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

TO THE HONORABLE
JAMES E. McGREEVEY
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor McGreevey:

The Board of Trustees of the

POLICE AND FIREMEN'S RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2004 Annual Report in accordance with the provisions of N.J.S.A. 43:16A-13.

Respectfully submitted,

MARTY BARRETT
Chairperson

Police and Firemen's Retirement System

2004 BOARD OF TRUSTEES

SIGNIFICANT LEGISLATION

Chapter 108, P.L. 2003

This new law provides for the following:

1. Reduces the pension contributions that local employers must make to the Public Employees' Retirement System of New Jersey (PERS) and the Police and Firemen's Retirement System (PFRS) for four years,
2. Exempts local employer contributions to PERS and PFRS from the local budget cap law for a limited period, and
3. Provides for a prospective increase to the PFRS special retirement benefit upon the pension system attaining a funded level in excess of 104 percent.

1. Pension Contribution Reduction

This law provides that the State Treasurer will reduce local employer PERS normal and accrued liability contributions to be a percentage of the amount certified annually by PERS as follows: 20% for payments due in State fiscal year 2005; not more than 40% for payments due in State fiscal year 2006; not more than 60% for payments due in State fiscal year 2007; and not more than 80% for payments due in State fiscal year 2008. Local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the retirement system for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the retirement system as the State Treasurer will determine, but not more than 40% for payments due in State fiscal year 2005, not more than 60% for payments due in State fiscal year 2006, and not more than 80% for payments due in State fiscal year 2007.

2. Budget Cap Exemption

This law provides that, for the respective four-year periods during which local public employers' pension contributions to PERS and PFRS will be reduced, and for the year thereafter when the employers would again be subject to the full contribution requirement, the affected contribution payments shall be exempt from the limits imposed by the local budget "cap" law.

3. Prospective PFRS Special Retirement Benefit Enhancement

This law provides for an increase to the special retirement benefit for members of the Police and Firemen's Retirement System (PFRS) beginning with the fiscal year following the adopted valuation report for the retirement system which indicates a funded level in excess of 104%. PFRS members who have 25 or more years of service are currently eligible for a pension of 65% of final compensation, plus 1% of final compensation multiplied by the number of years of creditable service over 25 but not over 30 (70% maximum). This law will increase that benefit to a pension of 70% of final compensation, plus 1% of final compensation for each year of creditable service over 25 but not over 30 (75% maximum) once the funded level exceeds 104%.

The law also provides for the establishment in PFRS of a benefit enhancement fund to which will be credited an amount of excess valuation assets for the valuation period beginning with the valuation report which indicates a funded level of 104%. The amount of excess valuation assets credited to the benefit enhancement fund will not exceed the present value of the expected additional normal and accrued liability contributions attributable to the increase in the PFRS special retirement benefits payable on behalf of the active PFRS members. No additional excess valuation assets will be credited to the benefit enhancement fund after the maximum amount is attained. The normal and accrued liability contributions for this increase in PFRS benefits for active employees will be paid from the benefit enhancement fund. If fund assets are insufficient to pay those contributions for a valuation period, the retirement system will pay the amount not covered by assets from the benefit enhancement fund.

This law was effective July 1, 2003.

SIGNIFICANT LEGISLATION

Chapter 130, P.L. 2003

This law provides for additional retirement benefits for employees of an employer other than the State, that elects to offer the benefits, who retire under the Police and Firemen's Retirement System (PFRS). The governing body of the employer will have one year after the enactment of this law to adopt a resolution to offer the benefits. Once a resolution is adopted and effective, employees will have three months to retire.

Employees who have at least 25 years of service credit as of the effective date of retirement will receive an additional three years of service credit.

Employees who are at least 55 years of age with between 20 and 25 years of service as of the effective date of retirement will receive employer-paid coverage in the New Jersey State Health Benefits Program (SHBP). The retired employees, their dependents and survivors will be eligible for coverage in the program even if the employer does not participate in the SHBP or otherwise provide health care benefits coverage in retirement upon the normal retirement of such employees.

Employees who are at least 55 years of age with between 10 and 20 years of service as of the effective date of retirement will receive an additional pension payment of $500 per month for the first 24 months after retirement.

When the needs of an employer require the services of an employee who elects to retire and receive a benefit under this law, the employer, with the approval of the governing body and the consent of the employee, may delay the effective retirement date of the employee for up to one year. The delay authorized under the law does not extend the dates for qualification for benefits.

The cost of the enhanced PFRS pension benefits will be funded by employer contributions to the retirement systems and paid by the employers who elect to participate. The additional pension liability shall be paid by each electing entity over a period of 15 years. The SHBP health care benefits payments for eligible retirees and their dependents will be paid by the employer on a current cost basis.

