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

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

Dear Governor Corzine:

The Board of Trustees of the

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2006 Annual Report in accordance with the provisions of N.J.S.A. 43:15A-21.

Respectfully submitted,

GEORGE B. BABULA
Chairperson

Public Employees' Retirement System
BOARD OF TRUSTEES

George B. Babula
Chairman
State Representative

Roderick Lewis
State Representative

John Lowden
State Representative

James Brey
State Representative

Leon Flanagan
State Representative

Suzanna
Buriani-DeSantis
County Representative

Ronald Winthers
Gubernatorial Appointee

Edward Thomson, III
Gubernatorial Appointee

Susanne Culliton
Deputy Attorney General
Legal Adviser

Frederick J. Beaver
State Treasurer's
Representative

Unavailable for photo:

Stephen Florek
Gubernatorial Appointment

Kathleen Coates
Board Secretary

Jackie Bussanich
Support Staff

SIGNIFICANT LEGISLATION

CHAPTER 326, P.L. 2005

This law provides that only a currently employed firefighter who had been a volunteer appointed to a paid position by a municipality and who (1) was not eligible for Police and Firemen's Retirement System (PFRS) membership at the time of appointment to the paid position, (2) meets the PFRS definition of "fireman", and (3) is currently enrolled in Public Employees' Retirement System (PERS), may transfer, subject to the approval of the municipal governing body, from PERS to PFRS, regardless of age.

An eligible individual must waive their rights to their PERS benefits within 90 days of this law's effective date to qualify. Transfers under this law shall take effect on the first day of the first full calendar month following the effective date of this act by at least 180 days. PERS shall transmit to PFRS an amount equal to the present value of the benefit under PERS accrued to the date of transfer by each person transferring to PFRS. The service credit accrued in PERS to the date of transfer shall be transferred to PFRS and may be used to meet any service credit requirement for benefits under PFRS. Any benefit of a member who transfers membership from PERS to PFRS under this act based upon service credit shall be the amount of benefit determined as provided under PFRS based upon the total amount of service credit multiplied by the ratio of the service credit under PFRS from the date of transfer to the total amount of service credit, plus a benefit comparable to a PERS deferred, early or regular service retirement benefit, as appropriate, based upon the age of the member at the time of retirement and the amount of PERS service credit transferred to PFRS, determined as provided under the law and regulations governing PERS for the benefit. The total amount of service credit in PFRS, including the transferred PERS service credit, may be used to meet the service credit requirement for the benefit comparable to a PERS deferred or early retirement benefit, but the benefit shall be calculated only on the transferred PERS service credit.

Active and retired death benefits, accidental death benefits, and ordinary and accidental disability retirement benefits for members transferring to PFRS under this act shall be the benefits provided under PFRS.

For members transferring to PFRS under this act, the widows' or widowers' pensions provided under section 26 of P.L.1967, c.250 (C.43:16A 12.1) shall be the amount of the benefit determined as provided in section 26 multiplied by the ratio of the service credit under PFRS from the date of transfer to the total amount of service credit. Transferring members shall be entitled to elect optional retirement allowances for the portions of their retirement benefits based upon their PERS service credit as provided under the laws and regulations governing selection of optional retirement allowances under PERS.

A fireman who transfers membership from PERS to PFRS may receive full credit toward benefits under PFRS for the transferred PERS service credit if the member agrees to pay the full cost of the accrued liability for the transferred PERS service credit in the same manner and subject to the same terms and conditions provided for the purchase of credit for military service under section 3 of P.L.1991, c.153 (C.43:16A-11.11).

The law provides that the State will not be liable for additional costs to a local employer associated with a firefighter transferring to PFRS under this law.

This law became effective January 12, 2006.

CHAPTER 366, P.L. 2005

This law requires permanent, full-time county fire marshals and assistant county marshals authorized by their boards of chosen freeholders to provide municipal fire departments with assistance as necessary to coordinate, control, or extinguish any fire situation or other emergency situation, to be enrolled in the Police and Firemen's Retirement System (PFRS), as long as they meet all of the other eligibility requirements in applicable pension statutes to qualify for enrollment in PFRS. It also provides that any such permanent, full-time county fire marshal or assistant fire marshal who performs the duties in paragraph (8) of N.J.S.A. 40A:14-2, at the time this law takes effect, will be exempt from any age requirement for enrollment in the PFRS. Any permanent, full-time county fire marshal and assistant fire marshal given approval by the board of chosen freeholders on or after October 1, 2001 to engage in activities provided in N.J.S.40A:14-2b.(8) shall be enrolled as a member in the Police and Firemen's Retirement System effective upon the date when such approval by the board of chosen freeholders was given. Currently, fire marshals and assistant fire marshals are enrolled in Public Employees' Retirement System (PERS). The law also clarifies that the cost of enrollment of a full time county fire marshal or assistant fire marshal in the PFRS of New Jersey shall not be the responsibility of the State.

