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

TO THE HONORABLE
DONALD T. DIFRANCESCO
ACTING GOVERNOR of the STATE OF NEW JERSEY

Dear Acting Governor DiFrancesco:

The Board of Trustees of the

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2001 Annual Report in accordance with the provisions of N.J.S.A. 43:15A-21.

Respectfully submitted,

GARY SAAGE
Chairperson

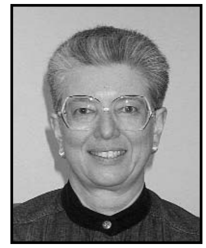
Public Employees' Retirement System

BOARD OF TRUSTEES

Gary A. Saage
Chairperson
Municipal Representative

Wayne Lodge
State Representative

Martin M. McElroy
Municipal Representative



Suzanna Buriani-DeSantis
County Representative

George B. Babula
Retired
State Representative

Edward Thomson, III
Gubernatorial Appointee

Alan E. Davis
Gubernatorial
Representative

Janice Vasil
Treasurer's Representative

Unavailable for photo:

Edward G. Hanna
State Representative

Susanne Culliton
Deputy Attorney General
Legal Adviser

Wendy Jamison
Board Secretary

Kim Smith
Support Staff

SIGNIFICANT LEGISLATION

CHAPTER 126, PUBLIC LAW OF 2000

This law revises certain mandates, requirements and procedures that are burdensome on counties, municipalities and school districts. It also resolves certain administrative ambiguities and encourages more business-like practices on the part of local units in order to effectuate cost savings that will benefit property taxpayers. It is an omnibus piece of legislation, much of which is not related to pension coverage. Sections of the law impacting pension and health benefit coverage are as follows:

Section 44: Permits a county governing body to adopt and implement an early retirement incentive program, upon the approval of the Director of the Division of Local Government Services in the Department of Community Affairs. The County must abide by the provisions of P.L. 1999, c.59 except for entering into an interlocal services contract or joint services agreement with another local unit.

This law was approved on September 21, 2000 and was effective immediately.

CHAPTER 127, PUBLIC LAW OF 2000

This law gives the Adjutant General of the Department of Military and Veterans' Affairs the responsibility for determining whether an individual meets the criteria to be considered a "veteran" or "disabled veteran" for the purpose of receiving a civil service preference; or as a "veteran" for the purpose of eligibility for a veteran's retirement allowance from the Teachers' Pension and Annuity Fund or the Public Employees' Retirement System, or for the purpose of purchasing military service credit in the Police and Firemen's Retirement System. The Adjutant General would also be responsible for all appeals of the above determinations.

The law also provides that the Adjutant General will adjudicate an appeal from any person disputing a decision of the assessor of a taxing district as to whether the person is to be considered a "veteran" for the purpose of receiving a property tax deduction or as having a "service-connected disability" for the purpose of receiving a property tax exemption.

The law requires the Adjutant General to promptly notify the public entity responsible for administering the relevant law of each determination. The determination will be binding on the public entity responsible for administering the law.

This law was approved on September 21, 2000 and was effective on March 1, 2001.

CHAPTER 4, PUBLIC LAW OF 2001

This law is intended to establish pension benefit parity for public safety officers who were not impacted by the 5% increase in the "special retirement" allowance provided to Police and Firemen's Retirement System (PFRS) retirees by P.L.1989, c.204.

This law provides for an increase in the pension allowance payable to certain previously retired members of the Consolidated Police and Firemen's Pension Fund (CPFPF), PFRS members who retired prior to December 29, 1989, the effective date of Chapter 204, and to certain past and prospective law enforcement officer (LEO) retirants under the Public Employees' Retirement System (PERS). To be eligible for the increase, a retirant from any of the specified retirement systems must have rendered at least 25 years of creditable service under the system.

The amount of the increase would be 5% of the retirant's final compensation, or such lesser amount as would provide the retirant with a total pension of 70% of final compensation.

The State is liable for any increased cost to local government employers participating in CPFPF as a result of the increase. For PFRS and PERS, the amount of the difference between the expected value and the full market value of the assets to be added to the expected value of the assets for the valuation period ending June 30, 1999 will include an additional amount of the market value of the assets sufficient to fund the unfunded accrued liability for the retirement allowances provided by the PFRS and PERS under this law.

This law was approved on January 16, 2001 and was effective on April 16, 2001.

