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

TEACHERS' PENSION AND ANNUITY FUND

is pleased to present the Fiscal Year 2001 Annual Report in accordance with the provisions of N.J.S.A. 18A:66-59.

Respectfully submitted,

HARRY BALDWIN
Chairperson

Teachers' Pension and Annuity Fund

BOARD OF TRUSTEES

SIGNIFICANT LEGISLATION

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 immediately.

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 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 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.

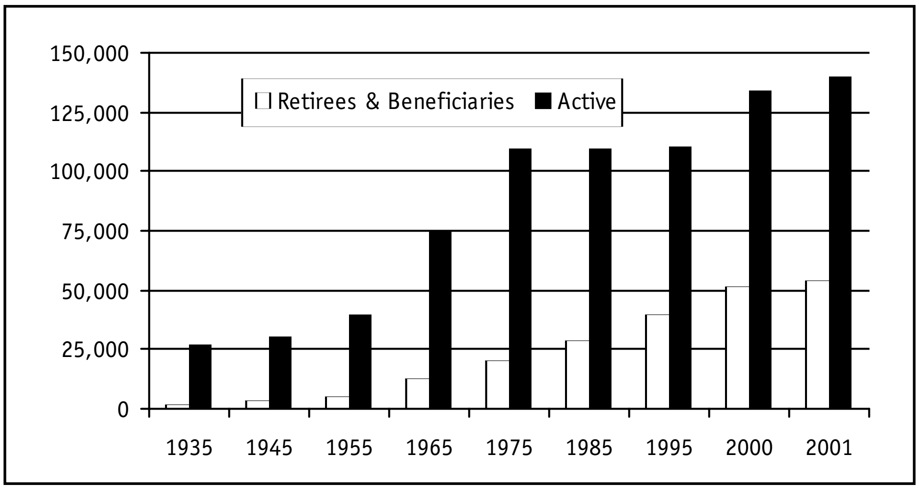
To fund the additional accrued liability for the increased benefits, the law provides that the actuarial value of assets for both TPAF and PERS, for the valuation period ending June 30, 1999, will be the full market value of the assets as of that date.

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 Fund totaled 139,631. This includes 477 State employees and 139,154 employees from 668 participating local employers. *There were 12,301 inactive members in the Fund as of June 30, 2001.*
- There were 53,784 retirees and beneficiaries receiving annual pensions totaling $1,275,079,809. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act)*.
- Beneficiaries of 103 active and 1,272 retired members received lump sum death benefits in the amount of $32,880,252.
- The Fund's assets totaled $31,374,320,886 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 Teachers' Pension and Annuity Fund of New Jersey.

- **LOANS** - 20,604 loans were issued to members. The total loans receivable as of June 30, 2001 is $258,167,626.
- **RETIREMENT** - 3,891 members retired under the following retirement types:

TYPE OF RETIREMENT	
Service	1,426
Early	1,930
Deferred	131
Ordinary Disability	202
Accidental Disability	7
Veteran	195
TOTAL	3,891

OPTION SELECTION	
Maximum	1,693
Option 1	598
Option 2	629
Option 3	935
Option 4	36
TOTAL	3,891

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 statements of plan net assets of the State of New Jersey Teachers' Pension and Annuity Fund 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 Fund'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 Teachers' Pension and Annuity Fund 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 Teachers' Pension and Annuity Fund. 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
TEACHERS' PENSION AND ANNUITY FUND

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	$ 94,042,019	—	$ 94,042,019	$ 83,118,013	—	$ 83,118,013
Investments, at fair value:						
Cash Management Fund	1,166,423,523	9,166,869	1,175,590,392	935,049,109	264,572,858	1,199,621,967
Bonds	101,485,351	1,109,159	102,594,510	113,914,136	—	113,914,136
Common Pension Fund A	14,665,931,942	159,947,191	14,825,879,133	17,400,585,676	—	17,400,585,676
Common Pension Fund B	7,917,729,354	86,351,257	8,004,080,611	7,545,119,460	—	7,545,119,460
Common Pension Fund D	5,168,375,030	56,371,354	5,224,746,384	7,234,689,548	—	7,234,689,548
Mortgages	1,219,160,514	13,277,281	1,232,437,795	1,496,135,065	—	1,496,135,065
Total investments	30,239,105,714	326,223,111	30,565,328,825	34,725,492,994	264,572,858	34,990,065,852
Receivables:						
Contributions:						
Members	68,501,700	—	68,501,700	68,506,498	—	68,506,498
Employers	212,517,719	—	212,517,719	222,078,120	—	222,078,120
Accrued interest and dividends	175,406,103	—	175,406,103	177,030,185	—	177,030,185
Members' loans	258,167,626	—	258,167,626	241,312,260	—	241,312,260
Other	356,894	—	356,894	37,022	—	37,022
Total receivables	714,950,042	—	714,950,042	708,964,085	—	708,964,085
Total assets	31,048,097,775	326,223,111	31,374,320,886	35,517,575,092	264,572,858	35,782,147,950
Liabilities:						
Accounts payable and accrued expenses	7,509,195	—	7,509,195	8,176,850	—	8,176,850
Retirement benefits payable	108,174,440	—	108,174,440	97,976,997	—	97,976,997
NCGI premiums payable	2,185,644	—	2,185,644	2,974,725	—	2,974,725
Total liabilities	117,869,279	—	117,869,279	109,128,572	—	109,128,572
Net assets held in trust for pension and post-retirement health benefits	$ 30,930,228,496	326,223,111	$ 31,256,451,607	$ 35,408,446,520	264,572,858	$ 35,673,019,378