This law became effective January 12, 2006.

CHAPTER 368, P.L. 2005

This law permits a State, county or municipal employer to grant a paid or unpaid leave of absence to public employees, excluding police officers and firefighters outside the civil service, who are elected or appointed as officers or representatives of a local, county or State labor organization. A paid leave may be granted provided the employer is reimbursed in advance for compensation and benefit costs including retirement system contributions and health benefit costs, or in accordance with the terms of a collective bargaining agreement. The length of a leave is subject to negotiation between the employer and the union.

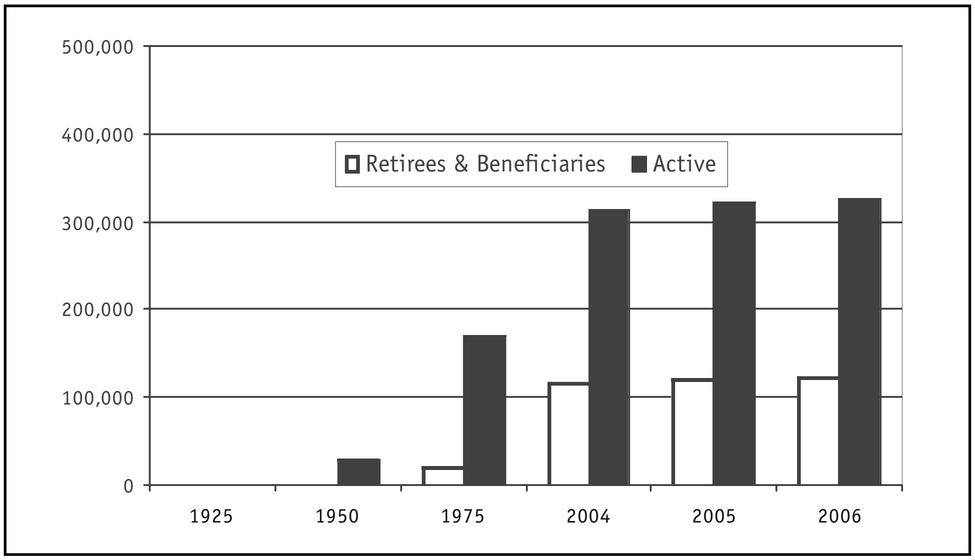
It also provides a member of the Public Employees' Retirement System (PERS) with the option of receiving PERS service credit for the period of an approved leave of absence, if the member pays PERS the full cost, employer and employee contributions, for the credit.

In addition, this law permits a public employee who had been granted and had taken an approved unpaid leave of absence in the past and who has not received PERS credit for that service to purchase the credit within one year after its effective date.

This became became effective January 12, 2006.

MEMBERSHIP

- As of June 30, 2006, the active membership of the System totaled 327,696. This includes 98,735 State employees and 228,961 employees from 1,680 participating local employers. Also, it includes inactive membership of 50,506 as of June 30, 2006.
- There were 124,333 retirees and beneficiaries receiving annual pensions totaling $1,717,907,371. *(This includes cost-of-living increases paid under the provisions of the Pension Adjustment Act)*.
- Beneficiaries of 785 active and 4,939 retired members received lump sum death benefits in the amount of $91,469,327.
- The System's assets totaled $30,106,370,751 at the close of the fiscal year 2006.



MEMBERSHIP ACTIVITY

During fiscal year 2006, 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.

- **ENROLLMENTS** - 30,129 new members were enrolled in PERS during fiscal year 2006.
- **LOANS** - 77,882 loans were issued to members. The total loans receivable as of June 30, 2006 is $203,052,970.
- **WITHDRAWALS** - there were 8,762 withdrawals during fiscal year 2006.
- **RETIREMENT** - 7,359 members retired under the following retirement types:

TYPE OF RETIREMENT	
Service	4,261
Early	436
Ordinary Disability	917
Accidental Disability	47
Accidental Death	1
Veteran	388
Deferred	366
Over 55 — Early	905
Active Death	1
Chapter 366	25
Other	12
TOTAL	7,359

OPTION SELECTION	
Maximum	3,815
Option 1	610
Option 2	147
Option 3	62
Option 4	9
Option A	1,174
Option B	400
Option C	648
Option D	490
Other	4
TOTAL	7,359

KPMG

KPMG LLP
Suite 402
301 Carnegie Center
Princeton, NJ 08540-6227

Independent Auditors' Report

The Board of Trustees
State of New Jersey
Public Employees' Retirement System:

We have audited the accompanying statement of fiduciary net assets of the State of New Jersey Public Employees' Retirement System (the System) as of June 30, 2006, and the related statement of changes in fiduciary net assets for the year 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 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 System'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 Public Employees' Retirement System as of June 30, 2006, 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 (Schedules 1 and 2) 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 System's basic financial statements. The schedule of changes in fiduciary net assets by fund (Schedule 3) is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. 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

January 25, 2007

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2006

Our discussion and analysis of the Public Employees' Retirement System (the System) financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2006 - 2005

- Net assets held in trust for pension and post-retirement medical benefits increased by $1,396,201,473 as a result of fiscal year 2006's operations from $23,915,813,615 to $25,312,015,088.
- Additions for the year were $3,503,000,862, which are comprised of member and employer pension contributions of $1,164,469,355 and investment income of $2,338,531,507.
- Deductions for the year were $2,106,799,389, which are comprised of benefit and refund payments of $2,089,433,661 and administrative expenses of $17,365,728.