CHAPTER 5, PUBLIC LAW OF 2001

This law revises New Jersey's "Administrative Procedure Act" (APA) to enhance access to the rule-making process. The provisions of the law include additional requirements for agencies involved in the rule-making process. These include the publication of a quarterly calendar of anticipated rule-making activities for the next six months, or in the absence of a calendar, a 60 day comment period instead of 30 days as well as a new "standard of clarity." The new law also requires four forms of notice of proposed rule-making, instead of two. These include a 30-day notice to the news media covering the State House Complex, an electronic notification through the Internet, publication in the New Jersey Register, and one additional means of notification such as an agency newsletter or direct mailing to interested parties.

This law was approved on January 16, 2001 and was effective on July 1, 2001.

CHAPTER 6, PUBLIC LAW OF 2001

This law allows a member of the Public Employees' Retirement System (PERS) or a member of the Teachers' Pension and Annuity Fund (TPAF) to transfer all service credit between the two retirement systems even though there was a period, not to exceed two years, of dual membership.

Prior to this law, a transfer of service credit between PERS and TPAF was allowed only if there was no period of overlapping membership. If not vested, this law allows a two year window in which to make the transfer.

The law does not permit the transfer of the concurrent service. N.J.S.A.18A:66-15 (concerning TPAF) and N.J.S.A.43:15A-39 (concerning PERS) each provide that not more than one year shall be credited for all service in a calendar year.

This law was approved on January 16, 2001 and was effective immediately.

CHAPTER 120, PUBLIC LAW OF 2001

This law provides an additional option for payment of a retirement allowance to members of the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS).

At the time of retirement, in lieu of a maximum retirement allowance providing the highest payment for the retiree's lifetime and no survivor benefit; TPAF and PERS members may choose to receive a reduced retirement and provide a beneficiary with a benefit under one of four existing options. Under Options 2, 3 and 4, if a beneficiary predeceases the retiree, the retiree's retirement allowance remains unchanged.

This law establishes a fifth option. Under this new option, a TPAF or PERS member may choose an actuarially reduced retirement allowance in order to provide a beneficiary an allowance equivalent to the full amount, three-quarters, one-half or one-quarter of the reduced allowance. If the beneficiary dies before the retiree, the retiree's allowance will increase to the maximum amount. The total benefit under this "pop-up survivor option" will be calculated and certified by the actuary to be of equivalent actuarial value to the member's maximum retirement allowance.

This law was approved on June 26, 2001 and was effective with July 1 retirants.

CHAPTER 127, PUBLIC LAW OF 2001

This law extends eligibility for certain veterans' benefits to veterans of the Lebanon Crisis of 1958.

Specifically, the law defines as a veteran any person who has served in Lebanon on or after July 1, 1958 or on board any ship actively engaged in patrolling the territorial waters of that nation for a period, continuous or in the aggregate, of at least 14 days commencing on or before November 1, 1958 or the date of termination of that conflict, as proclaimed by the President of the United States or Congress, whichever date of termination is later, in such active service. Any person receiving an actual service-incurred injury or disability shall be classed as a veteran whether or not that person has completed the 14 days' service provided by the law.

The inception and termination dates for the Lebanon Crisis in the law are those recognized by the United States Department of Defense for this operation.

The State shall be liable for any increased pension cost to local employers resulting from this law.

This law was approved on June 28, 2001 and was effective immediately.

CHAPTER 128, PUBLIC LAW OF 2001

This law expands the definition of veteran in the Teachers' Pension and Annuity Fund (TPAF), the Public Employees' Retirement System (PERS) and the Police and Firemen's Retirement System (PFRS) to include persons who served in the armed forces of the United States in peace-keeping operations in Somalia and the Republic of Bosnia and Herzegovina.

The law defines as a veteran any person who served in:

1. Operation "Restore Hope" in Somalia, commencing on or after December 5, 1992, or the date of inception of that operation as proclaimed by the President of the United States or the Congress, whichever date is earlier, and terminating on March 31, 1994, or the date of termination as proclaimed by the President of the United States or the Congress, whichever date is later, for at least 14 days, continuously or in the aggregate, in Somalia or on board any ship actively engaged in patrolling the territorial waters of that nation during the specified period; or
2. Operations "Joint Endeavor" and "Joint Guard" in the Republic of Bosnia and Herzegovina, commencing on or after November 20, 1995 or December 20, 1996, as the case may be, and terminating on December 20, 1996 or on such date as the United States Secretary of Defense may designate, as the case may be, who served in direct support of one or both of the operations for at least 14 days, continuously or in the aggregate, and was deployed in that nation or in another area in the region, or was on board a United States naval vessel operating in the Adriatic Sea, or operated in airspace above the Republic of Bosnia and Herzegovina.

