

DEPARTMENT OF  
THE TREASURY

Bradley I. Abelow  
*State Treasurer*

DIVISION OF PENSIONS  
AND BENEFITS

Frederick J. Beaver  
*Director*



State of New Jersey  
DIVISION OF PENSIONS AND BENEFITS  
PO Box 295 • Trenton, NJ 08625-0295

TEACHERS' PENSION  
AND ANNUITY FUND  
OF NEW JERSEY

BOARD OF TRUSTEES  
as of June 30, 2005

JAMES CLEMENTE  
*Chairperson*

FREDERICK J. BEAVER  
*State Treasurer's Representative*

GRACE HAISLIP

JOHN KEELER

MARIE FLYNN

KATHLEEN COATES  
*Secretary*

MILLIMAN  
*Actuaries and Consultants*

MEDICAL BOARD

David Jenkins, M.D.  
William E. Ryan, M.D.

TO THE HONORABLE  
JON S. CORZINE  
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor Corzine:

The Board of Trustees of the

TEACHERS' PENSION AND ANNUITY FUND

is pleased to present the Fiscal Year 2005 Annual Report in accordance with the provisions of N.J.S.A. 18A:66-59.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Clemente".

JAMES CLEMENTE  
Chairperson

**Teachers' Pension and Annuity Fund**  
**BOARD OF TRUSTEES**



James Clemente  
*Chairperson*  
*Teacher Representative*



John Keeler  
*Elected by Board*



Grace Haislip  
*Teacher Representative*



Marie Flynn  
*Gubernatorial*  
*Appointee*



Frederick J. Beaver  
*State Treasurer's*  
*Representative*



Susanne Culliton  
*Deputy Attorney General*  
*Legal Adviser*



Kathleen Coates  
*Board Secretary*



Gail Griffin  
*Support Staff*

## **SIGNIFICANT LEGISLATION**

### **CHAPTER 177, P.L. 2004**

This law concerns the retirement allowance of Teachers' Pension and Annuity Fund (TPAF) and Public Employees' Retirement System (PERS) veteran members who retire after having attained age 55, and who have at least 35 years of service credit. It provides that the retirement allowance shall be based on the 12-month period of membership providing the largest possible benefit to the member or the member's beneficiary instead of the last year of employment upon which contributions to the annuity savings fund or contingent reserve fund are made.

This law was effective December 22, 2004.

### **CHAPTER 64, P.L. 2005**

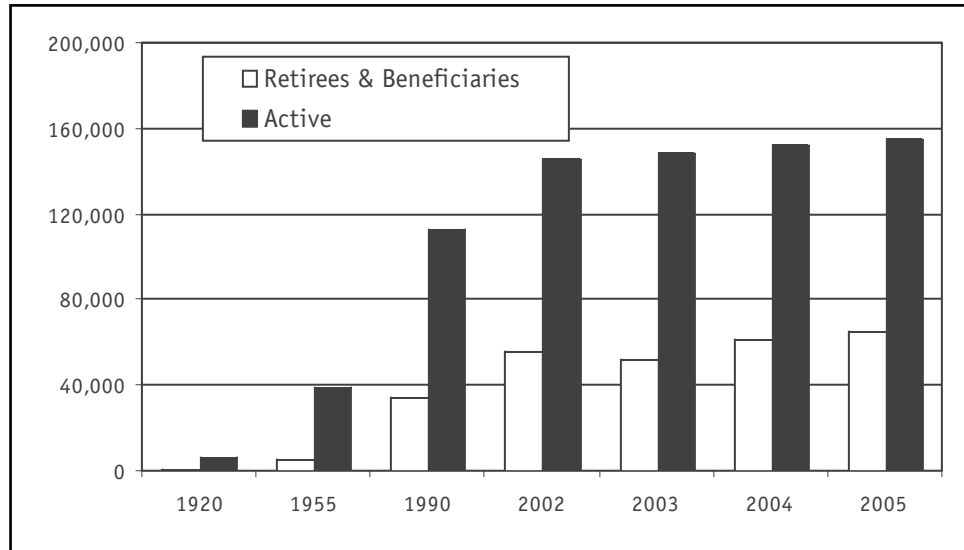
This law amends several statutes to define members of Operations Northern Watch and Southern Watch as veterans for the purposes of civil service hiring preferences, the purchase of service credit and the calculation of veterans benefits in the Public Employees' Retirement System (PERS) and Teachers' Pension and Annuity Fund (TPAF), the purchase of service credit in the Police and Firemen's Retirement System (PFRS), and the receipt of a property tax deduction or exemption.

Operation Northern Watch and Operation Southern Watch are the names given to the missions that monitored and controlled airspace above and below the 33rd parallel in Iraq, otherwise known as "no-fly zones."

The pension-related sections of this law are effective immediately (April 7, 2005).

## MEMBERSHIP

- As of June 30, 2005, the active membership of the Fund totaled 154,854. This includes 398 State employees and 154,456 employees from 101 participating local employers. There were 14,201 inactive members in the Fund as of June 30, 2005.
- There were 65,401 retirees and beneficiaries receiving annual pensions totaling \$1,998,447,461. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act).*
- Beneficiaries of 122 active and 1,742 retired members received lump sum death benefits in the amount of \$62,786,215.
- The Fund's assets totaled \$35,080,115,665 at the close of the fiscal year 2005.



## MEMBERSHIP ACTIVITY

During fiscal year 2005, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Teachers' Pension and Annuity Fund of New Jersey.

- **ENROLLMENTS** - 5,845 new members were enrolled during fiscal year 2005.
- **LOANS** - 16,695 loans were issued to members. The total loans receivable as of June 30, 2005 is \$212,373,895.
- **WITHDRAWALS** - there were 1,805 withdrawals during fiscal year 2005.
- **RETIREMENT** - 4,858 members retired under the following retirement types:

<u>TYPE OF RETIREMENT</u>		<u>OPTION SELECTION</u>	
Service	1,907	Maximum	2,084
Early	569	Option 1	267
Ordinary Disability	165	Option 2	85
Accidental Disability	7	Option 3	57
Veteran	176	Option 4	15
Deferred	185	Option A	582
Over 55 - Early	1,849	Option B	341
<u>TOTAL</u>	<u>4,858</u>	Option C	961
		Option D	466
		Other	0
		<u>TOTAL</u>	<u>4,858</u>

KPMG LLP  
New Jersey Headquarters  
150 John F. Kennedy Parkway  
Short Hills, NJ 07078

### Independent Auditors' Report

The Board of Trustees  
State of New Jersey  
Teachers' Pension and Annuity Fund:

We have audited the accompanying statement of fiduciary net assets of the State of New Jersey Teachers' Pension and Annuity Fund (the Fund) as of June 30, 2005, and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Teachers' Pension and Annuity Fund as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis and the supplementary information included in the schedule of funding progress and schedule of employer contributions are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted 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 made for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. The schedule of changes in fiduciary net assets by fund is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Fund. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

**KPMG LLP**

December 14, 2005

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Management's Discussion and Analysis  
June 30, 2005

Our discussion and analysis of the Teachers' Pension and Annuity Fund (the Fund) financial performance provides an overview of the Fund's financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

**FINANCIAL HIGHLIGHTS**

2005 - 2004

- Net assets held in trust for pension and post-retirement medical benefits increased by \$912,081,506 as a result of fiscal year 2005's operations from \$28,720,150,030 to \$29,632,231,536.
- Additions for the year were \$3,511,148,496, which are comprised of member and employer pension contributions of \$1,039,584,783 and investment income of \$2,471,563,713.
- Deductions for the year were \$2,599,066,990, which are comprised of benefit and refund payments of \$2,585,010,451 and administrative expenses of \$14,056,539.

**THE STATEMENT OF FIDUCIARY NET ASSETS AND THE STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS**

This annual report consists of two financial statements: *The Statement of Fiduciary Net Assets* and *The Statement of Changes in Fiduciary Net Assets*. These financial statements report information about the Fund and about its activities to help you assess whether the Fund, as a whole, has improved or declined as a result of the year's activities. The financial statements were prepared using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the period they are earned, and expenses are recorded in the year they are incurred, regardless of when cash is received or paid.

*The Statement of Fiduciary Net Assets* show the balances in all of the assets and liabilities of the Fund at the end of the fiscal year. The difference between assets and liabilities represents the Fund's fiduciary net assets. Over time, increases or decreases in the Fund's fiduciary net assets provide one indication of whether the financial health of the Fund is improving or declining. *The Statement of Changes in Fiduciary Net Assets* show the results of financial operations for the year. The statements provide an explanation for the change in the Fund's fiduciary net assets since the prior year. These two financial statements should be reviewed along with the information contained in the financial statement footnotes, including the required supplementary schedules, to determine whether the Fund is becoming financially stronger or weaker.

**FINANCIAL ANALYSIS**

**STATEMENT OF FIDUCIARY NET ASSETS**

2005 - 2004

	2005	2004	Increase (Decrease)
Assets	\$35,080,115,665	\$33,696,406,755	\$1,383,708,910
Liabilities	5,447,884,129	4,976,256,725	471,627,404
Net Assets	\$29,632,231,536	\$28,720,150,030	\$912,081,506

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Management's Discussion and Analysis, Continued

The Fund's assets mainly consist of cash, securities lending collateral, investments, and contributions due from members and participating employers. Between fiscal years 2004 and 2005, total assets increased by \$1.4 billion or 4.1%. The total assets increased mainly due to increase in contributions receivable from members, based on increase in membership and elimination of a reduction in the employee contribution rate (returning to the normal rate of 5% from 3%), effective January 1, 2004.

Employer contributions receivables decreased partly due to Chapter 42, P.L. 2002, which permitted local government units to issue refunding bonds to retire an unfunded accrued liability resulting from early retirement benefits. In fiscal year 2005, employer contributions receivables are including State appropriation based on Chapter 23, P.L. 2002 (early retirement incentive benefits to State employees) and appropriation due from local employers, based on Chapter 128 and 129 (early retirement incentive benefits to local employees).

Liabilities consist of pension and death benefit payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the Fund's insurance provider, securities lending collateral and rebates payable, and other payables. Total liabilities increased by \$471.6 million or 9.5% over last year. This is mainly due to increase in benefits payable to retirees and beneficiaries, partly related to the State Early Retirement Incentive (Chapter 23, P.L. 2002).

Net assets held in trust for pension and post-retirement medical benefits increased by \$912.1 million or 3.2%.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS

2005-2004

	2005	2004	Increase (Decrease)
Member Contributions	\$488,861,870	\$405,695,555	\$83,166,315
Employer Contributions	550,722,913	456,411,646	94,311,267
Investment	2,471,563,713	3,652,597,813	(1,181,034,100)
<b>Totals</b>	<b>\$3,511,148,496</b>	<b>\$4,514,705,014</b>	<b>\$(1,003,556,518)</b>

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$83.2 million or 20.5% due to increase in active member count and the contribution rate of 5% back from 3%, effective January 1, 2004.

Employer contributions increased by \$94.3 million or 20.7% over last year. The State made a contribution of \$494.7 million for fiscal year 2005 post-retirement medical (PRM). Also, employer contributions are including State appropriation based on Chapter 23, P.L. 2002 and appropriation due from local employers, based on Chapter 128 and 129, P.L. 2003.

For fiscal year 2005, the 50% of available excess valuation assets could be utilized to offset normal contributions. Thereafter, a certain percentage of available excess valuation assets may be used as specified in the legislation. The State was not required to make a normal contribution to the Fund between 1997 and 2005 based on Pension Security legislation passed in 1997.

Investment & other revenues decreased by \$1.2 billion or 32.3% due to decrease in net appreciation in fair value of investments.

The total investment gain for all pension funds was estimated to be 8.7% compared to 14.2% gain in the prior year.



**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Management's Discussion and Analysis, Continued

DEDUCTIONS FROM FIDUCIARY NET ASSETS  
2005 - 2004

	2005	2004	Increase (Decrease)
Benefits	\$2,555,774,692	\$2,306,188,800	\$249,585,892
Refunds & Adjustments	29,235,759	28,737,720	498,039
Administrative Expenses	14,056,539	8,788,960	5,267,579
<b>Totals</b>	<b>\$2,599,066,990</b>	<b>\$2,343,715,480</b>	<b>\$255,351,510</b>

Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the Fund. Benefit payments increased by \$249.6 million or 10.8% partly due to increase in number of retirees. The number of refunds processed has increased by 1.7% due to increase in member transfer-out. Administrative expenses increased by \$5.3 million or 59.9% mainly due to the reimbursement to the State General Fund for the Special Project Fund Appropriation for the system reengineering project.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 85.6% for fiscal year 2005 and 92.7% for 2004 indicate that the Fund has sufficient assets to meet its benefit obligations.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

The financial report is designed to provide our members, beneficiaries, investors and other interested parties with a general overview of the Fund's finances and to show the Fund's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Division of Pensions and Benefits, P.O. Box 295, Trenton, NJ 08625-0295.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Statement of Fiduciary Net Assets