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 System and about its activities to help you assess whether the System, 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 System at the end of the fiscal year. The difference between assets and liabilities represents the System's fiduciary net assets. Over time, increases or decreases in the System's fiduciary net assets provide one indication of whether the financial health of the System 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 System'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 System is becoming financially stronger or weaker.

FINANCIAL ANALYSIS

SCHEDULE OF FIDUCIARY NET ASSETS

2006 - 2005

	2006	2005	Increase (Decrease)
Assets	$30,106,370,751	$28,028,338,402	$2,078,032,349
Liabilities	4,794,355,663	4,112,524,787	681,830,876
Net Assets	$25,312,015,088	$23,915,813,615	$1,396,201,473

The System's assets mainly consist of cash, securities lending collateral, investments and contributions due from members and participating employers. Between fiscal years 2005 and 2006, total assets increased by $2.1 billion or 7.4%. The total assets increased due to an increase in contributions receivable from employers, an overall increase in fair value of investments, and an increase in securities lending collateral.

Employer contributions receivables include contribution receivables from local employers for appropriations due April 1, 2007 based on Chapter 108, P.L. 2003, which provided that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by the PERS to 60% for payments due in State fiscal year 2007. Employer contributions receivables also include 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 127, 128, and 129, P.L. 2003 (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 System's insurance provider, securities lending collateral and rebates payable, and other payables. Total liabilities increased by $681.8 million or 16.6% over last year. This is mainly due to an increase in retirement benefits payable to increased number of retirees and also an increase in securities lending collateral and rebates payable.

Net assets held in trust for pension and post-retirement medical benefits increased by $1.4 billion or 5.8%.

ADDITIONS TO FIDUCIARY NET ASSETS
2006 - 2005

	2006	2005	Increase (Decrease)
Member Contributions	$630,322,617	$533,862,353	$96,460,264
Employer Contributions & Other	534,146,738	410,736,970	123,409,768
Investment	2,338,531,507	1,928,822,241	409,709,266
Totals	$3,503,000,862	$2,873,421,564	$629,579,298

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by $96.5 million or 18.1% due to increase in active member count.

Employer contributions increased by $123.4 million or 30.1% over last year. The State made a contribution of $211.5 million for fiscal year 2006 post-retirement medical (PRM). Also, employer contributions include appropriation due April 1, 2007 from local employers, based on Chapter 108, P.L. 2003; State appropriation based on Chapter 23, P.L. 2002; and appropriation due from local employers, based on Chapter 127, 128, and 129, P.L. 2003.

Investment & other revenues increased by $409.7 million or 21.2% due to an increase in net appreciation in fair value of investments and a higher return on investments.

The total investment return for all pension funds was estimated to be 9.7% compared to 8.7% in the prior year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS
2006 - 2005

	2006	2005	Increase (Decrease)
Benefits	$2,019,162,139	$1,899,871,351	$119,290,788
Refunds & Adjustments	70,271,522	65,486,887	4,784,635
Administrative Expenses	17,365,728	25,602,118	(8,236,390)
Totals	$2,106,799,389	$1,990,960,356	$115,839,033

Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the System. Benefit payments increased by $119.3 million or 6.3% partly due to an increase in number of retirees. The number of refunds processed increased by $4.8 million or 7.3%. Administrative expenses have decreased by $8.2 million or 32.2%. Last year's administrative expense was higher due to the reimbursement to the State General Fund of the Special Project Fund Appropriation utilized for the system reengineering project.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 85.3% for fiscal year 2006 and 91.3% for fiscal year 2005 indicate that the System is reasonably funded.

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 System's finances and to show the System'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
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statement of Fiduciary Net Assets

