



**NEW JERSEY STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Financial Statements

June 30, 2016

(With Independent Auditors' Report Thereon)

**NEW JERSEY STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Financial Statements

June 30, 2016

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KPMG LLP
New Jersey Headquarters
51 John F. Kennedy Parkway
Short Hills, NJ 07078-2702

Independent Auditor's Report

New Jersey State Employees Deferred
Compensation Plan Board:

Report on the Financial Statements

We have audited the accompanying statements of fiduciary activities of the New Jersey State Employees Deferred Compensation Plan (the Plan) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Plan's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the fiduciary activities of the New Jersey State Employees Deferred Compensation Plan, as of June 30, 2016, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

Adoption of New Accounting Pronouncement

As discussed in note 2(f) to the basic financial statements, as of July 1, 2015, the Plan adopted Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis that U.S. generally accepted accounting principles require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

KPMG LLP

Short Hills, New Jersey
July 13, 2017

**STATE OF NEW JERSEY
NEW JERSEY STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Statement of Fiduciary Net Position

June 30, 2016

Assets:		
Cash	\$	14,031
Accrued interest and dividends receivable		635,110
Investments, at fair value:		
Cash Management Fund		17,510,020
Domestic equities		477,803,009
Fixed income mutual funds		394,909,679
Equity mutual funds		<u>2,687,843,042</u>
Total investments		<u>3,578,065,750</u>
Total assets		<u>3,578,714,891</u>
Liabilities:		
Accounts payable and accrued expenses		<u>1,221,100</u>
Total liabilities		<u>1,221,100</u>
Net position:		
Restricted for pensions	\$	<u><u>3,577,493,791</u></u>

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
NEW JERSEY STATE EMPLOYEES
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Statement of Changes in Fiduciary Net Position

Year ended June 30, 2016

Additions:	
Member contributions	\$ 180,268,889
Investment income:	
Net increase in fair value of investments	10,620,196
Interest	50,156
Dividends	<u>10,335,307</u>
	21,005,659
Less investment expense	<u>247,860</u>
Net investment income	<u>20,757,799</u>
Total additions	<u>201,026,688</u>
Deductions:	
Benefits	163,247,570
Administrative expenses	<u>190,880</u>
Total deductions	<u>163,438,450</u>
Change in net position	37,588,238
Net position restricted for pensions – beginning of year	<u>3,539,905,553</u>
Net position restricted for pensions - end of year	\$ <u><u>3,577,493,791</u></u>

See accompanying notes to financial statements.

**NEW JERSEY STATE EMPLOYEES
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Notes to Financial Statements

June 30, 2016

(1) Description of the Plan

(a) Organization

The State of New Jersey, Division of Pensions and Benefits (the Division) was created and exists pursuant to N.J.S.A. 52:18A to oversee and administer the pension trust and other postemployment benefit plans sponsored by the State of New Jersey (the State), including the New Jersey State Employees Deferred Compensation Plan (the Plan or NJSEDCP).

The Plan, a single employer defined contribution pension plan, was established by Chapter 39, P.L. 1978, which became effective June 19, 1978, amended by Chapter 449, P.L. 1985, effective January 14, 1986, and further amended by Chapter 116, P.L. 1997, effective June 6, 1997, and is available to any state employee who is a member of a state-administered retirement system or an employee of an eligible state agency, authority, commission or instrumentality of state government provided the employee has at least 12 continuous months of employment, and any individual employed through a Governor's appointment. The Plan's membership was 51,354 at June 30, 2016.

(b) Contributions

Participants may defer between 1% and 100% of their salary less any Internal Revenue Code (IRC) Section 414(h) reductions or \$18,000 annually. Under the limited "catch-up" provision, a participant may be eligible to defer up to a maximum of twice the annual maximum in the three years immediately preceding the retirement age at which no reduction in benefits would be applicable.

There are no employer or non-employer entities that are required to contribute to the Plan.

(c) Benefits

Assets in the Plan are held in trust for the exclusive benefit of Plan members and their beneficiaries in accordance with GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. Plan members are fully vested for the current valuation of their account from the date of enrollment in the Plan. Benefits are payable upon separation from service with the State of New Jersey.

(2) Summary of Significant Accounting Policies

(a) Measurement Focus and Basis of Accounting

The accompanying financial statements were prepared in accordance with U.S. generally accepted accounting principles as applicable to governmental organizations. In doing so, the Plan adheres to reporting requirements established by the Governmental Accounting Standards Board (GASB).

The accrual basis of accounting is used for measuring financial position and changes in net position of the Plan. Under this method, contributions are recorded in the accounting period in which they are collected from the member, and deductions are recorded at the time the liabilities are due and payable in accordance with the terms of the Plan. The Plan is accounted for using an economic resources measurement focus.

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June 30, 2016

(b) Investments

The Division of Investment, Department of the Treasury, State of New Jersey (Division of Investment) manages and invests certain assets of various divisions, agencies and employees of the State of New Jersey in various groups of funds, which includes the Plan.

In addition, the Division of Investment manages the State of New Jersey Cash Management Fund (CMF), which is available on a voluntary basis for investment by State and certain non-State participants. CMF is considered to be an investment trust fund as defined in GASB Statement No. 31, *Certain Investments and External Investment Pools*. Units of ownership in CMF may be purchased or redeemed on any given business day (excluding State holidays) at the unit cost or value of \$1.00. CMF values participant shares on a fair value basis. For additional information about CMF, refer to the audited financial statements, which can be obtained at <http://www.state.nj.us/treasury/doinvest/cm/FinancialStatementsFiscal2016.pdf>.