Any person receiving an actual service-incurred injury or disability will be classed as a veteran whether or not that person completed the 14 days service requirement.

The State shall be liable for any increased pension cost to local employers resulting from this law.

This law was approved on June 28, 2001 and was effective immediately.

CHAPTER 133, PUBLIC LAW OF 2001

This law increases the retirement benefits under the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS) for service, deferred and early retirement by changing the formula from 1/70 to 1/64 of final compensation for each year of Class A service and from 1/60 to 1/55 of final compensation for each year of Class B service. The law also increases the retirement benefit for TPAF and PERS veteran members with 35 or more years of service and reduces the age qualification for this veteran retirement benefit from 60 to 55. The law further provides that existing retirees and beneficiaries whose retirant allowance is based on a service, deferred, early, or 35-year veteran retirement, would also receive a comparable percentage increase in their retirement allowances (9.09%).

This law also provides up to a 2% reduction in TPAF member contributions from the normal contribution rate of 5% beginning with calendar year 2002. After calendar year 2002, the rate of contribution will be reduced equally with employer normal contributions, but not by more than 2%, from excess valuation assets if the State Treasurer determines that excess valuation assets will be used to reduce normal contributions by the State. This change provides that future reductions in TPAF and PERS member contribution rates will be calculated in a similar fashion.

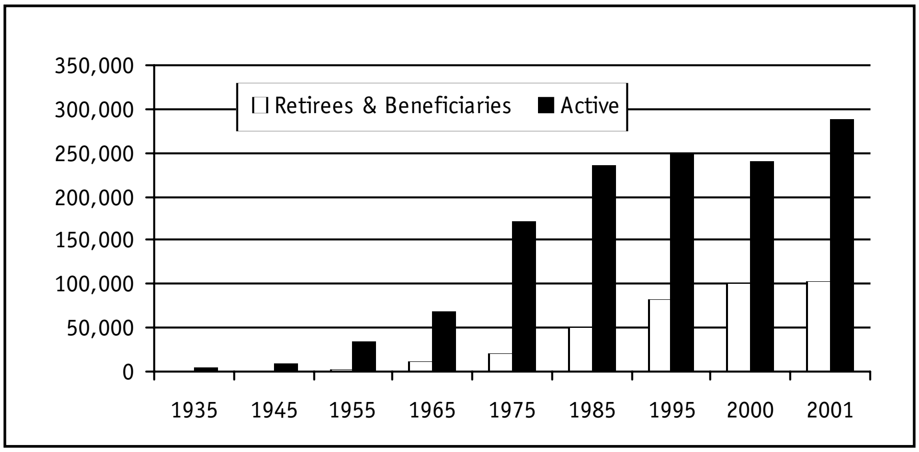
To fund the additional accrued liability for the increased benefits, the law provides that the actuarial value of assets for both TPAF and PERS, for the valuation period ending June 30, 1999, will be the full market value of the assets as of that date.

To fund the additional annual employer normal contribution for the increased benefits, the law establishes a benefit enhancement fund for both TPAF and PERS which would be funded by excess valuation assets beginning with the valuation period ending June 30, 1999. The amount of excess assets credited to the fund cannot exceed the amount of member contributions for the fiscal year in which the normal contributions are payable. To prevent over funding, the amount of excess valuation assets that can be credited to the benefit enhancement fund is limited to the present value of the expected additional normal contributions for the increased benefits over the expected working lives of the active members for the valuation period. No additional excess valuation assets will be credited to the benefit enhancement fund after the maximum amount is attained. If the assets in the benefit enhancement fund are insufficient to pay the normal contribution for the increased benefits for a valuation period, the State will pay the amount of the normal contribution for both the State and local employers not covered by assets from the benefit enhancement fund.

This law was approved on June 29, 2001 and was effective on November 1, 2001.

MEMBERSHIP

- As of June 30, 2001, the active membership of the System totaled 287,699. This includes 82,945 State employees and 204,754 employees from 1,688 participating local employers. *Total inactive membership as of June 30, 2001 was 39,302.*
- There were 103,560 retirees and beneficiaries receiving annual pensions totaling $1,033,479,125. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act)*.
- Beneficiaries of 490 active and 2,446 retired members received lump sum death benefits in the amount of $50,808,500.
- The System's assets totaled $24,653,723,116 at the close of the fiscal year 2001.