June 30, 2006

		PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Assets:				
Cash	$	3,817,601	—	3,817,601
Securities Lending Collateral		4,729,781,295	—	4,729,781,295
Investments, at fair value:				
Cash Management Fund		664,928,677	89,147	665,017,824
Bonds		74,440,866	9,980	74,450,846
Common Pension Fund A		11,669,444,915	1,564,521	11,671,009,436
Common Pension Fund B		6,184,132,280	829,106	6,184,961,386
Common Pension Fund D		4,610,369,932	618,112	4,610,988,044
Common Pension Fund E		368,270,120	49,374	368,319,494
Mortgage Backed Securities		75,275,176	10,092	75,285,268
Total investments		23,646,861,966	3,170,332	23,650,032,298
Receivables:				
Contributions:				
Members		70,330,362	—	70,330,362
Employers		1,038,055,087	—	1,038,055,087
Accrued interest and dividends		157,878,640	—	157,878,640
Members' loans		453,057,643	—	453,057,643
Other		3,417,825	—	3,417,825
Total receivables		1,722,739,557	—	1,722,739,557
Total assets		30,103,200,419	3,170,332	30,106,370,751
Liabilities:				
Accounts payable and accrued expenses		16,918,449	—	16,918,449
Retirement benefits payable		42,632,483	—	42,632,483
Non-contributory group insurance premiums payable		5,023,436	—	5,023,436
Cash overdraft		—	—	—
Securities lending collateral and rebates payable		4,729,781,295	—	4,729,781,295
Total liabilities		4,794,355,663	—	4,794,355,663
Net Assets:				
Held in trust for pension benefits	$	25,308,844,756	3,170,332	25,312,015,088

See schedule of funding progress on pages 28-29.
See accompanying notes to financial statements.

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Statement of Changes in Fiduciary Net Assets

Year ended June 30, 2006

		PENSION FUND	POST-RETIREMENT MEDICAL FUND	TOTAL
Additions:				
Contributions:				
Members	$	630,322,617	—	630,322,617
Employers		322,613,192	211,533,546	534,146,738
Total contributions		952,935,809	211,533,546	1,164,469,355
Investment income:				
Net appreciation in fair value of investments		1,575,604,593	125,285	1,575,729,878
Interest		524,267,525	—	524,267,525
Dividends		242,745,117	—	242,745,117
		2,342,617,235	125,285	2,342,742,520
Less: investment expense		4,211,013	—	4,211,013
Net investment income		2,338,406,222	125,285	2,338,531,507
Total additions		3,291,342,031	211,658,831	3,503,000,862
Deductions:				
Benefits		1,809,376,698	209,785,441	2,019,162,139
Withdrawals		70,271,522	—	70,271,522
Administrative expenses		17,365,728	—	17,365,728
Total deductions		1,897,013,948	209,785,441	2,106,799,389
Change in net assets		1,394,328,083	1,873,390	1,396,201,473
Net assets - Beginning of year		23,914,516,673	1,296,942	23,915,813,615
Net assets - End of year	$	25,308,844,756	3,170,332	25,312,015,088

See accompanying notes to financial statements.

(1) DESCRIPTION OF THE SYSTEM

The State of New Jersey Public Employees' Retirement System (the System; PERS) 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 basic financial statements of the State of New Jersey.

At June 30, 2005, the date of the most recent actuarial valuation, participating employers consisted of the following:

	Participating employers
State of New Jersey	1
County agencies	65
Municipalities	588
School districts	567
Other public agencies	460
Total	1,681

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 or under the disability provisions of the System. 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 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.

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.

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.

Chapter 23, P.L. 2002 provided early retirement incentive benefits to State employees who meet specified age and service requirements and who retired within a specified time period that generally extended 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 127, 128, and 129, P.L. 2003 provided early retirement incentive benefits to local employees.

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.

Chapter 259, P.L. 2001 amended the PERS statutes and created special retirement benefits for members employed as workers' compensation judges. PERS members entitled to the new benefits are the Chief Judge, the administrative supervisory judges, the supervisory judges, and the judges of compensation of the Division of Workers' Compensation of the Department of Labor. Those in eligible titles would receive retirement benefits comparable to those provided to members of the Judicial Retirement System. The effective date of this legislation was December 6, 2001.

Chapter 366, P.L. 2001 provided enhanced pension benefits to selected individuals with County Prosecutor Offices and in the Division of Criminal Justice.

Significant Legislation:

P.L. 2003, effective July 14, 2003, provided employees of local employers with additional retirement benefits through early retirement incentive programs: Chapter 127 for a public agency other than State agencies under PERS; Chapter 128 for a county, a county college, or a municipality; and Chapter 129 for a local school board or educational services commission. 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.

Chapter 108, P.L. 2003, effective July 1, 2003, provided that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by the PERS as follows: 20% for payments due in State fiscal year 2005; not more than 40% in fiscal year 2006; not more than 60% in fiscal year 2007; and not more than 80% in fiscal year 2008. According to the Appropriation Act of 2003**,** the State as well is paying pension obligations through a five-year phase-in.

Membership:

Membership in the System consisted of the following at June 30, 2005, the date of the most recent actuarial valuation:

	PENSION BENEFITS	POST-RETIREMENT MEDICAL BENEFITS
Retirees and beneficiaries receiving benefits currently and terminated employees entitled to benefits but not yet receiving them	123,016	19,992
Active members:		
Vested	140,390	11,300
Non-vested	170,542	83,065
Total active members	310,932	94,365
Total	433,948	114,357

(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 System is accounted for using an economic resources measurement focus.