An employer may elect to provide these benefits by the adoption of a resolution by its governing body and the filing of a certified copy with the Director of the Division of Pensions and Benefits within three business days. The effective date of the resolution must fall within one year of enactment of this law. An employer may offer these benefits only once. An employer covered by this law must meet with the employee union representatives, whether or not the employer adopts a resolution, within a year of the enactment of this law.

This law also provides for the following:

- Partial purchase of pension service credit to qualify.
- The employer shall pay the cost of the actuarial work to determine the additional liability of the retirement systems for the benefits under this act, which shall be included in the initial contribution required from the employer.
- The promulgation of rules and regulations by the Division of Pensions and Benefits deemed necessary for the effective implementation of this act.
- The enrollment in the SHBP of those retiring under this act at age 55 with between 20 and 25 years of service within 60 days of retirement.
- Authorizes counties and municipalities to issue refunding bonds to retire the present value of the unfunded accrued pension liabilities for early retirement incentive benefits granted by the law.

This law was effective July 14, 2003.

Chapter 181, Public Law of 2003

This law provides that the eligibility of a surviving spouse to receive an accidental death benefit under the Police and Firemen's Retirement System (PFRS) or the State Police Retirement System (SPRS) shall not terminate upon remarriage.

Under the PFRS, when a member of the system dies in active service as a result of an accident met in the actual performance of duty, the surviving spouse is eligible to receive a survivorship benefit consisting of (i) a pension equal to 70% of the compensation upon which contributions by the member were based in the last year of creditable service, and (ii) State-paid coverage under the member's employer-sponsored health insurance plan. Under the SPRS, the corresponding accidental death benefit to the surviving spouse is a pension of 70% of the average compensation received by the member in the last 12 months of creditable service prior to death, plus the health benefit coverage.

Prior to the enactment of this law, under both the PFRS and SPRS, the surviving spouse ceased to be eligible for the accidental death benefit if he or she remarried. This law allows these surviving spouses to remarry without losing the benefit.

This law was effective September 12, 2003.

Chapter 197, P.L. 2003

This law extends eligibility for certain veterans' benefits to veterans of Operations "Enduring Freedom" and "Iraqi Freedom" who served at least 14 days in the theater of operation of those campaigns and in direct support thereof.

The benefits for which a qualified veteran will become eligible under this law include:

1. For eligible public employees, absolute civil service preference under Title 11A of the New Jersey Statutes;
2. For eligible members of the public employee pension systems, (a) the veteran's retirement allowance under the Teachers' Pension and Annuity Fund (TPAF) or the Public Employees' Retirement System (PERS), and (b) the right to purchase additional pension credit in the Police and Firemen's Retirement System (PFRS), TPAF or PERS; and
3. For homeowners, entitlement to the annual property tax deduction provided for by Article VIII of the New Jersey Constitution ($250 in each tax year) or a property tax exemption if the eligible person has a total and permanent service-incurred disability.

Of the three operations, service that may qualify a person for benefits under the law is as follows:

a. "Enduring Freedom" refers collectively to operations conducted abroad since September 11, 2001, in prosecution of the war against terror, including but not limited to operations conducted in Afghanistan.

b. "Iraqi Freedom" refers to the operations in and around Iraq beginning in March 2003 and still ongoing.

In addition to its broadening of veterans' benefit eligibility, this law makes technical changes and updates to descriptions of what constitutes service during the military conflicts of Operation "Restore Hope" in Somalia and Operations "Joint Endeavor" and "Joint Guard" in the Republic of Bosnia and Herzegovina.

This law was effective December 16, 2003.

Chapter 246, P.L. 2003

This new law is designated the "Domestic Partnership Act." It creates a mechanism, through the establishment of domestic partnerships, for New Jersey to recognize and support adult individuals in this State who share an important personal, emotional and committed relationship with another adult.

The law provides that two persons who desire to become domestic partners may execute and file an Affidavit of Domestic Partnership with the local registrar upon payment of a fee, in an amount to be determined by the Commissioner of Health and Senior Services, if they meet all of the following requirements:

- Both persons share a common residence in this State, or share the same place to live in another jurisdiction and at least one of them is a member of a State-administered retirement system;

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- Both persons are otherwise jointly responsible for each other's common welfare as evidenced by joint financial arrangements or joint ownership of real or personal property, which are to be demonstrated by at least one of the following: a joint deed, mortgage agreement or lease; a joint bank account; designation of one of the persons as a primary beneficiary in the other person's will; designation of one of the persons as a primary beneficiary in the other person's life insurance policy or retirement plan; or joint ownership of a motor vehicle;
- Both persons agree to be jointly responsible for each other's basic living expenses during the domestic partnership;
- Neither person is in a marriage recognized by New Jersey law or a member of another domestic partnership;
- Neither person is related to the other by blood or affinity up to and including the fourth degree of consanguinity;
- Both persons are of the same sex and therefore unable to enter into a marriage with each other that is recognized by New Jersey law, or are each 62 years of age or older and not of the same sex;
- Both persons have chosen to share each other's lives in a committed relationship of mutual caring;
- Both persons are at least 18 years of age;
- Both persons file jointly an Affidavit of Domestic Partnership; and
- Neither person has been a partner in a domestic partnership that was terminated less than 180 days prior to the filing of the current Affidavit of Domestic Partnership, except that this prohibition does not apply if one of the partners died; and, in all cases in which a person registered a prior domestic partnership, the domestic partnership must have been terminated in accordance with the provisions of the law.