MEMBERSHIP ACTIVITY

During fiscal year 2001, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Public Employees' Retirement System of New Jersey.

- **LOANS** - 83,982 loans were issued to members. The total loans receivable as of June 30, 2001 is $451,164,387.
- **RETIREMENT** - 6,357 members retired under the following retirement types:

TYPE OF RETIREMENT	
Service	3,919
Early	945
Deferred	211
Ordinary Disability	1,032
Accidental Disability	1
Veteran	210
TOTAL	6,357

OPTION SELECTION	
Maximum	3,152
Option 1	1,348
Option 2	1,108
Option 3	726
Option 4	23
TOTAL	6,357

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
Public Employees' Retirement System:

We have audited the accompanying statements of plan net assets of the State of New Jersey Public Employees' Retirement System as of June 30, 2001 and 2000, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State of New Jersey Public Employees' Retirement System as of June 30, 2001 and 2000, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The supplementary information included in the schedule of funding progress and schedule of employer contributions is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The schedule of changes in plan net assets by fund is presented for purposes of additional analysis and is not a required part of the financial statements of the State of New Jersey Public Employees' Retirement System. Such information has been subjected to the auditing procedures applied in the audits 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

September 7, 2001

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statements of Plan Net Assets

June 30, 2001 and 2000

	2001			2000		
	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Assets:						
Cash	$ 77,805,428	—	$ 77,805,428	$ 69,815,652	—	$ 69,815,652
Investments, at fair value:						
Cash Management Fund	597,185,222	3,084,577	600,269,799	524,718,998	104,539,820	629,258,818
Bonds	213,624,055	1,525,524	215,149,579	118,431,568	—	118,431,568
Common Pension Fund A	11,664,301,974	83,585,336	11,747,887,310	13,980,351,453	—	13,980,351,453
Common Pension Fund B	6,418,642,720	46,000,434	6,464,643,154	6,122,150,521	—	6,122,150,521
Common Pension Fund D	3,703,700,588	26,537,422	3,730,238,010	5,103,097,465	—	5,103,097,465
Mortgages	964,026,898	6,906,771	970,933,669	1,253,452,786	—	1,253,452,786
Total investments	23,561,481,457	167,640,064	23,729,121,521	27,102,202,791	104,539,820	27,206,742,611
Receivables:						
Contributions:						
Members	49,768,723	—	49,768,723	49,335,638	—	49,335,638
Employers	201,630,725	—	201,630,725	205,181,272	—	205,181,272
Accrued interest and dividends	142,180,843	—	142,180,843	142,981,612	—	142,981,612
Members' loans	451,164,387	—	451,164,387	424,426,204	—	424,426,204
Other	2,051,489	—	2,051,489	1,756,017	—	1,756,017
Total receivables	846,796,167	—	846,796,167	823,680,743	—	823,680,743
Total assets	24,486,083,052	167,640,064	24,653,723,116	27,995,699,186	104,539,820	28,100,239,006
Liabilities:						
Accounts payable and accrued expenses	12,809,653	—	12,809,653	13,562,277	—	13,562,277
Retirement benefits payable	87,941,736	—	87,941,736	81,788,395	—	81,788,395
NCGI premiums payable	3,812,373	—	3,812,373	4,567,820	—	4,567,820
Total liabilities	104,563,762	—	104,563,762	99,918,492	—	99,918,492
Net assets held in trust for pension and post-retirement health benefits	$ 24,381,519,290	167,640,064	$ 24,549,159,354	$ 27,895,780,694	104,539,820	$ 28,000,320,514

See schedule of funding progress on page 16.
See accompanying notes to financial statements.