June 30, 2005

	<b>PENSION FUND</b>	<b>POST-RETIREMENT MEDICAL FUND</b>	<b>TOTAL</b>
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Assets:</b>			
Securities lending collateral	\$ 5,263,308,403	—	5,263,308,403
Investments, at fair value:			
Cash Management Fund	612,691,720	9,828	612,701,548
Bonds	49,564,719	1,052	49,565,771
Common Pension Fund A	14,850,768,277	315,250	14,851,083,527
Common Pension Fund B	7,911,361,668	167,941	7,911,529,609
Common Pension Fund D	5,748,588,068	122,030	5,748,710,098
Mortgage Backed Securities	132,630,891	2,816	132,633,707
Total investments	<u>29,305,605,343</u>	<u>618,917</u>	<u>29,306,224,260</u>
Receivables:			
Contributions:			
Members	75,120,796	—	75,120,796
Employers	57,211,970	—	57,211,970
Accrued interest and dividends	164,448,049	—	164,448,049
Members' loans	212,373,895	—	212,373,895
Other	1,428,292	—	1,428,292
Total receivables	<u>510,583,002</u>	<u>—</u>	<u>510,583,002</u>
Total assets	<u>35,079,496,748</u>	<u>618,917</u>	<u>35,080,115,665</u>
<b>Liabilities:</b>			
Accounts payable and accrued expenses	10,144,262	—	10,144,262
Retirement benefits payable	170,914,458	—	170,914,458
NCGI premiums payable	1,651,560	—	1,651,560
Cash overdraft	1,865,446	—	1,865,446
Securities lending collateral and rebates payable	5,263,308,403	—	5,263,308,403
Total liabilities	<u>5,447,884,129</u>	<u>—</u>	<u>5,447,884,129</u>
<b>Net Assets:</b>			
Held in trust for pension benefits	<u>\$ 29,631,612,619</u>	<u>618,917</u>	<u>29,632,231,536</u>

See schedule of funding progress on pages 25-26.  
See accompanying notes to financial statements.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2005

	<b>PENSION FUND</b>	<b>POST-RETIREMENT MEDICAL FUND</b>	<b>TOTAL</b>
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Additions:</b>			
Contributions:			
Members	\$ 488,861,870	—	488,861,870
Employers	56,025,944	494,695,969	550,721,913
Other	1,000	—	1,000
	<u>544,888,814</u>	<u>494,695,969</u>	<u>1,039,584,783</u>
Total contributions			
Investment income:			
Net appreciation in fair value of investments	1,569,513,311	36,897	1,569,550,208
Interest	600,320,556	—	600,320,556
Dividends	304,071,768	—	304,071,768
	<u>2,473,905,635</u>	<u>36,897</u>	<u>2,473,942,532</u>
Less: investment expense	<u>2,378,819</u>	<u>—</u>	<u>2,378,819</u>
Net investment income	<u>2,471,526,816</u>	<u>36,897</u>	<u>2,471,563,713</u>
Total additions	<u>3,016,415,630</u>	<u>494,732,866</u>	<u>3,511,148,496</u>
<b>Deductions:</b>			
Benefits	2,061,234,677	494,540,015	2,555,774,692
Refunds of contributions	29,235,759	—	29,235,759
Administrative expenses	14,056,539	—	14,056,539
	<u>2,104,526,975</u>	<u>494,540,015</u>	<u>2,599,066,990</u>
Total deductions			
Change in net assets	911,888,655	192,851	912,081,506
Net assets - Beginning of year	<u>28,719,723,964</u>	<u>426,066</u>	<u>28,720,150,030</u>
Net assets - End of year	<u>\$ 29,631,612,619</u>	<u>618,917</u>	<u>29,632,231,536</u>

See accompanying notes to financial statements.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2005

**(1) DESCRIPTION OF THE FUND**

The State of New Jersey Teachers' Pension and Annuity Fund (the Fund; TPAF) is a cost-sharing contributory defined benefit plan with a special funding situation which was established as of January 1, 1955, under the provisions of N.J.S.A. 18A:66. The Fund is included along with other state-administered pension trust and agency funds in the basic financial statements of the State of New Jersey.

The Fund's designated purpose is to provide retirement benefits, death, disability and medical benefits to certain qualified members. Membership in the Fund is mandatory for substantially all teachers or members of the professional staff certified by the State Board of Examiners, and employees of the Department of Education who have titles that are unclassified, professional and certified. The Fund's Board of Trustees is primarily responsible for the administration of the Fund.

According to the State of New Jersey Administrative Code, all obligations of the Fund will be assumed by the State of New Jersey should the Fund terminate.

***Vesting and Benefit Provisions:***

The vesting and benefit provisions are set by N.J.S.A. 18A:66. The Fund provides retirement, death and disability benefits, as well as medical benefits for certain qualified members. All benefits vest after ten years of service, except for medical benefits, which vest after 25 years of service or under the disability provisions of the Fund. Retirement benefits for age and service are available at age 60 and are generally determined to be 1/55 of final average salary for each year of service credit (as defined). Final average salary equals the average salary for the final three years of service prior to retirement (or highest three years' compensation if other than the final three years). Members may seek early retirement after achieving 25 years service credit, as defined, or they may elect deferred retirement after achieving ten years of service credit, in which case benefits would begin the first day of the month after the member attains normal retirement age.

Members are always fully vested for their own contributions and, after three years of service credit, become vested for 2% of related interest earned on the contributions. In the case of death before retirement, members' beneficiaries are entitled to full interest credited to the members' accounts.

Eligible retirees receiving monthly benefits are entitled to cost-of-living increases equal to 60% of the change in the average consumer price index for the calendar year in which the pensioner retired as compared to the average consumer price index for a 12-month period ending with each August 31st immediately preceding the year in which the adjustment becomes payable. The regular retirement allowance is multiplied by the 60% factor as developed and results in a dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits (COLA) after 24 months of retirement.

Chapter 23, P.L. 2002 provided early retirement incentive benefits to State employees who meet specified age and service requirements and who retire within a specified time period that generally extends from February 1, 2002 to July 1, 2002. The incentive benefits include an additional three years of service credit to employees who are at least 50 years of age with at least 25 years of service credit; State paid health care benefits to employees who are at least 60 years of age with at least 20 but less than 25 years of service credit; and an additional monthly benefit of \$500 per month for 24 months following the date of retirement to employees who are at least 60 years of age with at least 10 but not more than 20 years of service credit. For those eligible for veterans' retirement benefit, the incentive is an additional pension of 3/55 of the compensation upon which the retirement benefit is based to employees who are at least 55 years of age with 25 or more years of service credit. Similarly, Chapter 128 and 129, P.L. 2003 provided early retirement incentive benefits to local employees.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

Chapter 353, P.L. 2001 provided an increase in the special veterans' retirement allowance and the ordinary and accidental disability retirement allowances. The special veterans retirement allowance increased from 50% to 54.5% of the members' compensation during the highest-paid year of service. The minimum ordinary disability retirement allowance increased from 40% to 43.6% of final average compensation, and the accidental disability retirement allowance increased from 66.66% to 72.7% of the actual annual compensation at the time of the accident. Existing retirees and beneficiaries are eligible for the increases, which was effective October 2001.