Prudential Retirement is the third-party administrator for the NJSEDCP. Prudential Retirement provides recordkeeping, administration services and access to 22 investment options through a combination of their separate account product offerings and retail branded mutual funds. The four state-managed investments options (NJSEDCP Fixed Income Fund, NJSEDCP Equity Fund, NJSEDCP Small Capitalization Equity Fund and NJSEDCP Cash Management Fund) were closed to new contributions on December 31, 2005. On August 1, 2014, the NJSEDCP Fixed Income Fund and the NJSEDCP Cash Management Fund were closed. On December 15, 2014, the NJSEDCP Equity Fund and the NJSEDCP Small Capitalization Fund were opened to new contributions. The Board of the NJSEDCP is the fiduciary for the investments of the Plan. The Division of Pensions and Benefits maintains its administrative oversight functions for the Plan.

Investment transactions are accounted for on a trade or investment date basis. Interest and dividend income is recorded on the accrual basis, with dividends accruing on the ex-dividend date. Net increase in the fair value of investments includes the net realized and unrealized gains (losses) on investments.

(c) Administrative Expenses

Administrative expenses are paid by the Plan and are included in the accompanying financial statements.

(d) Income Tax Status

The Plan is an eligible plan as described in the IRC Section 457.

(e) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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June 30, 2016

(f) New Accounting Standards Adopted

In State fiscal year 2016, the Plan adopted GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72). The statement addresses accounting and financial reporting issues related to fair value measurements of assets and liabilities. GASB 72 identifies various approaches to measuring fair value and levels of inputs based on the objectivity of the data used to measure fair value. It provides additional fair value application guidance and requires enhanced disclosures about fair value measurements. As a result of the adoption of GASB 72, the Plan added note 4 to the financial statements.

(3) Investments

The Plan's investments as of June 30, 2016 are as follows:

	2016
Cash management fund	\$ 17,510,020
Domestic equities	477,803,009
Fixed income mutual funds	394,909,679
Equity mutual funds	2,687,842,042
	\$ 3,578,064,750

New Jersey state statute provides for a State Investment Council (Council) and a Director of the Division of Investment. The role of the Council is to formulate investment policies. The Council issues regulations, which establish guidelines for permissible investments. The regulations provide that at the election of the participants, moneys from salary deductions may be deposited in funds managed by the Division of Investment, or in approved investment options offered and managed by outside vendors.

The NJSEDCP Equity Fund and the NJSEDCP Small Capitalization Equity Fund are invested in equity securities that are denominated in U.S. dollars that trade on a securities exchange in the United States or the over-the-counter market. The NJSEDCP Equity Fund and the NJSEDCP Small Capitalization Equity Fund may hold up to 25% of their assets either in short-term fixed income securities, as permitted by the Council regulations, or in CMF. Not more than 10% of the market value of the NJSEDCP Equity Fund or the NJSEDCP Small Capitalization Equity Fund can be invested in the equity of any one issuer and affiliated entities. The total amount of a particular class of stock directly purchased or acquired of any one entity cannot exceed 5% of that class of stock outstanding. The total amount of shares directly purchased or acquired of any one exchange-traded fund shall not exceed 5% of the total shares outstanding of such fund.

The funds managed by Prudential Retirement investments for the NJSEDCP consist of a number of individual investment managers, which individually have investment guidelines that they comply with and follow. For Prudential Retirement, the NJSEDCP is a participant directed program offering a range of diversified investment alternatives. The options that include bond investments are diversified by sector and number of securities held, mitigating undue concentration of both credit and foreign currency risks as well as interest rate risk.

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The fixed income mutual funds held by NJSEDCP as of June 30, 2016 have a weighted average duration of 5.37 years. These funds are unrated.

(4) Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants at the measurement date. Inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The three levels of the fair value hierarchy are as follows:

Level 1 – Quoted prices are available in active markets for identical investments as of the reporting date.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies.

Level 3 – Pricing inputs are unobservable for the investment and inputs into the determination of fair value require significant management judgment or estimation, including assumptions about risk.

Investments are reported at fair value as follows:

- Domestic equity securities are valued using closing sales prices reported on recognized securities exchanges on which the securities are principally traded; these securities are included as Level 1 in the chart below.
- Fixed income and equity mutual funds are valued using the published daily closing prices reported by Prudential and are included as Level 1 in the chart below.

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The following table summarizes the fair value hierarchy of the investment portfolio as of June 30, 2016:

	Total	Level 1
Investments by fair value		
Equity securities:		
Domestic equities	\$ 477,803,009	477,803,009
Equity mutual funds	2,687,843,042	2,687,843,042
Total equity securities	3,165,646,051	3,165,646,051
Debt securities:		
Fixed income mutual funds	394,909,679	394,909,679
Total investments by fair value level	3,560,555,730	3,560,555,730
Local Government Investment Pool		
Cash Management Fund	17,510,020	
Total investments measured at fair value	\$ 3,578,065,750	

(5) Contingencies

The Plan is a party to various legal actions arising in the ordinary course of its operations. While it is not feasible to predict the ultimate outcome of these actions, it is the opinion of management that the resolution of these matters will not have a material adverse effect on the Plan's financial statements.