The accrual basis of accounting is used for measuring financial position and changes in fiduciary net assets of the System. 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 System 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 System. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

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.
- Alternative investments (private equity, real assets and absolute return strategy funds) – estimated fair value provided by the investment manager and reviewed by management. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the value that would be used if a ready market for such investments existed. Accordingly, the realized value received upon the sale of the asset may differ from the fair value.

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 value of Common Funds A, B, D and E (Common Funds) is 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 Fund D, and the income earned on Common Fund D units is reinvested. Income earned per unit is calculated monthly for Common Fund E, and the income earned on Common Fund E units is reinvested.

Securities Lending:

Common Funds A, B and D and several of the directly-held pension plan portfolios participate in securities lending programs, whereby securities are loaned to brokers or to other borrowers and, in return, the pension funds have rights to the collateral received. All of the securities held in Common Funds A, B and D, and certain securities held directly by the pension plans, 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 to an individual borrower, 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 to an individual borrower, 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, 2006, 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 on the securities while they are on loan. The custodian bank for Common Fund D also indemnifies Common Funds for any loss of principal or interest on the invested collateral. For any losses on the investment collateral in Common Funds A or B or other pension plan portfolios, the lending fee paid to the lending agent shall be reduced by 25% of the amount of such loss, up to an amount not to exceed 75% of the previous six months' securities lending fees. The securities loans can be terminated by notification by either the borrower 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 portfolio 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 held directly by the Common Funds as of June 30, 2006 is as follows:

Forward currency receivable	$ 1,887,515,323
Forward currency payable	1,902,654,117
Net unrealized loss (gain)	15,138,794

The net unrealized gain or loss is included in investments in the accompanying statement of net assets at June 30, 2006.

The Common Funds utilize covered call and put options in an effort to add value to or reduce the risk level in the portfolio. Covered options are agreements that give the owner of the option the right, but not obligation, to buy (in the case of a call option) or to sell (in the case of a put option) a specific amount of an asset for a specific price (called the strike price) on or before a specified expiration date. The writer of call options receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the instrument underlying the option. The Common Funds have written call options on 182,000 shares with a fair value of $470,032 at June 30, 2006 which are reflected as contra-assets to the fair value of the portfolio. The Common Funds own put options on 6,990,800 shares with a fair value of $1,631,358, which are included in the portfolio at June 30, 2006.

Certain alternative investment funds and partnerships may use derivative instruments to hedge against market risk and to enhance investment returns. At any point during the year, the Common Funds may have additional exposure to derivatives primarily through limited liability vehicles such as limited partnerships and commingled investment funds.

Members' Loans:

Members who have at least three years of service in the System 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 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 statement of changes in fiduciary net assets.

(3) INVESTMENTS

The System is invested in Common Pension Fund A, Common Pension Fund B, Common Pension Fund D, Common Pension Fund E, and other investments, including bonds and mortgage backed securities, which represent 32.10%, 33.73%, 32.10%, 33.09%, and 11.20%, respectively, of each investment total of the pension funds as of June 30, 2006.

The pension funds investments as of June 30, 2006 are as follows:

Domestic equities	$ 36,206,866,148
International equities	12,953,297,531
Domestic fixed income	16,949,855,296
International fixed income	1,187,184,887
Domestic floating rate securities	77,882,139
Police and Fireman's mortgages	965,008,210
Private equity	236,208,692
Real estate	81,345,789
Absolute return strategy funds	260,707,666
Net forward foreign exchange contracts	(15,138,794)
	$ 68,903,217,564

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, private equity, real estate, other real assets and absolute return strategy funds.

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 evaluated 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 held directly by the pension funds and limit the amount that can be invested in any one issuer or issue as follows:

Category	Minimum Rating Moody's	Minimum Rating S&P	Limitation of Issuer's Outstanding Debt	Limitation of Issue	Other Limitations
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 greater of 10% of issue or $10 million; not more than 2% of fund assets can be invested in any one issuer
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

For securities in the fixed income portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2006:

	Moody's Rating				
(000's)	**Aaa**	**Aa**	**A**	**Baa**	**Ba**
United States Treasury Notes	$ 3,516,004	—	—	—	—
United States Treasury Bills	389,716	—	—	—	—
United States Treasury TIPS	790,555	—	—	—	—
United States Treasury Bonds	1,984,003	—	—	—	—
United States Treasury Strips	37,219	—	—	—	—
Title XI Merchant Marine Notes	3,615	—	—	—	—
Federal Agricultural Mortgage Corp. Notes	95,763	—	—	—	—
Federal Farm Credit Bank Bonds	50,270	—	—	—	—
Federal Home Loan Bank Bonds	466,312	—	—	—	—
Federal Home Loan Bank Discounted Notes	89,894	—	—	—	—
Federal Home Loan Mortgage Corp. Notes	341,897	—	—	—	—
Federal National Mortgage Association Notes	226,193	—	—	—	—
Resolution Funding Corp. Obligations	6,397	—	—	—	—
Floating Rate Notes	25,023	20,020	9,999	22,841	—
Corporate Obligations	509,357	674,474	2,172,927	1,545,710	—
Real Estate Investment Trust Obligations	—	—	—	93,436	—
Finance Company Debt	217,653	623,016	626,864	9,097	55,587
Supranational Obligations	75,512	—	—	—	—
International Bonds and Notes	208,740	99,215	19,539	—	—
Foreign Government Obligations	470,461	313,716	—	—	—
Remic/FHLMC	731,131	—	—	—	—
Remic/FNMA	67,108	—	—	—	—
Remic/GNMA	17,650	—	—	—	—
GNMA Mortgage Backed Certificates	78,051	—	—	—	—
FHLM Mortgage Backed Certificates	598,915	—	—	—	—
FNMA Mortgage Backed Certificates	620,790	—	—	—	—
Asset Backed Obligations	178,119	—	—	—	—
Private Export Obligations	55,971	—	—	—	—
Exchange Traded Securities	—	—	51,735	—	—
	$ 11,852,319	1,730,441	2,881,064	1,671,084	55,587

The table does not include certain corporate obligations totaling $24,426,500 which have an S&P rating of A and do not have a Moody's rating. 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.

The following table summarizes the maturities (or, in the case of Remics, Police and Firemen's Mortgages and mortgage-backed securities, the expected average life) of the fixed income portfolio at June 30, 2006:

(000's)			Maturities in Years			
Fixed Income Investment Type		Total Market Value	Less than 1	1-5	6-10	More than 10
United States Treasury Notes	$	3,516,004	747,277	796,007	1,972,720	—
United States Treasury Bills		389,716	389,716	—	—	—
United States Treasury TIPS		790,555	—	60,532	580,319	149,704
United States Treasury Bonds		1,984,003	—	—	215,305	1,768,698
United States Treasury Strips		37,219	—	—	—	37,219
Title XI Merchant Marine Notes		3,615	—	—	—	3,615
Federal Agricultural Mortgage Corp. Notes		95,763	—	95,763	—	—
Federal Farm Credit Bank Bonds		50,270	—	50,270	—	—
Federal Home Loan Bank Bonds		466,312	175,074	268,104	23,134	—
Federal Home Loan Bank Discounted Notes		89,894	—	—	—	89,894
Federal Home Loan Mortgage Corp. Notes		341,897	322,470	—	19,427	—
Federal National Mortgage Association Notes		226,193	129,785	96,408	—	—
Resolution Funding Corp. Obligations		6,397	—	—	—	6,397
Floating Rate Notes		77,883	35,021	32,863	9,999	—
Corporate Obligations		4,926,894	712,831	1,267,070	1,126,601	1,820,392
Real Estate Investment Trust Obligations		93,436	—	42,914	50,522	—
Finance Company Debt		1,532,217	380,558	741,111	273,382	137,166
Supranational Obligations		75,512	—	—	—	75,512
International Bonds and Notes		327,494	124,499	145,353	18,137	39,505
Foreign Government Obligations		784,177	22,393	459,160	193,953	108,671
Remic/FHLMC		731,131	3,383	—	39,299	688,449
Remic/FNMA		67,108	1,321	—	17,827	47,960
Remic/GNMA		17,650	—	—	—	17,650
Police and Firemen's Mortgages		965,008	—	—	—	965,008
GNMA Mortgage Backed Certificates		78,051	12	637	—	77,402
FHLM Mortgage Backed Certificates		598,915	—	148	3,698	595,069
FNMA Mortgage Backed Certificates		620,790	149	9,291	21,177	590,173
Asset Backed Obligations		178,119	—	118,906	59,213	—
Private Export Obligations		55,971	—	11,887	44,084	—
	$	19,128,194	3,044,489	4,196,424	4,668,797	7,218,484

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The pension funds invest in global markets. The pension 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% of the market value of the pension funds. Not more than 5% of the value of the assets held by Common Fund D can be invested in companies incorporated in emerging market countries, and not more than 5% of the market value of the emerging market securities can be invested in any one corporation. Council regulations permit the pension funds to enter into foreign exchange contracts for the purpose of hedging the international portfolio. The pension funds held forward contracts totaling approximately $1.9 billion at June 30, 2006. Common Fund D had the following foreign currency exposure (expressed in U.S. dollars and 000's):

Currency		Total Market Value	Equities	Foreign Government Obligations
Australian dollar	$	387,324	387,324	—
Canadian dollar		635,640	635,640	—
Danish krone		198,388	198,388	—
Euro		4,789,852	4,286,765	503,087
Hong Kong dollar		130,126	130,126	—
Japanese yen		3,039,675	3,039,675	—
Mexican peso		46,306	46,306	—
New Zealand dollar		18,426	18,426	—
Norwegian krone		269,692	269,692	—
Pound sterling		1,712,822	1,637,310	75,512
Singapore dollar		98,276	98,276	—
South Korean won		121,267	121,267	—
Swedish krona		760,561	682,104	78,457
Swiss franc		1,263,174	1,263,174	—
	$	13,471,529	12,814,473	657,056

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.