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statements of Changes in Plan Net Assets

Years ended June 30, 2001 and 2000

	2001			2000		
	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL	PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Revenues and additions:						
Contributions:						
Members	$ 314,235,958	—	$ 314,235,958	$ 345,462,658	—	$ 345,462,658
Employers	658,027	85,441,000	86,099,027	632,256	56,650,732	57,282,988
Other	7,553	—	7,553	10,630	—	10,630
Total contributions	314,901,538	85,441,000	400,342,538	346,105,544	56,650,732	402,756,276
Investment income:						
Net (depreciation) appreciation in fair value of investments	(3,389,756,119)	(10,872,141)	(3,400,628,260)	2,104,277,012	—	2,104,277,012
Interest	697,664,009	—	697,664,009	656,073,576	8,577,434	664,651,010
Dividends	138,065,495	—	138,065,495	149,837,299	—	149,837,299
	(2,554,026,615)	(10,872,141)	(2,564,898,756)	2,910,187,887	8,577,434	2,918,765,321
Less investment expense	4,645,553	—	4,645,553	5,161,266	—	5,161,266
Net investment income	(2,558,672,168)	(10,872,141)	(2,569,544,309)	2,905,026,621	8,577,434	2,913,604,055
Total revenues and additions	(2,243,770,630)	74,568,859	(2,169,201,771)	3,251,132,165	65,228,166	3,316,360,331
Expenditures and deductions:						
Benefits	1,117,905,183	73,392,100	1,191,297,283	1,046,941,574	58,716,166	1,105,657,740
Withdrawals	74,428,304	—	74,428,304	73,268,805	—	73,268,805
Administrative expenses	16,233,802	—	16,233,802	19,993,910	—	19,993,910
Total expenditures and deductions	1,208,567,289	73,392,100	1,281,959,389	1,140,204,289	58,716,166	1,198,920,455
Net (decrease) increase before transfers among reserves	(3,452,337,919)	1,176,759	(3,451,161,160)	2,110,927,876	6,512,000	2,117,439,876
Transfers among reserves:						
Other	(61,923,485)	61,923,485	—	—	—	—
Net assets held in trust for pension and post-retirement health benefits:						
Beginning of year	27,895,780,694	104,539,820	28,000,320,514	25,784,852,818	98,027,820	25,882,880,638
End of year	$ 24,381,519,290	167,640,064	$ 24,549,159,354	$ 27,895,780,694	104,539,820	$ 28,000,320,514

See accompanying notes to financial statements.

(1) DESCRIPTION OF THE SYSTEM

The State of New Jersey Public Employees' Retirement System (the System) is a cost-sharing multiple-employer contributory defined benefit plan which was established as of January 1, 1955, under the provisions of N.J.S.A. 43:15A. The System is included along with other state-administered pension trust and agency funds in the general purpose financial statements of the State of New Jersey.

At June 30, 2000, the date of the most recent actuarial valuation, and June 30, 1999, participating employers consisted of the following:

	2000	1999
State of New Jersey	1	1
County agencies	66	67
Municipalities	577	582
School districts	562	559
Other public agencies	436	418
Total	1,642	1,627

The System's designated purpose is to provide retirement, death, disability and medical benefits to certain qualified members. Membership in the System is mandatory for substantially all full-time employees of the State of New Jersey or any county, municipality, school district or public agency, provided the employee is not required to be a member of another state-administered retirement system or other state pension fund or local jurisdiction's pension fund. The System's Board of Trustees is primarily responsible for the administration of the System.

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

Vesting and benefit provisions

The vesting and benefit provisions are set by N.J.S.A. 43:15A and 43:3B. The System provides retirement, death and disability benefits, as well as medical benefits for certain qualified members. All benefits vest after eight to ten years of service, except for medical benefits, which vest after 25 years of service. Retirement benefits for age and service are available at age 60 and, under recently enacted legislation referred to below, 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 eight to ten years of service credit, in which case benefits would begin the first day of the month after the member attains normal retirement age.

The System provides specified medical benefits for members who retire after achieving 25 years of qualified service, as defined, or under the disability provisions of the System.

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

(1) DESCRIPTION OF THE SYSTEM, Continued

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 after 24 months of retirement.

Two pieces of legislation passed during 2001 have a significant impact on the System's benefit provisions: Chapter 133, Public Law of 2001, increases retirement benefits for 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 increases the retirement benefit for veteran members with 35 or more years of service and reduces the age qualification from 60 to 55. The legislation further provides that existing retirees and beneficiaries would also receive a comparable percentage increase in their retirement allowance. The benefit enhancements are effective with the November 1, 2001 benefit checks. Chapter 120, Public Law of 2001, establishes an additional retirement option for plan members. Under the new option, a retiree's actuarially reduced allowance (to provide a benefit to the retiree's beneficiary upon the retiree's death) would "pop-up" to the maximum retirement allowance if the beneficiary predeceases the retiree.