Chapter 133, P.L. 2001 increased the retirement benefits under service, deferred, and early retirement by changing the formula from 1/60 to 1/55 of final compensation for each year of service. This legislation also increased the retirement benefit for veteran members with 35 or more years of service and reduced the age qualification from 60 to 55. Existing retirees and beneficiaries received a comparable percentage increase in their retirement allowances. This benefit enhancement was effective with the November 1, 2001 benefit payments.

***Significant Legislation:***

P.L. 2003, effective July 14, 2003, provided employees of local employers with additional retirement benefits through early retirement incentive programs: Chapter 128 for a county college and Chapter 129 for a local school board. They also permitted issuance of refunding bonds to fund benefits. Any employee who was eligible, or could have been if the employer elected, to participate in the State early retirement incentive program offered in 2002 pursuant to Chapter 23, P.L. 2002, is not eligible for the early retirement incentive benefits under this law.

***Membership and Contributing Employers:***

Membership in the Fund consisted of the following at June 30, 2004, the date of the most recent actuarial valuation:

	<b>PENSION BENEFITS</b>	<b>POST-RETIREMENT MEDICAL BENEFITS</b>
Retirees and beneficiaries receiving benefits currently and terminated employees entitled to benefits but not yet receiving them	<u>62,918</u>	<u>45,209</u>
Active members:		
Vested	76,328	28,774
Non-vested	<u>72,769</u>	<u>120,323</u>
Total active members	<u>149,097</u>	<u>149,097</u>
Total	<u><u>212,015</u></u>	<u><u>194,306</u></u>
Contributing Employers	102	1

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

**(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Measurement Focus and Basis of Accounting:***

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Fund is accounted for using an economic resources measurement focus. The Fund that focuses on total economic resources employs the accrual basis of accounting, which recognizes increases and decreases in economic resources as soon as the underlying event or transaction occurs.

The accrual basis of accounting is used for measuring financial position and changes in fiduciary net assets of the Fund. Under this method, revenues are recorded in the accounting period in which they are earned, and deductions are recorded at the time the liabilities are incurred. The financial statements of the Fund conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans" and No. 26, "Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans." Employer contributions are recognized when payable to the Fund. Benefits and refunds are recognized when payable in accordance with the terms of the Fund.

***Adoption of Accounting Standard:***

Effective July 1, 2004, the Division adopted Statement No. 40 of the Governmental Accounting Standards Board (GASB), "Deposit and Investment Risk Disclosures", an amendment of GASB Statement No. 3.

***Valuation of Investments:***

Investments are reported at fair value as follows:

- U.S. Government and Agency, Foreign and Corporate obligations – prices quoted by a major dealer in such securities.
- Common Stock and Equity Funds, Foreign Equity Securities, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.
- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund – closing bid price on the last day of trading during the period as determined by the Transfer Agent.

***Investment Transactions:***

Investment transactions are accounted for on a trade date basis. Gains and losses from investment transactions are determined by the average cost method. Interest and dividend income is recorded on the accrual basis, with dividends accruing on the ex-dividend date.

***Unit Transactions:***

The net asset values of Common Funds A, B and D (Common Funds) are determined as of the close of the last day of business of each month. Purchases and redemptions of participants' units are transacted each month within fifteen days subsequent to that time and at such net asset value.

Dividends and interest earned per unit are calculated monthly and distributed quarterly for Common Fund A and B. Dividends and interest earned per unit are calculated monthly for Common D, and the income earned on Common Fund D units is reinvested.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

***Securities Lending:***

Common Funds A, B and D and several of the direct pension plan portfolios participate in securities lending programs with their custodian banks, whereby securities are loaned to brokers and, in return, the pension funds have rights to the collateral received. All of the securities held in Common Funds A, B and D are eligible for the securities lending program. Collateral received may consist of cash, letters of credit, or government securities having a market value equal to or exceeding 102% (U.S. dollar denominated) or 105% (non-U.S. dollar denominated) of the value of the loaned securities at the time the loan is made. For Common Funds A and B, in the event that the market value of the collateral falls below 101% of the market value of all the outstanding loaned securities, additional collateral shall be transferred by the borrower to the respective funds no later than the close of the next business day so that the market value of such additional collateral, when added to the market value of the other collateral, shall equal 102% of the market value of the loaned securities. For Common Fund D, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% of the market value of the outstanding loaned securities, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. As of June 30, 2005, the Common Funds have no aggregate credit risk exposure to brokers because the collateral amount held by the Common Funds exceeded the market value of the securities on loan.

The contracts with the Common Funds' custodian banks require them to indemnify the Common Funds if the brokers fail to return the securities or fail to pay the Common Funds for income distributions by the securities' issuers while the securities are on loan. The securities loans can be terminated by notification by either the broker or the Common Funds. The term to maturity of the securities loans is generally matched with the term to maturity of the investment of the cash collateral.

***Derivatives:***

The Common Funds' international managers utilize forward foreign currency contracts, a derivative security, as a means to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in market prices or currency rates will cause the value of a financial instrument to decrease or become more costly to settle.

Forward foreign currency contracts are agreements to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed upon price. Forward foreign currency contracts are used to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios.

The fair value of foreign forward currency contracts outstanding as of June 30, 2005 is as follows:

	<u>Amount</u>
Forward currency receivable	\$ 745,577,063
Forward currency payable	745,525,163
Net unrealized gain	(51,900)

The net unrealized gain is included in investments at June 30, 2005.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

The Common Funds utilize covered call options in an effort to add value to the portfolio (collect premiums). Covered call options are agreements that give the owner of the option the right, but not obligation, to buy a specific amount of an asset from the Common Funds for a specific price (called the strike price) on or before a specified expiration date. As the writer of financial options, the Common Funds receive a premium at the outset of the agreement and bear the risk of an unfavorable change in the price of the instrument underlying the option. The Common Funds have written call options on 215,400 shares with a fair value of \$548,100 at June 30, 2005 which are reflected as a contra-asset to the fair value of the portfolio.

***Members' Loans:***

Members who have at least three years of service in the Fund may borrow up to 50% of their accumulated member contributions. Repayment of loan balances is deducted from payroll checks and bears an interest rate of 4%. Members who retire with an outstanding loan have the option of paying the loan in full prior to receiving any benefits or continuing their monthly loan payment schedule into retirement.