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

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

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	$ 371,618,136	—	$ 371,618,136	$ 349,654,314	—	$ 349,654,314
Employers	1,984,203	175,558,000	177,542,203	1,718,360	120,810,276	122,528,636
Other	1,475	—	1,475	2,011	—	2,011
Total contributions	373,603,814	175,558,000	549,161,814	351,374,685	120,810,276	472,184,961
Investment income:						
Net (depreciation) appreciation in fair value of investments	(4,426,011,126)	(27,515,577)	(4,453,526,703)	2,725,719,146	—	2,725,719,146
Interest	889,672,402	—	889,672,402	823,953,785	22,955,904	846,909,689
Dividends	172,570,738	—	172,570,738	183,839,492	—	183,839,492
	(3,363,767,986)	(27,515,577)	(3,391,283,563)	3,733,512,423	22,955,904	3,756,468,327
Less investment expense	3,372,858	—	3,372,858	3,803,457	—	3,803,457
Net investment income	(3,367,140,844)	(27,515,577)	(3,394,656,421)	3,729,708,966	22,955,904	3,752,664,870
Total revenues and additions	(2,993,537,030)	148,042,423	(2,845,494,607)	4,081,083,651	143,766,180	4,224,849,831
Expenditures and deductions:						
Benefits	1,330,171,296	209,247,505	1,539,418,801	1,204,685,231	141,546,514	1,346,231,745
Refunds of contributions	23,730,536	—	23,730,536	21,555,188	—	21,555,188
Adjustment to employer receivable	—	—	—	22,026,543	—	22,026,543
Administrative expenses	7,923,827	—	7,923,827	9,826,788	—	9,826,788
Total expenditures and deductions	1,361,825,659	209,247,505	1,571,073,164	1,258,093,750	141,546,514	1,399,640,264
Net (decrease) increase before transfers among reserves	(4,355,362,689)	(61,205,082)	(4,416,567,771)	2,822,989,901	2,219,666	2,825,209,567
Transfers among reserves :						
Other	(122,855,335)	122,855,335	—	—	—	—
Net assets held in trust for pension and post-retirement health benefits:						
Beginning of year	35,408,446,520	264,572,858	35,673,019,378	32,585,456,619	262,353,192	32,847,809,811
End of year	$ 30,930,228,496	326,223,111	$ 31,256,451,607	$ 35,408,446,520	264,572,858	$ 35,673,019,378

See accompanying notes to financial statements.

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

Notes to Financial Statements

June 30, 2001 and 2000

(1) DESCRIPTION OF THE FUND

The State of New Jersey Teachers' Pension and Annuity Fund (the Fund) 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 general purpose 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 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 Fund provides specific medical benefits for members who retire after 25 years of qualified service, as defined, or under the disability provisions of the Fund.

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.

Two pieces of legislation passed during 2001 have a significant impact on the Fund'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

(1) DESCRIPTION OF THE FUND, Continued

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 an allowance 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 and Contributing Employers

Membership and contributing employers of the Fund consisted of the following at June 30:

2000	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	52,605	35,088
Active members:		
Vested	77,994	29,385
Non-vested	51,993	100,602
Total active members	129,987	129,987
Total	182,592	165,075
Contributing Employers	123	1

1999	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them	50,291	32,766
Active members:		
Vested	78,595	29,474
Non-vested	46,228	95,349
Total active members	124,823	124,823
Total	175,114	157,589
Contributing Employers	123	1

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of the Fund 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 Post-employment Healthcare Plans Administered By Defined Benefit Pension Plans." Plan assets and lia-

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

bilities are recorded at fair value. Employer contributions are recognized when payable to the Fund. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

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 Fund. 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 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 Fund, through the State Treasurer, and custodian banks as agents for the Fund. 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.