In the case of domestic partners that are not of the same sex, the domestic partnership will terminate automatically upon the partners' entry into a marriage with each other that is recognized by New Jersey law.

This law accords domestic partners rights and responsibilities that reflect the mutually interdependent and supportive nature of domestic partnership relationships. It provides all domestic partners with:

- statutory protection through the "Law Against Discrimination" (N.J.S.A.10:5-1 et seq.) against various forms of discrimination based on domestic partnership status, including employment, housing and credit discrimination;
- visitation rights for a hospitalized domestic partner and the right to make medical or legal decisions for an incapacitated partner; and
- an additional personal exemption under the "New Jersey Gross Income Tax Act" (N.J.S.A.54A:1-1 et seq.) and an exemption from the New Jersey transfer inheritance tax on the same basis as a spouse.

This law also makes certain health and pension benefits available to dependent domestic partners in the case of domestic partnerships in which both persons are of the same sex and therefore unable to enter into a marriage with each other that is recognized by New Jersey law:

- in the case of State employees, eligibility for dependent coverage under the State Health Benefits Program and dependent benefits under State-administered retirement systems (Public Employees' Retirement System, Police and Firemen's Retirement System, Judicial Retirement System, Teachers' Pension and Annuity Fund, and State Police Retirement System);
- in the case of other public employees, including employees of counties, municipalities and boards of education, eligibility for dependent coverage under the State Health Benefits Program and State-administered retirement systems, if the employer adopts a resolution providing for such coverage; and
- eligibility for dependent coverage under health insurance contracts and policies that commercial health and dental insurers are required to offer to covered persons under the law.

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It also provides that two adults who have not filed an Affidavit of Domestic Partnership are to be treated as domestic partners in an emergency medical situation for the purposes of allowing one adult to accompany the other adult who is ill or injured while the latter is being transported to a hospital, or to visit the other adult who is a hospital patient, on the same basis as a member of the latter's immediate family, if both persons, or one of the persons in the event that the other person is legally or medically incapacitated, advise the emergency care provider that the two persons have met the other requirements for establishing a domestic partnership; however, this provision is not to be construed to permit the two adults to be treated as domestic partners for any other purpose prior to their having filed an Affidavit of Domestic Partnership.

Additionally, this law stipulates that, notwithstanding any other provisions of law to the contrary, the following provisions in this law shall not be deemed an unlawful discrimination under the "Law Against Discrimination" (N.J.S.A.10:5-1 et seq.):

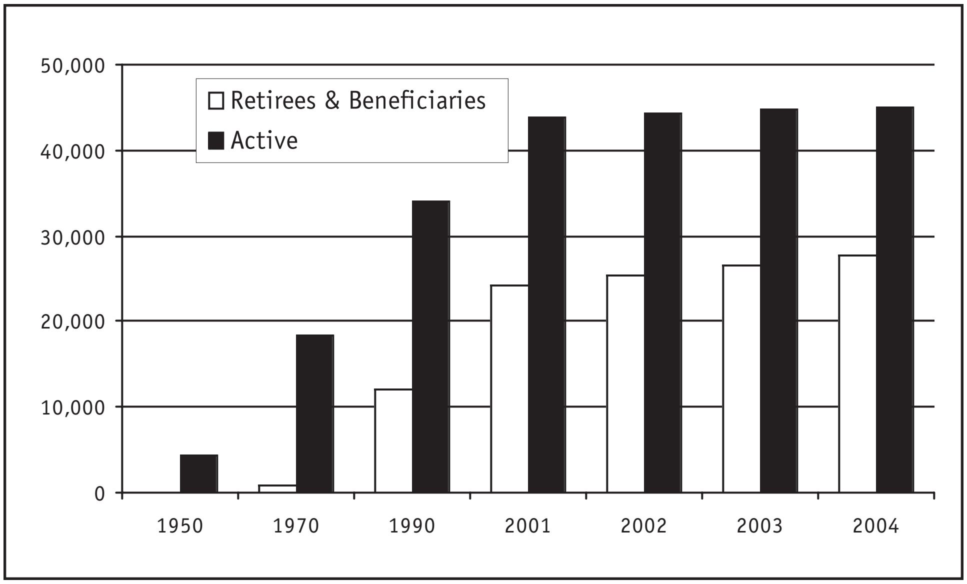
- Section 57, which permits an employer that provides a health benefits plan (as defined in N.J.S.A.26:2S 2) to its employees and their dependents to require that an employee contribute a portion or the full amount of the cost of dependent coverage under the plan for the employee's domestic partner, and
- Section 58, which deals with the distinction between same-sex couples and opposite-sex couples over 62 years of age who establish domestic partnerships with respect to health and pension benefits made available to dependent domestic partners under this law.