Under the Internal Revenue Service regulations effective January 1, 2004, the Division changed its pension loan repayment policy: Members who take multiple loans must repay the outstanding balance of the original loan, and all subsequent loans taken before the original loan is completely paid off, within a period not to exceed 5 years from the issuance of the first loan taken after January 1, 2004. Failure to repay the loan within the five-year period will result in the unpaid balance being declared a taxable distribution.

***Administrative Expenses:***

The Fund is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the Fund to the State of New Jersey, Department of the Treasury, and are included in the accompanying statement of changes in fiduciary net assets.

**(3) INVESTMENTS**

The Fund is invested in Common Pension Fund A, Common Pension Fund B, Common Pension Fund D, and other investments, including mortgage backed securities, which represent 41.75%, 45.22%, 42.00%, and 10.61%, respectively, of each investment total of the pension funds.

The pension funds investments as of June 30, 2005 are as follows:

	<b>Amount</b>
Domestic equities	\$ 34,782,276,119
International equities	11,232,483,997
Domestic fixed income	16,521,446,786
International fixed income	2,201,826,936
Domestic floating rate securities	77,922,181
Police and Firemen's mortgages	896,706,544
Net forward foreign exchange contracts	51,900
	\$ 65,712,714,463

New Jersey state statute provides for a State Investment Council (Council) and a Director. Investment authority is vested in the Director of the Division and the role of the Council is to formulate investment policies. The Council issues regulations which establish guidelines for permissible investments which include domestic and international equities, obligations of the U.S. Treasury, government agencies, corporations, finance companies and banks, international government and agency obligations, Canadian obligations, New Jersey State and Municipal general obligations, public authority revenue obligations, collateralized notes and mortgages, commercial paper, certificates of deposit, repurchase agreements, bankers acceptances, guaranteed income contracts and money market funds.



**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

The pension funds investments are subject to various risks. Among these risks are credit risk, concentration of credit risk, interest rate risk and foreign currency risk. Each one of these risks is discussed in more detail below.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally recognized statistical rating agencies such as Moody's Investors Service, Inc. (Moody's) or Standard & Poor's Corporation (S&P). Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. There are no restrictions in the amount that can be invested in United States treasury and government agency obligations. Council regulations require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue as follows:

<u>Category</u>	<u>Minimum Rating</u>		<u>Limitation of Issuer's Outstanding Debt</u>	<u>Limitation of Issue</u>	<u>Other Limitations</u>
	<u>Moody's</u>	<u>S&amp;P</u>			
Corporate obligations	Baa	BBB	25%	25%	—
U.S. finance company debt, bank debentures and NJ state & municipal obligations	A	A	10%	10%	—
Canadian obligations	A	A	10%	10%	Purchase cannot exceed \$10 million
International government and agency obligations	Aa	AA	2%	10%	Not more than 1% of fund assets can be invested in any one issuer
Public Authority revenue obligations	A	A	—	10%	Not more than 2% of fund assets can be invested in any one public authority
Collateralized notes and mortgages	Baa	BBB	—	33.3%	Not more than 2% of fund assets can be invested in any one issuer
Commercial paper	P-1	A-1	—	—	—
Certificates of deposit and Banker's acceptances (rating applies to international)	Aa/P-1	—	—	—	Uncollateralized certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital
Guaranteed income contracts	P-1	—	—	—	A+ rating from A.M. Best for insurance companies
Money market funds	—	—	—	—	Not more than 10% of fund assets can be invested in money market funds; limited to 5% of shares or units outstanding

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

For securities exposed to credit risk in the fixed income portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2005:

(000's)	<b>Moody's Rating</b>			
	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>
United States Treasury Notes	\$ 1,813,358	—	—	—
United States Treasury TIPS	598,125	—	—	—
United States Treasury Bonds	2,193,224	—	—	—
United States Treasury Strips	42,326	—	—	—
Title XI Merchant Marine Notes	3,956	—	—	—
Federal Agricultural Mortgage Corp. Notes	—	101,698	—	—
Federal Farm Credit Bank Bonds	102,225	—	—	—
Federal Home Loan Bank Bonds	521,527	—	—	—
Federal Home Loan Bank Discounted Notes	4,244	—	—	—
Federal Home Loan Mortgage Corp. Notes	265,077	26,953	—	—
Federal National Mortgage Association Notes	698,324	26,078	—	—
Resolution Funding Corp. Obligations	7,337	—	—	—
Floating Rate Notes	25,026	19,983	9,999	22,914
Corporate Obligations	645,239	594,643	2,722,186	1,310,398
Real Estate Investment Trust Obligations	—	—	—	99,301
Finance Company Debt	285,528	963,800	757,113	132,094
Supranational Obligations	122,496	—	—	—
International Bonds and Notes	420,419	—	—	—
Foreign Government Obligations	1,293,765	283,284	58,319	—
Remic/FHLMC	638,865	—	—	—
Remic/ FNMA	73,982	—	—	—
Remic/ GNMA	17,993	—	—	—
GNMA Mortgage Backed Certificates	112,091	—	—	—
FHLM Mortgage Backed Certificates	774,802	—	—	—
FNMA Mortgage Backed Certificates	645,810	—	—	—
Asset Backed Obligations	252,973	—	—	—
Private Export Obligations	34,127	—	—	—
Exchange Traded Securities	—	—	56,050	—
	<u>\$ 11,592,839</u>	<u>2,016,439</u>	<u>3,603,667</u>	<u>1,564,707</u>

The table does not include certain investments which do not have a Moody's rating which include foreign government obligations totaling \$18,842,884 with an S&P rating of AAA and convertible zero coupon bonds totaling \$4,701,462 with an S&P rating of BBB. The Police and Firemen's Mortgages and the Cash Management Fund are unrated.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Commercial paper must mature within 270 days. Certificates of deposits and bankers acceptances are limited to a term of one year or less. The maturity of repurchase agreements shall not exceed 15 days. The investment in a guaranteed income contract is limited to a term of 10 years or less.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

The following table summarizes the maturities of the fixed income portfolio at June 30, 2005:

(000's) Fixed Income Investment Type	Total Market Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
United States Treasury Notes	\$ 1,813,358	111,930	795,152	906,276	—
United States Treasury Tips	598,125	—	—	517,312	80,813
United States Treasury Bonds	2,193,224	—	—	—	2,193,224
United States Treasury Strips	42,326	—	—	—	42,326
Title XI Merchant Marine Notes	3,956	—	—	—	3,956
Federal Agricultural Mortgage Corp. Notes	101,698	—	101,698	—	—
Federal Farm Credit Bank Bonds	102,225	49,578	52,647	—	—
Federal Home Loan Bank Bonds	521,527	49,610	471,917	—	—
Federal Home Loan Bank Discounted Notes	4,244	—	—	—	4,244
Federal Home Loan Mortgage Corp. Notes	292,030	—	174,938	117,092	—
Federal National Mortgage Association Notes	724,402	226,752	315,835	26,078	155,737
Resolution Funding Corp. Obligations	7,337	—	—	—	7,337
Floating Rate Notes	77,922	—	67,923	9,999	—
Corporate Obligations	5,272,466	492,077	1,632,208	1,509,472	1,638,709
Real Estate Investment Trust Obligations	99,301	—	19,836	79,465	—
Finance Company Debt	2,138,535	405,222	1,021,737	576,593	134,983
Supranational Obligations	122,496	25,227	—	—	97,269
International Bonds and Notes	420,419	54,846	300,229	19,865	45,479
Foreign Government Obligations	1,654,211	45,065	632,606	567,437	409,103
Remic/FHLMC	638,865	—	9,872	20,959	608,034
Remic/ FNMA	73,982	196	4,734	18,358	50,694
Remic/ GNMA	17,993	—	—	—	17,993
Police and Firemen's Mortgages	896,707	—	—	—	896,707
GNMA Mortgage Backed Certificates	112,091	41	1,479	—	110,571
FHLM Mortgage Backed Certificates	774,802	—	265	4,999	769,538
FNMA Mortgage Backed Certificates	645,810	—	7,343	29,116	609,351
Asset Backed Obligations	252,973	—	153,828	34,509	64,636
Private Export Obligations	34,127	—	12,289	21,838	—
Convertible Zero Coupon Bonds	4,701	—	—	4,701	—
	<u>\$ 19,641,853</u>	<u>1,460,544</u>	<u>5,776,536</u>	<u>4,464,069</u>	<u>7,940,704</u>

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Common Funds invest in global markets. The Common Funds can invest in securities of companies incorporated in one of thirty countries approved by the Council. The market value of international preferred and common stocks and issues convertible into common stocks, when combined with the market value of international government and agency obligations, cannot exceed 22 percent of the market value of forward contracts totaling approximately \$650 million at June 30, 2005. At June 30, 2005, the Common Funds had the following foreign currency exposure (expressed in U.S. dollars):

<u>Currency</u>	<u>Total Market Value</u>	<u>Equities</u>	<u>Foreign Government Obligations</u>
Australian dollar	\$ 401,418,580	272,431,668	128,986,912
Canadian dollar	587,693,580	502,887,128	84,806,452
Danish krone	148,396,127	148,396,127	—
Euro	4,447,969,733	3,646,096,193	801,873,540
Hong Kong dollar	167,808,826	167,808,826	—
Japanese yen	2,218,395,101	2,213,693,639	4,701,462
Mexican peso	40,732,398	40,732,398	—
New Zealand dollar	72,765,425	32,928,859	39,836,566
Norwegian krone	198,279,321	91,284,080	106,995,241
Pound sterling	2,181,964,380	1,957,488,690	224,475,690
Singapore dollar	75,677,979	75,677,979	—
South Korean won	141,633,342	141,633,342	—
Swedish krona	735,391,335	628,135,901	107,255,434
Swiss franc	1,017,523,657	1,017,523,657	—
	<u>\$ 12,435,649,784</u>	<u>10,936,718,487</u>	<u>1,498,931,297</u>

The Cash Management Fund is unrated. The Cash Management Fund is not evidenced by securities that exist in physical or book entry form held by the pension funds.

Net appreciation or depreciation in fair value of investments includes net realized gains and the change in net unrealized gains and losses on investments for the fiscal year ended June 30, 2005. The net realized gain from investment transactions amounted to \$2,729,925,208 and the net increase in unrealized gains on investments amounted to \$935,762,205 for the year ended June 30, 2005.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

**(4) SECURITIES LENDING COLLATERAL**

The Fund's share in the securities lending program is 43.4% of the total market value of the collateral at June 30, 2005.

The securities lending collateral is subject to various risks. Among these risks are credit risk, concentration of credit risk and interest rate risk. Agreements with the lending agents require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue as follows:

<u>Category</u>	<u>Minimum Rating</u>		<u>Limitation of Issuer's Outstanding Debt</u>	<u>Limitation of Issue</u>	<u>Other Limitations</u>
	<u>Moody's</u>	<u>S&amp;P</u>			
Corporate obligations	A3	A-	25%	25%	—
U.S. finance company debt and bank debentures	A2	A	10%	10%	—
Collateralized notes and mortgages	Aaa	AAA	—	33.3%	Limited to not more than 10% of the assets of the collateral portfolio
Commercial paper	P-1	A-1	—	—	—
Certificates of deposit/ Banker's acceptances	Aa3/P-1	—	—	—	Uncollateralized cer- tificates of deposit and banker's ac- ceptances' cannot exceed 10% of issuer's primary capital
Guaranteed income contracts	P-1	—	—	—	Limited to 5% of the assets of the col- lateral portfolio; A+ rating from A.M. Best for insurance companies
Money market funds	—	—	—	—	Limited to 10% of the assets of the collateral portfolio; limited to approved money market funds

Maturities of corporate obligations, U.S. finance company debt, bank debentures, collateralized notes and mortgages and guaranteed income contracts must be less than 25 months. Commercial paper maturities cannot exceed 270 days. Repurchase agreement maturities cannot exceed 15 days. Certificates of deposit and banker's acceptances must mature in one year or less.

The collateral for repurchase agreements is limited to obligations of the U.S. Government or certain U.S. Government agencies.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

Total exposure to any individual issuer is limited, except for U.S. Treasury and Government Agency Obligations. For money market funds, the total amount of shares or units purchased or acquired of any money market fund shall not exceed five percent of the shares or units outstanding of said money market fund. For Collateralized Notes and Mortgages, not more than two percent of the assets of the collateral portfolio shall be invested in the obligations of any one issuer. For Guaranteed Income Contracts, the total investment in any one issuer shall be limited to 2.5% of the collateral portfolio. The Division sets individual issuer limits for Commercial Paper and Certificate of Deposits. For Corporate Obligations, U.S. Finance Company Debt, Bank Debentures and Bankers Acceptances, exposure to any one issuer shall be limited to the following percentages of the collateral portfolio in accordance with the issuer's rating from Moody's: Aaa (4%), Aa (3%) and A (2%).