Membership

Membership in the System consisted of the following at June 30, 2000, the date of the most recent actuarial valuation, and 1999:

2000	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	104,200	13,068
Active members:		
Vested	139,165	9,349
Non-vested	130,777	73,082
Total active members	269,942	82,431
Total	374,142	95,499

(1) DESCRIPTION OF THE SYSTEM, Continued

1999	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	100,971	12,199
Active members:		
Vested	134,305	7,789
Non-vested	127,971	72,521
Total active members	262,276	80,310
Total	363,247	92,509

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting and conform to the provisions of Governmental Accounting Standards Board (GASB) Statements No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans" and No. 26, "Financial Reporting for Postemployment Healthcare Plans Administered By Defined Benefit Pension Plans." Plan assets are recorded at fair value. Employer contributions are recognized when payable to the System. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Investment Valuation

Investments, including short-term investments (State of New Jersey Cash Management Funds), are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value.

The State of New Jersey Division of Investment, under the jurisdiction of the State Investment Council, has the investment responsibility for all funds administered by the State of New Jersey Division of Pensions and Benefits. All investments must conform to standards set by state law.

The State of New Jersey Division of Investment administers three common pension funds which are utilized by the System. A brief description of each common pension fund is as follows:

Common Pension Fund A - The operations of Common Pension Fund A are governed by the provisions of Article 62 of the State of New Jersey Investment Council regulations for the purpose of investing in corporate common stocks, securities convertible into corporate common stocks or covered call options.

Common Pension Fund B - The operations of Common Pension Fund B are governed by the provisions of Article 63 of the State of New Jersey Investment Council regulations for the purpose of

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

investing in fixed income and debt securities.

Common Pension Fund D - The operations of Common Pension Fund D are governed by the provisions of Article 67 of the State of New Jersey Investment Council regulations for the purpose of investing in international debt and equity securities, currencies, currency futures, and options.

The State of New Jersey, Department of the Treasury, Division of Investment, issues publicly available financial reports that include the financial statements of the State of New Jersey Cash Management Funds, Common Pension Fund A, Common Pension Fund B and Common Pension Fund D. The financial reports may be obtained by writing to the State of New Jersey, Department of the Treasury, Division of Investment, P.O. Box 290, Trenton, New Jersey 08625-0290.

The purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the System, through the State Treasurer, and custodian banks as agents for the System. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institutions, amount of the portfolio to be covered by the agreements, and other pertinent matters.

In 2001, the Board of Trustees approved that the Post-Retirement Medical Fund earn a rate of return consistent with the Pension Fund. In prior years, the Post-Retirement Medical Fund earned a statutorily determined rate of return.

GASB Statement No. 3 requires disclosure of the level of risk assumed by the System. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. As of June 30, 2001 and 2000, all investments held by the System (other than mortgages and the State of New Jersey Cash Management Funds which are not categorized) are classified as Category 1.

Federal securities are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the System. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the System. The custodian banks, as agents for the System, maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the System.

Securities not maintained by the Federal Reserve Banks or DTC are in the name of a designated nominee representing the securities of the System, which establishes the System's unconditional right to the securities.

Member Loans

Members can borrow up to 50% of their accumulated member contributions. To obtain a loan, a member must have at least three years of service credit in the System. 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.

Administrative Expenses

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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

Cash and Cash Equivalents

GASB Statement No. 3 also requires that deposits held in financial institutions be categorized to indicate the level of risk assumed by the entity. Category 1 consists of deposits that are insured or collateralized with securities held by the entity or by its agent in the entity's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name. Category 3 consists of deposits which are uninsured and uncollateralized.

Based upon aggregate collateral levels maintained for all state bank accounts as a whole, substantially all cash balances maintained in financial institutions as of June 30, 2001, which include funding for the July 1, 2001 retirement payroll, are designated Category 3.

The categorization of cash and cash equivalents for all state funds, including the pension trust funds, can be found in the notes to the general purpose financial statements of the State of New Jersey.

(3) CONTRIBUTIONS

The contribution policy is set by N.J.S.A. 43:15A 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. From January 1, 1998 to December 31, 1999, the contribution rate was 4.5% of base salary. In accordance with Chapter 415, P.L. 1999, referred to below, the member rate was lowered to 3.0% effective January 1, 2000. Employers are required to contribute at an actuarially determined rate. The annual employer contribution includes 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 are funded on a pay-as-you-go basis plus an additional contribution that will ensure an increase in the Post-Retirement Medical Reserve Fund equal to 1/2 of 1% of the salary of active state employees.