The SHBP and State administered pension statutes impacted by this law can be found in Sections 41 through 46 of the law.

This law was effective on July 10, 2004.

MEMBERSHIP

- As of June 30, 2004, the active membership of the System totaled 45,124. There were 1,650 inactive members in the System as of June 30, 2004.
- There were 27,826 retirees and beneficiaries receiving annual pensions totaling $956,173,745. *(Includes benefits paid under the provisions of the Pension Adjustment Act.)*
- The System's assets totaled $16,439,571,152 at the close of the fiscal year 2004.



MEMBERSHIP ACTIVITY

During fiscal year 2004, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Police and Firemen's Retirement System of New Jersey.

- **LOANS** - 22,572 loans were issued to members. The total loans receivable as of June 30, 2004 is $464,718,668.
- **RETIREMENT** - 1,299 members retired under the following retirement types:

TYPE OF RETIREMENT

Service	31
Special	955
Deferred	7
Ordinary Disability	167
Accidental Disability	100
Accidental Death	39
TOTAL	1,299

KPMG LLP
New Jersey Headquarters
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Independent Auditors' Report

The Board of Trustees
State of New Jersey
Police and Firemen's Retirement System:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Police and Firemen's Retirement System (the System) as of June 30, 2004 and 2003, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Police and Firemen's Retirement System as of June 30, 2004 and 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis and the supplementary information included in the schedule of funding progress and schedule of employer contributions are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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 audits were 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 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 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.

September 24, 2004

KPMG LLP

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2004 and 2003

Our discussion and analysis of the Police and Firemen's Retirement System (the System)'s financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2004 and 2003. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

FINANCIAL HIGHLIGHTS

2004 - 2003

- Net assets held in trust for pension benefits increased by $1,473,240,741 as a result of this year's operations from $14,879,955,591 to $16,353,196,332.
- Additions for the year were $2,470,975,465, which are comprised of member and employer pension contributions of $527,337,156 and investment income of $1,943,638,309.
- Deductions for the year were $997,734,724, which are comprised of benefit and refund payments of $994,203,954 and administrative expenses of $3,530,770.
- The System utilized net assets (excess assets above the required funding level) to meet the employers' portion of normal pension contribution requirement.

2003 - 2002

- Net assets held in trust for pension benefits decreased by $325,088,769 as a result of this year's operations from $15,205,044,360 to $14,879,955,591.
- Additions for the year were $602,647,142, which are comprised of member and employer pension contributions of $172,406,722 and investment income of $430,240,420.
- Deductions for the year were $927,735,911, which are comprised of benefit and refund payments of $923,708,392 and administrative expenses of $4,027,519.
- The System utilized net assets (excess assets above the required funding level) to meet the employers' portion of normal pension contribution requirement.

THE STATEMENTS OF FIDUCIARY NET ASSETS AND THE STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

This annual report consists of two financial statements: *The Statements of Fiduciary Net Assets* and *The Statements 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 Statements 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 Statements 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

STATEMENTS OF FIDUCIARY NET ASSETS

2004 - 2003

	2004	2003	Increase (Decrease)
Assets	$16,439,571,152	$14,960,120,605	$1,479,450,547
Liabilities	86,374,820	80,165,014	6,209,806
Net Assets (Deficit)	$16,353,196,332	$14,879,955,591	$1,473,240,741

The System's assets mainly consist of cash, investments and contributions due from members and participating employers. Between fiscal years 2003 and 2004, total assets increased by $1.5 billion or 9.9%. The total assets increased due to an increase in contributions receivable from employers and also overall increase in fair value of investments. Employer contribution receivables include contribution receivables from local employers for appropriations due April 1, 2005 based on Chapter 108, P.L. 2003. Last year employer contribution receivables decreased partly due to Chapter 42, P.L. 2002, which permitted local government units to issue refunding bonds to retire an unfunded accrued liability resulting from early retirement benefits.

Liabilities consist of pension and death benefit payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the System's insurance provider, and other payables. Total liabilities increased by $6.2 million or 7.8% over last year. This is mainly due to an increase in retirement benefit payables.

Net assets held in trust for pension benefits increased by $1.5 billion or 9.9%.

2003 - 2002

	2003	2002	Increase (Decrease)
Assets	$14,960,120,605	$15,283,968,390	$(323,847,785)
Liabilities	80,165,014	78,924,030	1,240,984
Net Assets (Deficit)	$14,879,955,591	$15,205,044,360	$(325,088,769)

Between fiscal years 2002 and 2003, total assets decreased by $323.8 million or 2.1%. The total assets decreased because pension benefit payments to retirees and beneficiaries exceeded the revenues received by the System. Also, the decrease in assets is related to decrease in local employer contribution receivable by reducing the previous appropriations down to 20% of the normal and accrued liability contributions.

