain outstanding as of June 30, 2003.

- **Accumulated Sick and Vacation** Pursuant to GASB Statement No. 16, Accounting for Compensated Balances, Accumulated Sick and Vacation payable represents the liability due to employees for unused sick and vacation time as of June 30, 2003. This amount totals $449.9 million.

- **Net Pension Obligation** Net Pension Obligation represents the $115.0 million pension fund liability due to the State Police Retirement System and the Consolidated Police and Firemen's Retirement System as of June 30, 2003. Financial reporting requirements for net pension fund obligations fall under the purview of GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers.

- **Other** Other includes obligations required to be reported as long-term indebtedness in accordance with the National Council on Governmental Accounting (NCGA) Statement No. 1. These obligations include health ($107.0 million), dental ($3.3 million), and medicaid benefit claims ($221.7 million of which $105.3 million is federally reimbursable), which have been incurred but not reported.

The following pie chart shows the percentage of each long-term debt category for Fiscal Year 2003:




Note: Unamortized Deferral on Refunding has been merged with Other for presentation purposes.

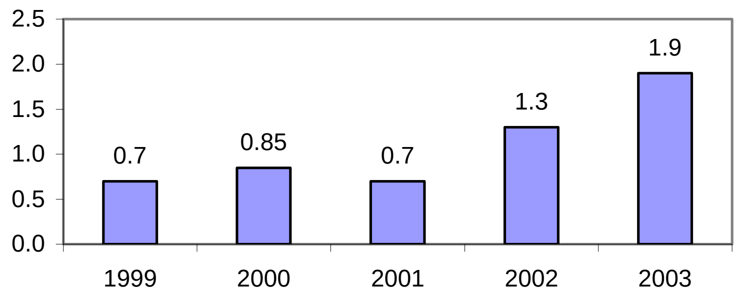
More detailed information about the State's long-term obligations and its debt limitations is presented in Note 9 – Long-term Obligations in the Notes to the Financial Statements.

**Short-term Debt**

The State's short-term note program provides effective cash flow management of imbalances that occur in the timing between collections and disbursements of State revenues and appropriations during the fiscal year. The State Treasurer is authorized to issue short-term debt instruments without it constituting a general obligation of the State, or a debt, or a liability within the meaning of the State Constitution. All short-term notes must be retired within twelve months of their issuance date. During Fiscal Year 2003, the State issued and retired $1.9 billion in short-term notes.

The following chart details the amount of short-term borrowings the State has issued and retired since 1999:

**Short-Term Debt**
**Fiscal Year 1999 to Fiscal Year 2003**
**(Expressed in Billions)**




More detailed information about the State's short-term debt program is presented in Note 8 – Short-term Debt, in the Notes to the Financial Statements.

**Credit Ratings**

Standard & Poor's Corporation, Moody's Investors Service, and Fitch Investors Service rate the State's debt. As of June 30, 2003, the State's short-term and long-term credit rating are as follows:

| Rating Agency | Short-Term | Long-Term |
|---|---|---|
| Standard & Poor's Corporation | SP-1+ | AA |
| Moody's Investors Service | MIG 1 | Aa2 |
| Fitch Investors Service | F1+ | AA |

## ECONOMIC CONDITION AND OUTLOOK

New Jersey has been experiencing an economic slowdown similar to the rest of the nation due to the economic recession that began in March 2001. Although economic activity has remained sluggish in Calendar Year 2003, signs of improving economic conditions are emerging. In July 2003, the National Bureau of Economic Research's (NBER) Business-Cycle Dating Committee announced that the eight-month long recession ended in November 2001.

New Jersey's employment increased by 0.5 percent in October 2003 over a year ago adding 2,300 more jobs compared to September and continuing the positive year-to-year growth trend for the seventh consecutive month since April 2003. Overall, the State added over 29,000 jobs between January and October of this calendar year. Payroll employment for 2003 is growing at 0.3% through October.

However, the State continues to suffer from job losses in manufacturing and downsizing in the telecommunications industry. Most of the job losses in New Jersey, between January and October 2003, were concentrated in Trade, Transportation and Utilities and Information (-5,900) and Manufacturing (-7,400). The latter has been declining for more than a decade and fell by 2.4 percent on a year-to-year basis in October 2003. New Jersey's employment level remained consistently above 4.01 million for the last seven months since April 2003.

The United States' Department of Commerce's Bureau of Economic Analysis preliminary report released on October 23, 2003 shows that during the second quarter of Calendar Year 2003, New Jersey's growth rate for personal income improved 3.0 percent over the revised growth rate of 2.3 percent during first quarter of Calendar Year 2003. The third quarter Calendar Year 2003 Gross National Product was just revised upward and may indicate a potential for an upward trend in the personal income growth numbers for New Jersey as well. Despite labor market conditions, low inflation in the neighborhood of 2.0 percent continues to benefit New Jersey consumers and businesses. In addition, low interest rates continue to support spending on housing and other consumer durables in the state.

The State and the nation may experience further near-term slow growth and the expected recovery may stall into early Calendar Year 2004 if consumers, investors, and businesses become more concerned about geopolitical conditions. The future direction of economic recovery nationally and in New Jersey to a large extent hinges on the assumptions of no further terrorist attacks, supportive monetary and fiscal stimulus and no further turmoil in the financial markets. However, the fundamentals of the State's economic health remain stable and the long run prospects for economic growth of the State in Calendar Year 2004 and beyond are favorable.

New Jersey State Government has undertaken several budgetary initiatives to address revenue pressures facing the State while the economic recovery becomes self-sustaining and stable. These initiatives include implementing a new Hotel/Motel Occupancy Tax, increasing the tax rate on Realty Transfers and on Cigarettes. Other initiatives include taxing "complimentary" rooms in Atlantic City.

## REQUEST FOR INFORMATION

This Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003 is designed to provide a general overview of the State of New Jersey's finances to our citizens, taxpayers, customers, investors, and creditors and to demonstrate the State's accountability for the money it receives and the stewardship over its resources. Requests concerning any of the data presented in this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003 or for additional information should be addressed to the State of New Jersey, Office of Management and Budget, P.O. Box 221, 33 West State Street, 6th Floor, Trenton, New Jersey, 08625. Copies of this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003, the State Budget, and the Appropriations Handbook are also available at the following website: www.state.nj.us/treasury/omb.