Chapter 133, P.L. 2001, referred to in Note 1, provides for increased benefits for certain types of retirement. Under this legislation, the cost of the increased benefits will be funded using excess assets. To fund the initial accrued liability, the actuarial value of assets for the valuation period ending June 30, 1999, will be the full market value of the assets as of that date. The required normal contributions on behalf of active members will also be funded using available excess assets. A benefit enhancement fund will be established and maintained from which required normal contributions for the benefit enhancements will be charged. The legislation requires that the assets of the benefit enhancement fund shall not exceed the present value of the expected additional normal contribution over the expected working lives of the active members for the valuation period. If excess assets are not available when contributions are required, the legislation further provides that the state shall be responsible for the cost of the increased benefits for both State and local members. The amount of excess assets that can be utilized is also limited to the employee contributions for the year in which a payment is required. If the required funding in any year exceeds the employ-

(3) CONTRIBUTIONS, Continued

ee contributions, the State shall also be responsible for funding the excess amount.

Chapter 415, P.L. 1999 provides for a reduction in the employee contribution rate from 5% to 3% for calendar years 2000 and 2001. Prior to 1/1/00, the employee contribution rate was set at 4.5% in accordance with Chapter 115, P.L. 1997, which lowered the contribution rate by ½ of 1% for calendar years 1998 and 1999.

Legislation passed in 1997 (Chapter 115, P.L. 1997) provided for the use of excess actuarial valuation assets to offset the required normal contributions of the State of New Jersey and the local participating employers.

Through FY 2002, excess assets may be used to the extent possible to offset normal contributions. Thereafter, a certain percentage of available excess assets may be used as specified in the legislation.

As a result of Chapter 115, for the years ended June 30, 2001 and 2000, contributions by the State of New Jersey were limited to funding for post-retirement medical benefits while local employer contributions were limited to funding for early retirement incentive benefits. Employer contributions for basic pension benefits, noncontributory death benefits and cost-of-living adjustments were funded by excess assets for both the State and local employers.

(4) RESERVES

This System maintains the following legally required reserves:

Members' Annuity Savings and Accumulative Interest Fund (2001 - $5,745,676,091; 2000 - $5,332,091,725)

The Members' Annuity Savings Fund is credited with all contributions made by active members of the System. 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%.

Contingent Reserve Fund (2001 - $9,246,598,990; 2000 - $13,573,851,209)

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

Retirement Reserve Fund (2001 - $9,247,794,308; 2000 - $8,594,854,019)

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 regular interest, are transferred to the Retirement Reserve Fund from the Members' Annuity Savings Fund and Accumulative Interest 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 2001 and 2000) is credited to the

(4) RESERVES, Continued

Retirement Reserve Fund.

Special Reserve Fund (2001 - $0; 2000 - $270,827,210)

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 System, excluding Cash Management Fund investments and bonds allocated to the Contributory Group Insurance Premium Fund which amounted to $140,452,687 and $124,021,571 as of June 30, 2001 and 2000, respectively. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

Contributory Group Insurance Premium Fund (2001 - $141,449,901; 2000 - $124,156,531)

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 0.5 of 1% of salary, as defined.

Post-Retirement Medical Fund (2001 - $167,640,064; 2000 - $104,539,820)

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.

(5) INCOME TAX STATUS

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

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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)
State						
March 31, 1995	$ 5,499,850,766	$ 5,921,281,646	$ 421,430,880	92.9%	$ 2,830,000,937	14.9%
March 31, 1996	6,565,471,539	6,225,818,232	(339,653,307)	105.5%	2,762,479,385	(12.3%)
March 31, 1997	6,987,217,172	6,606,707,924	(380,509,248)	105.8%	2,714,991,457	(14.0%)
March 31, 1998	7,600,621,930	7,155,035,122	(445,586,808)	106.2%	2,805,791,909	(15.9%)
June 30, 1999	8,879,920,323	7,823,576,056	(1,056,344,267)	113.5%	2,928,470,790	(36.1%)
June 30, 2000	9,743,727,383	8,538,685,222	(1,205,042,161)	114.1%	3,094,280,664	(38.9%)
Local						
March 31, 1995	8,629,411,069	8,433,456,163	(195,954,906)	102.3%	4,191,703,372	(4.7%)
March 31, 1996	9,919,779,257	8,960,275,181	(959,504,076)	110.7%	4,301,404,278	(22.3%)
March 31, 1997	10,523,061,499	9,599,816,842	(923,244,657)	109.6%	4,407,751,955	(20.9%)
March 31, 1998	11,486,495,310	10,286,532,879	(1,199,962,431)	111.7%	4,513,357,772	(26.6%)
June 30, 1999	13,171,311,650	11,163,283,877	(2,008,027,773)	118.0%	4,655,241,261	(43.1%)
June 30, 2000	14,380,511,913	12,007,160,806	(2,373,351,107)	119.8%	4,910,962,708	(48.3%)