Total liabilities increased by $1.2 million or 1.6% over last year. This is mainly due to an increase in retirement benefit payments.

Net assets held in trust for pension benefits decreased by $325.0 million or 2.1%.

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

ADDITIONS TO FIDUCIARY NET ASSETS
2004 - 2003

	2004	2003	Increase (Decrease)
Member Contributions	$263,173,065	$252,281,888	$10,891,177
Employer Contributions	264,164,091	(79,875,166)	344,039,257
Investment & Other	1,943,638,309	430,240,420	1,513,397,889
Totals	$2,470,975,465	$ 602,647,142	$1,868,328,323

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions rose by $10.9 million or 4.3% due to increased membership.

Employer contributions increased by $344.0 million or 430.7%. Last year there was a retroactive reduction down to 20% of the revenues of fiscal year 2002. This year employer contributions include accrued appropriations due April 1, 2005 and 2006, based on Chapter 108, P.L. 2003.

The Chapter 108, effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 40% and 60% of the amount certified by the PFRS for payments due in State fiscal year 2005 and 2006, respectively and thereafter a percentage of the amount certified by the System as the State Treasurer will determine. According to the Budget Appropriations Act of 2004**,** the State as well will pay pension obligations through a five-year phase-in.

For fiscal year 2004, 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 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).

Investment & other revenues increased by $1.5 billion or 351.8% due to an increase in earnings and net appreciation in fair value of investments.

The total investment gain for all pension funds was estimated to be 14.2% compared to 3.3% gain in the prior year.

2003 - 2002

	2003	2002	Increase (Decrease)
Member Contributions	$252,281,888	$240,012,580	$12,269,308
Employer Contributions	(79,875,166)	286,887,105	(366,762,271)
Investment & Other	430,240,420	(1,258,970,598)	1,689,211,018
Totals	$ 602,647,142	$ (732,070,913)	$1,334,718,055

Member contributions rose 5.1% due to normal salary increases and increased membership. Employer contributions recognized by the System decreased by 127.8% mainly due to a retroactive reduction of the previous appropriations down to 20% of the normal and accrued liability contributions, based on the new legislation, Chapter 108 (P.L. 2003).

The Chapter 108, effective July 1, 2003, provides that local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the PFRS for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the System as the State Treasurer will determine. According to the Budget Appropriations Act of 2004, the State as well will pay pension obligations through a five-year phase-in.

For fiscal year 2003, the 68% 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 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).

After the prior two consecutive years of investment losses, the System had investment gain in fiscal year 2003. The total investment gain for all pension funds was estimated to be 3.3% compared to 9.0% loss in the prior year.

DEDUCTIONS FROM FIDUCIARY NET ASSETS

2004 - 2003

	2004	2003	Increase (Decrease)
Benefits	$987,055,680	$916,882,474	$70,173,206
Refunds & Adjustments	7,148,274	6,825,918	322,356
Administrative Expenses	3,530,770	4,027,519	(496,749)
Totals	$997,734,724	$927,735,911	$69,998,813

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 $70.2 million or 7.7% primarily due to an increase in number of retirees receiving benefits. The number of refunds processed increased by 4.8%. Administrative expenses decreased by 12.3% mainly due to a decrease in salaries and wages cost over the last year.

2003 - 2002

	2003	2002	Increase (Decrease)
Benefits	$916,882,474	$842,051,581	$74,830,893
Refunds & Adjustments	6,825,918	6,271,845	554,073
Administrative Expenses	4,027,519	3,889,898	137,621
Totals	$927,735,911	$852,213,324	$75,522,587

Benefit payments increased by 8.9% primarily because more members are receiving benefits. The number of refunds processed has increased by 8.8%. Administrative expenses have slightly increased.

RETIREMENT SYSTEM AS A WHOLE

The overall funded ratios of 89.3% for fiscal year 2004 and 95.8% for 2003 indicate that the System has assets sufficient to meet its benefit obligations.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

The financial report is designed to provide our members, beneficiaries, investors and other interested parties with a general overview of the 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
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Statements of Fiduciary Net Assets

June 30, 2004 and 2003

		2004	2003
Assets:			
Investments, at fair value:			
Cash Management Fund		432,623,728	678,099,545
Bonds		6,423,878	12,669,144
Common Pension Fund A		7,740,431,927	6,650,424,087
Common Pension Fund B		3,162,429,106	3,118,811,410
Common Pension Fund D		3,070,174,067	2,358,943,811
Mortgage Backed Securities		1,026,565,950	1,260,874,507
Total investments		15,438,648,656	14,079,822,504
Receivables:			
Contributions:			
Members		47,104,066	47,455,802
Employers		390,478,775	256,931,014
Accrued interest and dividends		74,087,774	76,884,636
Members' loans		464,718,668	468,255,038
Other		24,533,213	30,771,611
Total receivables		1,000,922,496	880,298,101
Total assets		16,439,571,152	14,960,120,605
Liabilities:			
Accounts payable and accrued expenses		2,085,411	2,142,026
Retirement benefits payable		79,948,728	74,250,504
NCGI premiums payable		1,746,494	3,044,899
Cash overdraft		2,594,187	727,585
Total liabilities		86,374,820	80,165,014
Net Assets:			
Held in trust for pension benefits	$	16,353,196,332	14,879,955,591

See schedule of funding progress on page 21.
See accompanying notes to financial statements.