For securities exposed to credit risk in the collateral portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2005:

(000's)	Moody's Rating				S&P Rating (1)
	Aaa	Aa	A	P-1	A
Corporate Obligations	\$ 440,053	3,748,203	2,052,074	—	—
Commercial Paper	—	—	—	2,373,183	—
Certificates of Deposit	—	1,357,406	—	—	97,900
Repurchase Agreements	—	—	—	—	—
Guaranteed Investment Contracts	—	150,000	200,000	—	—
Money Market Funds	103,815	—	—	—	—
Collateralized Notes	10,000	—	—	—	—
	<u>\$ 553,868</u>	<u>5,255,609</u>	<u>2,252,074</u>	<u>2,373,183</u>	<u>97,900</u>

(1) Moody's rating not available

In addition, the collateral portfolio includes money market funds with a current market value of \$1,074,355 and repurchase agreements with a current market value of \$1,588,984,270 at June 30, 2005 which are not rated.

The following table summarizes the maturities of the collateral portfolio at June 30, 2005:

(000's)	Total Market Value	Maturities	
		Less than one year	One year to 25 months
Corporate Obligations	\$ 6,240,331	4,753,161	1,487,170
Commercial Paper	2,373,183	2,373,183	—
Certificates of Deposit	1,455,306	1,455,306	—
Repurchase Agreements	1,588,984	1,588,984	—
Guaranteed Investment Contracts	350,000	250,000	100,000
Money Market Funds	104,889	104,889	—
Collateralized Notes	10,000	10,000	—
	<u>\$ 12,122,693</u>	<u>10,535,523</u>	<u>1,587,170</u>

As of June 30, 2005, the Common Funds had received cash collateral of \$12,166,888,240 for outstanding loaned investment securities having market values of \$11,780,098,612. In addition, as of June 30, 2005, the Common Funds loaned investment securities having market values of \$38,245,996, against which it had received non-cash collateral with a current value of \$39,118,460, which is not reflected in the accompanying financial statements.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

**(5) CONTRIBUTIONS**

The contribution policy is set by N.J.S.A. 18:66 and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. Members contribute at a uniform rate. In accordance with legislation passed in 2001 (Chapter 133, P.L. 2001), the employee contribution rate was lowered to 3% effective January 1, 2002. Prior to this date, employees had been contributing at a rate of 4.5%. The rate returned to the normal rate of 5% effective January 1, 2004 per statute since there are no longer surplus assets available in the Fund. Employers are required to contribute at an actuarially determined rate. The annual employer contributions include funding for basic retirement allowances, cost-of-living adjustments and noncontributory death benefits. The State of New Jersey's contribution also includes funding for the cost of medical premiums after retirement for qualified retirees. In accordance with Chapter 62, P.L. 1994, post-retirement medical benefits have been funded on a pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial basis. Beginning 1996, the State has made an additional contribution to the Post-Retirement Medical Reserve Fund to ensure an increase in the fund balance of 1/2 of 1% of the salary of active state employees.

For fiscal year 2005, the 50% of available excess valuation assets could be utilized to offset normal contributions. Thereafter, a certain percentage of available excess valuation assets may be used as specified in the legislation. The State was not required to make a normal contribution to the Fund between the years 1997 and 2005. The normal contribution for basic pension benefits, noncontributory death benefits, and cost-of-living adjustments was funded by excess valuation assets in accordance with Chapter 115, P.L. 1997. This legislation provides for actuarially determined excess valuation assets to offset the required normal contributions of the State of New Jersey and the local participating employers.

The State made a contribution of \$494.7 million for fiscal year 2005 post-retirement medical (PRM). Legislation passed in 2002 (Chapter 11, P.L. 2002) allowed the State to use net assets in PRM Fund to cover the required pay-as-you-go medical premiums.

To fund the benefit increases provided by Chapter 133, the legislation provided for the use of excess assets. A special benefit enhancement fund (BEF) was established from which the required normal contributions for the increased benefits will be charged. To fund the accrued liabilities incurred by the Fund, the actuarial value of assets for the valuation period ending June 30, 1999 was adjusted to reflect the full market value of assets.

The BEF will also provide funding for the benefit increases under Chapter 353, P.L. 2001. Actuarially determined excess valuation assets will cover the additional accrued liability incurred by the retirement fund. No additional formula State contribution is required in fiscal year 2005; instead, that contribution will be covered by the BEF.

According to the Appropriation Act of 2003, the State is paying pension obligations through a five-year phase-in. In fiscal year 2005, the State paid 30% of the normal and accrued liability pension cost by using the BEF.

**(6) FUNDS**

This Fund maintains the following legally required funds:

**Members' Annuity Savings and Accumulative Interest Fund (\$6,813,180,653)**

The Members' Annuity Savings Fund is credited with all contributions made by active members of the Fund. Interest earned on member contributions is credited to the Accumulated Interest Fund. The annual rate of interest on member contributions, as required by Chapter 62, P.L. 1994, is 8.75%.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements, Continued

**Contingent Reserve Fund (\$1,312,591,471)**

The Contingent Reserve Fund is credited with the contributions of contributing employers other than post-retirement medical contributions. Interest earnings, after crediting the Accumulative Interest Fund, Retirement Reserve Fund, and Special Reserve Fund, as required, are credited to this account. Additionally, payments for life insurance premiums are made from this Fund.

**Retirement Reserve Fund (\$20,785,937,925)**

The Retirement Reserve Fund is the account from which retirement benefits other than life insurance premiums, contributory group insurance premiums, and post-retirement medical premiums, including cost-of-living benefits and medical benefits for certain retirees, are paid. Upon retirement of a member, accumulated contributions, together with accumulated interest, are transferred to the Retirement Reserve Fund from the Members' Annuity Savings Fund. Any additional reserves needed for the retirement and cost-of-living benefits are transferred from the Contingent Reserve Fund. Annually, interest as determined by the State Treasurer (8.75% for fiscal year 2005) is credited to the Retirement Reserve Fund.

**Special Reserve Fund (\$328,374,407)**

The Special Reserve Fund is the fund to which excess interest earnings and gains from sales and maturities of investments are transferred and against which any losses from the sales of securities are charged. The maximum limit on the accumulation of this account is 1% of the market value of the investments allocated to the Fund, excluding Cash Management Fund investments and bonds allocated to the Contributory Group Insurance Premium Fund which amounted to \$102.39 million as of June 30, 2005. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

**Contributory Group Insurance Premium Fund (\$101,254,877)**

The Contributory Group Insurance Premium Fund represents the accumulation of member group insurance contributions in excess of premiums disbursed to the insurance carrier since the inception of the contributory death benefit program plus reserves held by the insurance carrier. Members are required by statute to participate in the contributory group insurance plan in the first year of membership and may cancel the contributory coverage thereafter. The current contribution rate for active members is 0.4 of 1% of salary, as defined.

**Post-Retirement Medical Fund (\$618,917)**

The Post-Retirement Medical Fund is credited with employer contributions for post-retirement medical benefits, interest earnings on post-retirement medical reserves, and from which post-retirement medical premiums are paid.