The pension funds' interests in alternative investments may contain elements of credit, currency and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition. Council regulations require that not more than 13 percent of the market value of the pension funds can be invested in alternative investments, with the individual categories of real assets, private equity and absolute return strategy investments limited to 5 percent, 7 percent and 5 percent of the market value, respectively. Not more than 5 percent of the market value of Common Fund E may be committed to any one partnership or investment, without the prior written approval of the Council. Common Fund E cannot own more than 25 percent of any individual investment. The investments in Common Fund E cannot comprise more than 20 percent of any one investment manager's total assets.

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, 2006. The net realized gain from investment transactions amounted to $3,946,824,420 and the net increase in unrealized gains on investments amounted to $567,526,008 for the year ended June 30, 2006.

(4) SECURITIES LENDING COLLATERAL

The System's share in the securities lending program is 33.36% of the total market value of the collateral at June 30, 2006.

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:

	Minimum Rating		Limitation of Issuer's Outstanding	Limitation	
Category	**Moody's**	**S&P**	**Debt**	**of Issue**	**Other Limitations**
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	—	—	Dollar limits by issuer
Certificates of deposit/ Banker's acceptances (rating applies to international)	Aa3/P-1	—	—	—	Uncollateralized certificates of deposit and banker's acceptances' cannot exceed 10% of issuer's primary capital; dollar limits by issuer
Guaranteed income contracts	P-1	—	—	—	Limited to 5% of the assets of the collateral 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.

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, 2006. In those cases where an issuer and/or security have both a long-term and short-term rating, the short-term rating is disclosed.

	Moody's Rating				
(000's)	**Aaa**	**Aa**	**A**	**P1**	**Not rated**
Corporate Obligations	$ 699,376	3,646,543	1,621,567	—	—
Commercial Paper	14,996	—	—	3,683,532	—
Certificates of Deposit	1,957,748	—	—	—	—
Repurchase Agreements	—	—	—	—	1,609,375
Guaranteed Investment	—	—	—	—	—
Contracts	—	450,000	—	—	—
Money Market Funds	254,354	—	—	—	101,483
Collateralized Notes	—	138,926	—	—	—
Cash	—	—	—	—	187
	$ 2,926,474	4,235,469	1,621,567	3,683,532	1,711,045

The following table summarizes the maturities of the collateral portfolio at June 30, 2006.

(000's)	Total Market Value	Maturities: Less than one year	Maturities: One year to 25 months
Corporate Obligations	$ 5,967,487	2,345,430	3,622,057
Commercial Paper	3,698,527	3,698,527	—
Certificates of Deposit	1,957,748	1,957,748	—
Repurchase Agreements	1,609,375	1,609,375	—
Guaranteed Investment Contracts	450,000	350,000	100,000
Money Market Funds	355,837	355,837	—
Collateralized Notes	138,926	—	138,926
	$ 14,177,900	10,316,917	3,860,983

As of June 30, 2006, the pension funds had received cash collateral of $14,115,678,308 for outstanding loaned investment securities having market values of $13,824,349,093. In addition, as of June 30, 2006, the pension funds loaned investment securities having market values of $1,471,340, against which it had received non-cash collateral with a current value of $1,494,859, which is not reflected in the accompanying financial statements.

(5) 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. The full normal employee contribution rate is 5% of base salary. However, as a result of special legislation (Chapter 415, P.L. 1999), the employee rate was reduced to 3% of base salary effective January 1, 2000. The rate for State and local employees returned to the normal rate of 5% effective July 1, 2004 and January 1, 2005, respectively per statute since there are no longer surplus assets available in the System. On the other hand, the rate for members who are eligible for the Prosecutors Part of the PERS (Chapter 366, P.L. 2001) remains unchanged at 7.5% of base salary. 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.

For fiscal year 2006, 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 and local employers were not required to make a normal contribution to the System between the years 1997 and 2004. 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 $211.53 million for fiscal year 2006 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 System, 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 system. No additional formula State contribution is required in fiscal year 2006; instead, that contribution will be covered by the BEF.

Chapter 108, P.L. 2003 provided that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by the PERS as follows: 20% for payments due in State fiscal year 2005; not more than 40% in fiscal year 2006; not more than 60% in fiscal year 2007; and not more than 80% in fiscal year 2008. According to the Appropriation Act of 2003 related to fiscal year 2006, the State as well is paying pension obligations through a five-year phase-in.

(6) FUNDS

This System maintains the following legally required funds:

Members' Annuity Savings and Accumulative Interest Fund ($7,918,422,325)

The Members' Annuity Savings Fund (ASF) 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, has changed from 8.75% to 8.25% due to an economic assumption change.