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2004 and 2003

		2004	2003
Additions:			
Contributions:			
Members	$	263,173,065	252,281,888
Employers		264,164,091	(79,875,166)
Total contributions		527,337,156	172,406,722
Investment income:			
Net appreciation (depreciation) in fair value of investments		1,498,740,652	(25,962,866)
Interest		318,069,582	347,301,479
Dividends		127,838,134	110,122,507
		1,944,648,368	431,461,120
Less: investment expense		1,010,059	1,220,700
Net investment income		1,943,638,309	430,240,420
Total additions		2,470,975,465	602,647,142
Deductions:			
Benefits		987,055,680	916,882,474
Refunds of contributions		7,148,274	6,825,918
Administrative expenses		3,530,770	4,027,519
Total deductions		997,734,724	927,735,911
Change in net assets		1,473,240,741	(325,088,769)
Net Assets - Beginning of year		14,879,955,591	15,205,044,360
Net Assets - End of year	$	16,353,196,332	14,879,955,591

See accompanying notes to financial statements.

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2004 and 2003

(1) DESCRIPTION OF THE SYSTEM

State of New Jersey Police and Firemen's Retirement System (the System; PFRS) is a cost-sharing multiple-employer contributory defined benefit plan which was established as of July 1, 1944, under the provisions of N.J.S.A. 43:16A. 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, 2003 and June 30, 2002, the dates of the most recent actuarial valuations, participating employers consisted of the following:

	2003	**2002**
State of New Jersey	1	1
Municipalities	583	587
Total	584	588

The System's designated purpose is to provide retirement, death and disability benefits to its members. Membership in the System is mandatory for substantially all full-time county and municipal police or firemen, and state firemen or officer employees with police powers appointed after June 30, 1944. The System's Board of Trustees is primarily responsible for its administration.

According to 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. 43:16A and 43:3B. The System provides retirement as well as death and disability benefits. All benefits vest after ten years of service except disability benefits which vest after four years of service. Retirement benefits for age and service are available at age 55 and are generally determined to be 2% of final compensation for each year of creditable service, as defined, up to 30 years plus 1% for each year of service in excess of 30 years. Final compensation equals the compensation for the final year of service prior to retirement. Members may seek special retirement after achieving 25 years of creditable service or they may elect deferred retirement after achieving ten years of service, in which case benefits would begin at age 55 equal to 2% of final compensation for each year of service. The annual benefit under special retirement is 65% of the member's final compensation plus 1% for each year of creditable service over 25 years but not to exceed 30 years. The maximum allowance is therefore 70 percent of final compensation.

Widow/widowers of members retired since December 18, 1967 receive 50% of the retiree's final compensation. The minimum annual widow/widower's benefits of an accidental disability retiree prior to December 18, 1967 and of all retirees since December 18, 1967 is $4,500.

Members are always fully vested for their own contributions. In the case of death before retirement, members' beneficiaries are entitled to full payment of members' contributions providing no survivor death benefits are payable.

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 the dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits after 24 months of retirement. The cost-of-living increases are funded by the retirement system and are included in the annual actuarial calculations of the required state and state-related employer contributions.

Chapter 4, P.L. 2001 provided increased benefits to certain members who retired prior to December 29, 1989 with at least 25 years of creditable service. The maximum amount of the increase was 5% of the retiree's final compensation. For those with 30 or more years of service, the total pension benefit would increase from 65% to 70% of final compensation.

Significant Legislation:

Chapter 108 (P.L. 2003), effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the PFRS for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the System as the State Treasurer will determine, but not more than 40% in fiscal year 2005, not more than 60% in fiscal year 2006, and not more than 80% in fiscal year 2007. According to the Budget Appropriations Act of 2004, the State as well will pay pension obligations through a five-year phase-in.

Chapter 42, P.L. 2002 permitted local government units to issue refunding bonds to retire an unfunded accrued liability resulting from early retirement benefits, effective July 12, 2002.

Membership:

Membership in the System consisted of the following at June 30:

	2003	2002
Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	26,746	25,567
Active members:		
Vested	26,365	26,073
Non-vested	17,613	17,518
Total active members	43,978	43,591
Total	70,724	69,158

(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 System that focuses on total economic resources employs the accrual basis of accounting, which recognizes increases and decreases in economic resources as soon as the underlying event or transaction occurs.