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2000 and 1999 actuarial valuations included the following:

	June 30, 2000	**June 30, 1999**
Actuarial cost method	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value
Amortization method	Level percent, closed	Level percent, closed
Payroll growth rate for amortization	5.00%	5.00%
Remaining amortization period	32 years	33 years
Actuarial assumptions:		
Interest rate	8.75%	8.75%
Salary range	5.95%	5.95%
Cost-of-living adjustments	2.40%	2.40%

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

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Employer Contributions

YEAR ENDED JUNE 30,	ANNUAL REQUIRED CONTRIBUTION	EMPLOYER CONTRIBUTIONS(1)	PERCENTAGE CONTRIBUTED
State:			
1997	$ 134,878,582	$ 241,106,642(2)	178.8%
1998	78,833,287	—	0.0%
1999	86,945,810	—	0.0%
2000	103,033,425	—	0.0%
2001	85,078,620	—	0.0%
Local:			
1997	142,672,255	67,476,771	47.0%
1998	84,639,988	19,034,673	22.5%
1999	111,886,040	19,599,153	17.5%
2000	112,800,127	20,541,177	18.2%
2001	88,717,727	21,670,774	24.4%

Notes to Schedule:

(1) Excludes post-retirement medical contributions (State only) and contributions received from other State of New Jersey retirement systems for certain members who transferred their eligible prior service credit to the Public Employees' Retirement System. The local employer contribution from 1998 to 2001 consists of required contributions under the early retirement incentive programs.

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

(2) For the year ended June 30, 1997, the state portion of 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
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Schedule of Changes in Plan Net Assets by Fund

Year ended June 30, 2001

	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	OTHER	TOTAL
Additions:								
Contributions:								
Members	$ 274,590,428	—	—	—	39,645,530	—	—	$ 314,235,958
Employers	—	658,027	—	—	—	85,441,000	—	86,099,027
Other	—	—	—	—	—	—	7,553	7,553
Total contributions	274,590,428	658,027	—	—	39,645,530	85,441,000	7,553	400,342,538
Distribution of net investment income	468,403,368	(3,801,799,171)	765,709,234	—	9,014,401	(10,872,141)	—	(2,569,544,309)
Total additions	742,993,796	(3,801,141,144)	765,709,234	—	48,659,931	74,568,859	7,553	(2,169,201,771)
Deductions:								
Benefit payments	—	53,059,497	1,033,471,572	—	31,366,561	73,392,100	7,553	1,191,297,283
Refunds of contributions	71,685,155	2,743,149	—	—	—	—	—	74,428,304
Administrative expenses	—	16,233,802	—	—	—	—	—	16,233,802
Total deductions	71,685,155	72,036,448	1,033,471,572	—	31,366,561	73,392,100	7,553	1,281,959,389
Net increase (decrease) before transfers among reserves	671,308,641	(3,873,177,592)	(267,762,338)	—	17,293,370	1,176,759	—	(3,451,161,160)
Transfers among reserves:								
Retirements	(261,515,828)	(512,452,794)	773,968,622	—	—	—	—	—
Other	3,791,553	58,378,167	146,734,005	(270,827,210)	—	61,923,485	—	—
Net increase (decrease)	413,584,366	(4,327,252,219)	652,940,289	(270,827,210)	17,293,370	63,100,244	—	(3,451,161,160)
Net assets held in trust for pension benefits:								
Beginning of year	5,332,091,725	13,573,851,209	8,594,854,019	270,827,210	124,156,531	104,539,820	—	28,000,320,514
End of year	$ 5,745,676,091	9,246,598,990	9,247,794,308	—	141,449,901	167,640,064	—	$ 24,549,159,354