Contingent Reserve Fund ($683,516,957)

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 ($15,752,810,411)

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' ASF 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 (8.25% for fiscal year 2006) is credited to the Retirement Reserve Fund.

Special Reserve Fund ($234,137,829)

The Special Reserve Fund is the fund to which excess 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 amounted to $236.25 million as of June 30, 2006. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

Contributory Group Insurance Premium Fund ($237,161,959)

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 ($3,170,332)

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 ($482,795,275)

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 2002 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 System is a qualified plan as described in Section 401(a) of the Internal Revenue Code.

Schedule 1

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information (Unaudited)

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, 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%)
June 30, 2001	11,123,818,861	9,886,463,368	(1,237,355,493)	112.5%	3,288,383,788	(37.6%)
June 30, 2002	11,073,156,965	10,760,557,483	(312,599,482)	102.9%	3,511,151,199	(8.9%)
June 30, 2003	10,829,953,189	11,942,299,170	1,112,345,981	90.7%	3,576,118,300	31.1%
June 30, 2004	10,693,508,592	12,620,379,435	1,926,870,843	84.7%	3,751,765,096	51.4%
June 30, 2005	10,631,348,826	13,432,528,883	2,801,180,057	79.1%	4,028,028,170	69.5%
Local						
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%)
June 30, 2001	16,625,288,260	13,819,038,491	(2,806,249,769)	120.3%	5,240,338,738	(53.6%)
June 30, 2002	16,503,081,054	14,929,334,103	(1,573,746,951)	110.5%	5,534,322,805	(28.4%)
June 30, 2003	16,406,284,200	15,887,012,746	(519,271,454)	103.3%	5,811,726,702	(8.9%)
June 30, 2004	16,414,022,003	17,077,938,057	663,916,054	96.1%	6,140,413,756	10.8%
June 30, 2005	16,482,040,944	18,341,857,304	1,859,816,360	89.9%	6,416,265,644	29.0%

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information (Unaudited)

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2005 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
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
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information (Unaudited)

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%
2002	88,911,187	—	0.0%
2003	44,636,619	—	0.0%
2004	50,365,892	526,505[3]	1.0%
2005	115,017,395	463,342[3]	0.4%
2006	153,436,981	568,139[3]	0.4%
Local			
1997	142,672,255	67,476,771	47.3%
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%
2002	77,254,063	16,174,534	20.9%
2003	—	16,987,033	N/A
2004	—	20,882,718	N/A
2005	29,425,853	56,916,883	193.4%
2006	102,618,135	141,498,069	137.9%

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 contributions from 1998 to 2004 consist of the 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.

(3) The statutory required contributions which were reduced in anticipation of the provisions of the Appropriation Act of 2003 will be covered by available excess assets in the Benefit Enhancement Fund. The amounts shown represent a fund transfer from the Second Injury Fund in accordance with Chapter 259, P.L. 2001.

STATE OF NEW JERSEY
PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2006

	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	TOTAL
Additions:								
Contributions:								
Members	$ 578,493,015	—	—	—	51,829,602	—	—	630,322,617
Employers	—	322,613,192	—	—	—	211,533,546	—	534,146,738
Total contributions	578,493,015	322,613,192	—	—	51,829,602	211,533,546	—	1,164,469,355
Distribution of net investment income	549,852,061	474,487,417	1,233,371,132	36,730,307	7,170,284	125,285	36,795,021	2,338,531,507
Total additions	1,128,345,076	797,100,609	1,233,371,132	36,730,307	58,999,886	211,658,831	36,795,021	3,503,000,862
Deductions:								
Benefit payments	—	58,411,226	1,717,907,371	—	33,058,101	209,785,441	—	2,019,162,139
Refunds of contributions	66,735,720	3,535,802	—	—	—	—	—	70,271,522
Administrative expenses	—	17,365,728	—	—	—	—	—	17,365,728
Total deductions	66,735,720	79,312,756	1,717,907,371	—	33,058,101	209,785,441	—	2,106,799,389
Net increase (decrease) before transfers among reserves	1,061,609,356	717,787,853	(484,536,239)	36,730,307	25,941,785	1,873,390	36,795,021	1,396,201,473
Transfers among reserves:								
Retirements	(420,595,593)	(878,986,492)	1,299,582,085	—	—	—	—	—
Other	3,595,083	14,563,722	172,968,828	—	—	—	(191,127,633)	—
Net increase (decrease)	644,608,846	(146,634,917)	988,014,674	36,730,307	25,941,785	1,873,390	(154,332,612)	1,396,201,473
Net assets held in trust for pension and post-retirement medical benefits:								
Beginning of year	7,273,813,479	830,151,874	14,764,795,737	197,407,522	211,220,174	1,296,942	637,127,887	23,915,813,615
End of year	$ 7,918,422,325	683,516,957	15,752,810,411	234,137,829	237,161,959	3,170,332	482,795,275	25,312,015,088

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