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

Investment Valuation:

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

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

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

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

Common Pension Fund B - The operations of Common Pension Fund B are governed by the provisions of Article 63 of the State of New Jersey Investment Council regulations for the purpose of investing in fixed income and debt securities.

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

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

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

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, requires disclosure of the level of custodial risk assumed by the System. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. As of June 30, 2004 and 2003, all investments held by the System (other than mortgage backed securities and the State of New Jersey Cash Management Funds which are not categorized) are classified as Category 1.

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

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

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 new 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 statements of changes in fiduciary net assets.

Cash and Cash Equivalents:

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, also requires that deposits held in financial institutions be categorized to indicate the level of custodial 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, 2004 and 2003, which include funding for the July 1, 2004 and 2003 retirement payroll, are designated Category 3.

(3) CONTRIBUTIONS

The contribution policy is set by N.J.S.A. 43:16A and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. 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. Members contribute at a uniform rate of 8.5% of base salary.

For fiscal year 2004, 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 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 required normal contributions of the State of New Jersey and the local participating employers.

In 2004 and 2003, excess valuation assets were utilized to fund required State contributions of $7.03 million and $110.57 million, respectively.

In 2004, actuarially determined excess valuation assets also covered required local employer contributions of $31.71 million. In accordance with legislation passed in 2001 (Chapter 44, P.L. 2001), excess valuation assets were recognized to reduce 2001 local employer contributions by $150 million to approximately $75 million. This legislation required that the savings realized by counties and municipalities as a result of this reduction be used for property tax relief.

Chapter 108 (P.L. 2003), effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the PFRS for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the System as the State Treasurer will determine, but not more than 40% in fiscal year 2005, not more than 60% in fiscal year 2006, and not more than 80% in fiscal year 2007. According to the Budget Appropriations Act of 2004, the State as well will pay pension obligations through a five-year phase-in.

(4) FUNDS

This System maintains the following legally required funds:

Members' Annuity Savings Fund (2004 - $2,269,456,484; 2003 - $2,134,093,084)

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

Pension Accumulation Fund (2004 - $5,966,852,715; 2003 - $5,232,788,952)

The Pension Accumulation Fund is credited with the contributions of the State of New Jersey and other employers. Interest earnings, after crediting the ASF and the Retirement Reserve Fund, as required, are credited to this account. Additionally, payments for life insurance premiums are made from this Fund.

Retirement Reserve Fund (2004 - $7,962,500,646; 2003 - $7,513,073,555)

The Retirement Reserve Fund is the account from which retirement benefits other than life insurance premiums, including cost-of-living benefits, are paid. Upon retirement of a member, accumulated contributions are transferred to the Retirement Reserve Fund from the Members' Annuity Savings Fund. Any additional reserves needed to fund the balance of the retirement benefit are transferred from the Pension Accumulation Fund. Annually, interest as determined by the State Treasurer (8.75% for 2004 and 2003) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2004 - $154,386,487; 2003 - $0)

The Special Reserve Fund is a fund to which any 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 of the System. Amounts in excess of 1% are credited to the Pension Accumulation Fund.

(5) INCOME TAX STATUS

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

Schedule 1

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Required Supplementary Information

Schedule of Funding Progress

ACTUARIAL VALUATION DATE	ACTUARIAL VALUE OF ASSETS (a)	ACTUARIAL ACCRUED LIABILITY (b)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY (b - a)	FUNDED RATIO (a / b)	COVERED PAYROLL (c)	UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY AS A PERCENTAGE OF COVERED PAYROLL ((b - a) / c)
State						
June 30, 1997	$1,183,747,522	$1,234,959,165	$51,211,643	95.9%	$315,690,310	16.2%
June 30, 1998	1,559,131,933	1,377,734,455	(181,397,478)	113.2%	346,079,078	(52.4%)
June 30, 1999	1,717,248,151	1,534,470,501	(182,777,650)	111.9%	362,949,950	(50.4%)
June 30, 2000	1,884,870,936	1,666,842,906	(218,028,030)	113.1%	363,360,250	(60.0%)
June 30, 2001	1,991,299,968	1,866,140,391	(125,159,577)	106.7%	398,118,379	(31.4%)
June 30, 2002	2,032,977,241	2,046,820,189	13,842,948	99.3%	418,849,259	3.3%
June 30, 2003	1,907,107,359	2,288,937,652	381,830,293	83.3%	447,470,022	85.3%
Local						
June 30, 1997	10,854,173,290	11,746,169,752	891,996,462	92.4%	1,767,762,346	50.5%
June 30, 1998	13,169,957,658	12,881,842,367	(288,115,291)	102.2%	1,870,322,787	(15.4%)
June 30, 1999	14,536,570,357	13,894,951,617	(641,618,740)	104.6%	1,971,087,124	(32.6%)
June 30, 2000	15,644,750,281	14,924,699,712	(720,050,569)	104.8%	2,055,781,766	(35.0%)
June 30, 2001	16,083,153,842	16,056,446,646	(26,707,196)	100.2%	2,163,590,060	(1.2%)
June 30, 2002	16,392,195,411	17,181,142,310	788,946,899	95.4%	2,275,130,620	34.7%
June 30, 2003	16,447,612,874	18,258,853,488	1,811,240,614	90.1%	2,393,467,444	75.7%