**Benefit Enhancement Reserve Fund (\$290,273,286)**

The Benefit Enhancement Reserve Fund is a special reserve fund from which the required normal contributions to provide benefit increases under Chapter 353, P.L. 2001 and Chapter 133, P.L. 2001 will be charged. The fund was established in 2003 and credited with excess assets equivalent to member contributions for fiscal years 2000 and 2001 by transferring reserves in the Contingent Reserve Fund to the Benefit Enhancement Fund. Additional transfers will be made, as required, to maintain a fund balance equal to the present value of expected additional normal contributions due to the increased benefits. The State will be required to make contributions to the Benefit Enhancement Fund on behalf of State and local employers if excess valuation assets are not available.

**(7) INCOME TAX STATUS**

Based on a 1986 declaration of the Attorney General of the State of New Jersey, the Fund is a qualified plan as described in Section 401(a) of the Internal Revenue Code.



**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information

Schedule of Funding Progress

ACTUARIAL VALUATION DATE	ACTUARIAL VALUE OF ASSETS (a)	ACTUARIAL ACCRUED LIABILITY (b)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY (b - a)	FUNDED RATIO (a / b)	COVERED PAYROLL (c)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY AS A PERCENTAGE OF COVERED PAYROLL (b - a) / c
March 31, 1997	\$22,045,481,579	\$21,224,484,588	\$(820,996,991)	103.9%	\$5,771,763,164	(14.2%)
March 31, 1998	24,478,860,383	23,484,403,450	(994,456,933)	104.2%	5,989,748,156	(16.6%)
June 30, 1999	27,457,451,678	25,546,083,289	(1,911,368,389)	107.5%	6,254,198,406	(30.6%)
June 30, 2000	30,203,205,322	27,404,618,051	(2,798,587,271)	110.2%	6,571,641,181	(42.6%)
June 30, 2001	35,351,379,511	32,745,357,185	(2,606,022,326)	108.0%	6,948,381,383	(37.5%)
June 30, 2002	35,148,246,433	35,146,591,842	(1,654,591)	100.0%	7,348,993,141	0.0%
June 30, 2003	34,651,825,932	37,383,732,882	2,731,906,950	92.7%	7,702,854,159	35.5%
June 30, 2004	34,633,790,549	40,447,690,339	5,813,899,790	85.6%	8,047,272,269	72.2%

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information, Continued

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2004 actuarial valuation included the following:

Actuarial cost method	Projected unit credit
Asset valuation method	5 year average of market value
Amortization method	Level percent, closed
Payroll growth rate for amortization	4.00%
Remaining amortization period	30 years
Actuarial assumptions:	
Interest rate	8.25%
Salary range	5.45%
Cost-of-living adjustments	1.80%

Annual covered payroll is an estimate based upon annualizing one quarter's actual payroll.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information, Continued

Schedule of Employer Contributions

<b>YEAR ENDED JUNE 30.</b>	<b>ANNUAL REQUIRED CONTRIBUTION</b>	<b>EMPLOYER CONTRIBUTIONS<sup>(1)</sup></b>	<b>PERCENTAGE CONTRIBUTED</b>
1997	\$372,060,546	\$1,601,688,633 <sup>(2)</sup>	430.5%
1998	297,219,462	—	0.0%
1999	314,671,482	258,816,649	82.2%
2000	368,904,564	—	0.0%
2001	—	—	N/A
2002	—	—	N/A
2003	194,435,594	—	0.0%
2004	686,284,850	—	0.0%
2005	883,460,483	—	0.0%

**Notes to Schedule**

- (1) Excludes post-retirement medical contributions and contributions received from other State of New Jersey retirement systems or funds for certain members who transferred their eligible prior service credit to the Teachers' Pension and Annuity Fund.

In accordance with Chapter 115, P.L. 1997, available excess valuation assets were used to fund, in full or in part, the required employer contributions.

- (2) For the year ended June 30, 1997, the employer contributions exceeded the annual required contributions as a result of legislation that was enacted (Chapter 114, P.L. 1997) authorizing the New Jersey Economic Development Authority to issue bonds, notes or other obligations for the purpose of financing, in full or in part, the State of New Jersey's portion of the unfunded accrued liability under the State of New Jersey retirement systems.

STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2005

	MEMBERS' ANNUITY SAVINGS AND ACCUMULATIVE INTEREST FUND	CONTINGENT RESERVE FUND	RETIREMENT RESERVE FUND	SPECIAL RESERVE FUND	CONTRIBUTORY GROUP INSURANCE PREMIUM FUND	POST- RETIREMENT MEDICAL FUND	BENEFIT ENHANCEMENT FUND	OTHER	TOTAL
<b>Additions:</b>									
Contributions:									
Members	456,016,921	—	—	—	32,844,949	—	—	—	488,861,870
Employers	—	56,025,944	—	—	—	494,695,969	—	—	550,721,913
Other	—	—	—	—	—	—	1,000	—	1,000
Total contributions	456,016,921	56,025,944	—	—	32,844,949	494,695,969	1,000	—	1,039,584,783
Distribution of net investment income	506,563,645	213,695,239	1,679,778,685	45,462,787	2,671,138	36,897	23,355,322	—	2,471,563,713
Total additions	962,580,566	269,721,183	1,679,778,685	45,462,787	35,516,087	494,732,866	23,355,322	1,000	3,511,148,496
<b>Deductions:</b>									
Benefits	—	28,368,723	1,998,447,461	—	34,417,493	494,540,015	—	1,000	2,555,774,692
Refunds of contributions	28,483,474	752,285	—	—	—	—	—	—	29,235,759
Administrative expenses	—	14,056,539	—	—	—	—	—	—	14,056,539
Total deductions	28,483,474	43,177,547	1,998,447,461	—	34,417,493	494,540,015	—	1,000	2,599,066,990
Net increase (decrease) before transfers among reserves	934,097,092	226,543,636	(318,668,776)	45,462,787	1,098,594	192,851	23,355,322	—	912,081,506
Transfers among reserves:									
Retirements	(552,585,308)	(1,359,687,056)	1,912,272,364	—	—	—	—	—	—
Other	1,632,762	288,783,955	(3,527,346)	—	—	—	(286,889,371)	—	—
Net increase (decrease)	383,144,546	(844,359,465)	1,590,076,242	45,462,787	1,098,594	192,851	(263,534,049)	—	912,081,506
Net assets held in trust for pension and post-retirement medical benefits:									
Beginning of year	6,430,036,107	2,156,950,936	19,195,861,683	282,911,620	100,156,283	426,066	553,807,335	—	28,720,150,030
End of year	6,813,180,653	1,312,591,471	20,785,937,925	328,374,407	101,254,877	618,917	290,273,286	—	29,632,231,536