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

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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.

Federal securities are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the Fund. 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 Fund. The custodian banks, as agents for the Fund, maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the Fund.

Securities not maintained by the Federal Reserve Banks or DTC are in the name of a designated nominee representing the securities of the Fund, which establishes the Fund'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 Fund. 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 repayment schedule into retirement.

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 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. 18A:66-29 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 Chapter 115, P.L. 1997, referred to

(3) CONTRIBUTIONS, Continued

below, the current employee contribution rate is 4.5%. 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 employees. During 2000, the State eliminated $22,026,543 in contribution obligations to the Fund through the use of excess plan assets.

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

Chapter 133 also provides for a reduction in the member contribution rate to 3% for calendar year 2002. Reductions in the employee rate will be permitted after 2002 providing excess assets are being utilized to reduce normal contributions of the State.

Legislation passed in 1997 (Chapter 115, P.L. 1997) provided for the use of excess valuation assets to offset the required normal contributions of the State of New Jersey. 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. Chapter 115 also provided for a reduction in the employee contribution rate in calendar years 1998 and 1999 from 5% to 4.5% and for a similar reduction after calendar year 1999 providing excess assets are available.

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 Fund maintains the following legally required reserves:

Members' Annuity Savings and Accumulative Interest Fund (2001 - $5,431,880,738; 2000 - $5,034,537,875)

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%.

Contingent Reserve Fund (2001 - $ 12,374,096,154; 2000 - $18,252,655,276)

The Contingent Reserve Fund is credited with the contributions of 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 - $13,047,201,732; 2000 - $11,701,005,388)

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, but 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 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 2001 and 2000) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2001 - $0; 2000 - $349,168,164)

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 $78,814,799 and $73,249,378 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 - $77,049,872; 2000 - $71,079,817)

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.

Post-Retirement Medical Fund (2001 - $326,223,111; 2000 - $264,572,858)

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 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, 1995	$16,942,637,259	$18,410,393,538	$1,467,756,279	92.0%	$5,358,893,876	27.4%
March 31, 1996	20,843,247,418	19,828,428,735	(1,014,818,683)	105.1%	5,594,150,132	(18.1%)
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%)

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, 2000 and June 30, 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	8 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
TEACHERS' PENSION AND ANNUITY FUND

Required Supplementary Information, Continued

Schedule of Employer Contributions

YEAR ENDED JUNE 30,	ANNUAL REQUIRED CONTRIBUTION	EMPLOYER CONTRIBUTIONS(1)	PERCENTAGE CONTRIBUTED
1997	$ 372,060,546	$ 1,601,688,633(2)	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

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, 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.

Schedule 3

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

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	$ 344,781,744	—	—	—	26,836,392	—	—	$ 371,618,136
Employers	—	1,984,203	—	—	—	175,558,000	—	177,542,203
Other	—	—	—	—	—	—	1,475	1,475
Total contributions	344,781,744	1,984,203	—	—	26,836,392	175,558,000	1,475	549,161,814
Distribution of net investment income	418,613,905	(4,844,181,714)	1,053,552,922	—	4,874,043	(27,515,577)	—	(3,394,656,421)
Total additions	763,395,649	(4,842,197,511)	1,053,552,922	—	31,710,435	148,042,423	1,475	(2,845,494,607)
Deductions:								
Benefits	—	29,351,107	1,275,078,334	—	25,740,380	209,247,505	1,475	1,539,418,801
Refunds of contributions	23,620,115	110,421	—	—	—	—	—	23,730,536
Adjustment to employer receivable	—	—	—	—	—	—	—	—
Administrative expenses	—	7,923,827	—	—	—	—	—	7,923,827
Total deductions	23,620,115	37,385,355	1,275,078,334	—	25,740,380	209,247,505	1,475	1,571,073,164
Net increase (decrease) before transfers among reserves	739,775,534	(4,879,582,866)	(221,525,412)	—	5,970,055	(61,205,082)	—	(4,416,567,771)
Transfers among reserves:								
Retirements	(344,847,100)	(892,115,736)	1,236,962,836	—	—	—	—	—
Other	2,414,429	(106,860,520)	330,758,920	(349,168,164)	—	122,855,335	—	—
Net increase (decrease)	397,342,863	(5,878,559,122)	1,346,196,344	(349,168,164)	5,970,055	61,650,253	—	(4,416,567,771)
Net assets held in trust for pension benefits:								
Beginning of year	5,034,537,875	18,252,655,276	11,701,005,388	349,168,164	71,079,817	264,572,858	—	35,673,019,378
End of year	$ 5,431,880,738	12,374,096,154	13,047,201,732	—	77,049,872	326,223,111	—	$ 31,256,451,607