Adjusted to reflect the impact of legislation passed in fiscal year 2002 which retroactively affected the June 30,1999 and 1998 valuations. Chapter 4, P.L. 2001 provides benefit enhancements for certain eligible members who retired prior to December 29, 1989. The unfunded accrued liability attributable to the increased benefits was exactly offset by the recognition of an additional amount of market value of assets in the determination of the actuarial value of assets for the July 1, 1999 valuation. Chapter 44, P.L. 2001, referred to in Note 3, reduced the contribution of local employers by $150 million.

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Funding Progress - Additional Actuarial Information

Significant actuarial methods and assumptions used in the most recent June 30, 2003 and 2002 actuarial valuations included the following:

	June 30, 2003	**June 30, 2002**
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
Remaining amortization period	30 years	30 years
Actuarial assumptions:		
Interest rate	8.75%	8.75%
Salary range	5.95%	5.95%
Cost-of-living adjustments	2.40%	2.40%

The actuarial assumptions used in the June 30, 2003 and 2002 valuations reflect the actuarial assumptions developed from the three year experience investigation for the period ending June 30, 2001.

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

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Required Supplementary Information, Continued

Schedule of Employer Contributions

YEAR ENDED JUNE 30,	ANNUAL REQUIRED CONTRIBUTION	EMPLOYER CONTRIBUTIONS[1]	PERCENTAGE CONTRIBUTED
State			
1997	$111,775,028	$715,344,385[2]	640.0%
1998	84,167,834	73,587,848[3]	87.4%
1999	93,920,617	23,730,087[3]	25.3%
2000	98,974,449	60,521,749[3]	61.1%
2001	95,883,272	—[3]	0.0%
2002	103,580,989	—[3]	0.0%
2003	104,998,547	—[3]	0.0%
2004	118,297,232	22,215,429[3][4]	18.8%
Local			
1997	250,220,580	234,963,865	93.9%
1998	238,002,765	223,491,008	93.9%
1999	273,210,113	256,551,862	93.9%
2000	275,790,739	214,164,848	77.7%
2001	249,746,232	75,670,018	30.3%
2002	248,754,078	185,415[3]	0.1%
2003	259,969,532	364,850[3]	0.1%
2004	316,272,883	53,396,685[5]	16.9%

Notes to Schedule

(1) Local employer contributions include contributions made by the State to provide funding for certain benefits payable to local participants.

(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) In accordance with Chapter 115, P.L. 1997, all or a portion of the required contribution was funded by available excess valuation assets.

(4) In accordance with the provisions of the Appropriation Act of 2004, the State fiscal year 2004 required contribution of $111,077,147 has been reduced to $22,215,429.

(5) In accordance with Chapter 108, P.L. 2003, the local fiscal year 2004 required contribution of $266,983,423 has been reduced to $53,396,685.

Schedule 3

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2004

	MEMBERS' ANNUITY SAVINGS FUND	PENSION ACCUMULATION FUND	RETIREMENT RESERVE FUND	SPECIAL RESERVE FUND	TOTAL
Additions:					
Contributions:					
Members	$ 263,173,065	—	—	—	263,173,065
Employers	—	264,164,091	—	—	264,164,091
Total contributions	263,173,065	264,164,091	—	—	527,337,156
Distribution of net investment income	—	1,131,857,886	657,393,936	154,386,487	1,943,638,309
Total additions	263,173,065	1,396,021,977	657,393,936	154,386,487	2,470,975,465
Deductions:					
Benefits	—	30,881,935	956,173,745	—	987,055,680
Refunds of contributions	7,030,890	117,384	—	—	7,148,274
Administrative expenses	—	3,530,770	—	—	3,530,770
Total deductions	7,030,890	34,530,089	956,173,745	—	997,734,724
Net increase (decrease) before transfers among reserves	256,142,175	1,361,491,888	(298,779,809)	154,386,487	1,473,240,741
Transfers among reserves:					
Retirements	(122,185,674)	(633,710,012)	755,895,686	—	—
Other	1,406,899	6,281,887	(7,688,786)	—	—
Net increase (decrease)	135,363,400	734,063,763	449,427,091	154,386,487	1,473,240,741
Net assets held in trust for pension benefits:					
Beginning of year	2,134,093,084	5,232,788,952	7,513,073,555	—	14,879,955,591
End of year	$ 2,269,456,484	5,966,852,715	7,962,500,646	154,386,487	16,353,196,332