



The State of
New Jersey
CAFR

Comprehensive
Annual
Financial Report



Fiscal Year
Ended
June 30, 2018

Philip D. Murphy, Governor

Sheila Y. Oliver, Lt. Governor

State of New Jersey



Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2018

Philip D. Murphy
Governor

Sheila Y. Oliver
Lieutenant Governor

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State Treasurer

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Acting Director
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Assistant Director
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**STATE OF NEW JERSEY
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 FISCAL YEAR ENDED JUNE 30, 2018
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SECTION





State of New Jersey

PHILIP D. MURPHY
Governor

SHEILA Y. OLIVER
Lt. Governor

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April 30, 2019

Governor Philip D. Murphy
Members of the State Legislature
New Jersey Citizens

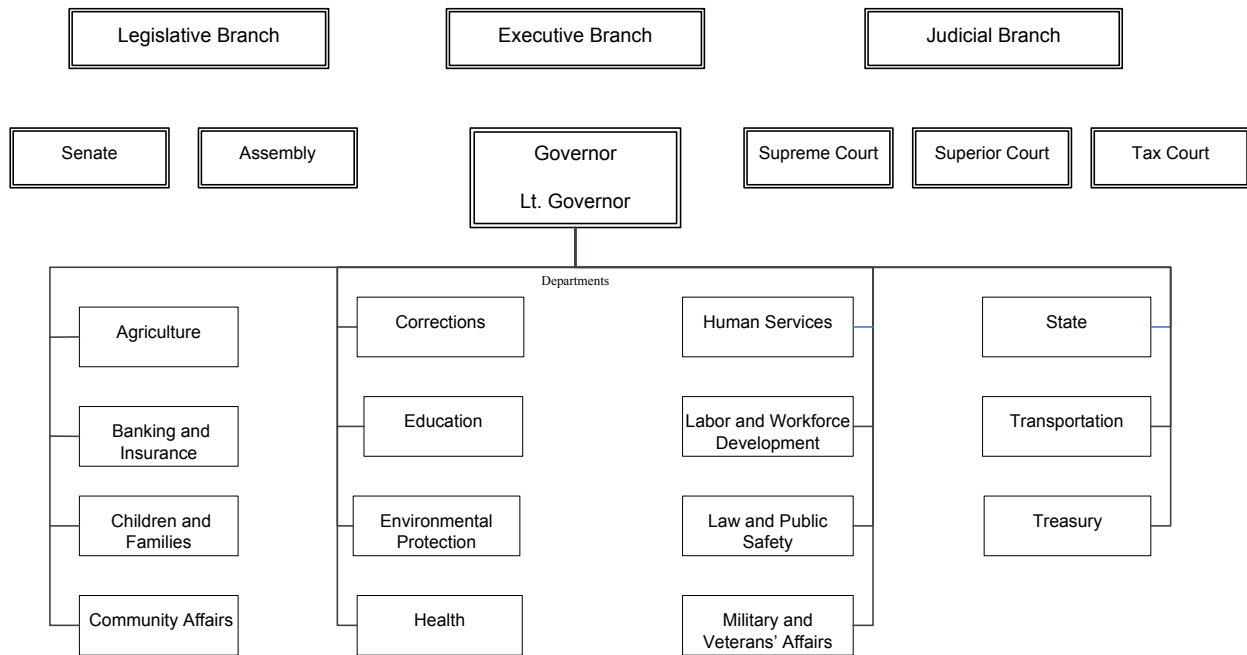
In accordance with the provisions of N.J.S.A.52:27B-46, it is our pleasure to transmit to you the State of New Jersey's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2018. The Department of the Treasury's Office of Management and Budget prepared this report. The Department of the Treasury and the Office of Management and Budget are responsible for the accuracy, completeness, and fairness of all data presented, including all disclosures.

This CAFR presents the financial position and operating results of the State under generally accepted accounting principles (GAAP) applicable to state and local governments, as established by the Governmental Accounting Standards Board (GASB). The State also participates in the Government Finance Officers Association (GFOA) of the United States and Canada's Certificate of Achievement for Excellence in Financial Reporting review program.

The State operates in accordance with the standards provided in GASB Statements No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. In addition to providing traditional fund financial statements, the objective of this reporting model is to provide a single, unified, transparent picture of the State's fiscal health; thus, this CAFR clearly displays all of the State's revenues, costs, assets, and liabilities. This report also includes a Management's Discussion and Analysis section, which provides users with an objective and easy-to-read analysis of New Jersey's financial performance for the fiscal year ended June 30, 2018. We are confident that the data is accurate in all material respects and presented in a manner designed to set forth fairly the financial position and results of the State's operations, as measured by the fiscal activity of its various funds, and includes all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs.

NEW JERSEY GOVERNMENT

The State of New Jersey was one of the original 13 colonies and was the third state to ratify the United States Constitution in 1787. The original State Constitution was adopted on July 2, 1776 and was subsequently superseded by the State Constitution of 1844. A new State Constitution was prepared by a constitutional convention in 1947 and was ratified by voters of the State in the General Election held November 4, 1947. The State Constitution divides the powers of government between three co-equal independent branches: Legislative, Executive, and Judicial.



Legislative: The State’s bicameral Legislative Branch, which consists of a total of 120 members from 40 legislative districts with elections held in odd-numbered years, meets in annual sessions in Trenton, the State’s capital. The 40 members of the State Senate are elected to terms of four years, except for the election following a decennial census, in which case the term is for two years. The 80 members of the General Assembly are elected to terms of two years. Neither State Senators nor Assembly Members are subject to term limits. The Office of Legislative Services (OLS) is a nonpartisan agency that provides legislators with legal, fiscal, research, information, and administrative services. Key OLS positions include an executive director, a legislative counsel, the State Auditor, a legislative budget and finance officer, a director of central staff, a director of data management, and a director of administration.

Executive: The Office of the Chief Executive, which oversees the entire Executive Branch, consists of the Governor, the Lieutenant Governor, Cabinet-level department heads, and staff who are responsible for carrying out the Governor’s constitutional powers and duties. Upon direct election by a plurality of the State’s voters, both the Governor and the Lieutenant Governor may serve two successive terms of four years. With the exception of the Secretary of Agriculture, who is chosen by the Board of Agriculture with the Governor’s approval, the New Jersey State Constitution grants the Governor the authority to appoint the entire cabinet as well as all Superior Court Judges and county prosecutors, subject to confirmation by the New Jersey Senate. Department heads remain in office until their successors are named and confirmed by the Senate; the only exceptions are the Attorney General and the Secretary of State, who are appointed to serve throughout the Governor’s entire term. Although the State Constitution permits a maximum of 20 departments, the State’s payroll consisted of approximately 55,110 employees in 15 departments as of January 2018. The Executive Branch also oversees the performance of 565 municipalities and 590 school districts, and the incarceration and rehabilitation of 16,666 prisoners. In addition to reliable transportation and protection for the State’s citizenry and environment, the Executive Branch provides social services for one out of every five New Jersey citizens.

Judicial: New Jersey’s Supreme Court consists of a Chief Justice, who is the administrative head of all courts under the State’s jurisdiction, as well as six Associate Justices. In addition to Municipal and Tax Courts located throughout the State, there are Superior Courts, with a minimum of two Judges, in each of New Jersey’s 21 counties. After nomination by the Governor and subsequent confirmation by the State Senate, all Supreme Court Justices and Superior Court Judges serve initial terms of seven years. Should they be deemed eligible by both the Governor and the State Senate, Supreme Court Justices and Superior Court Judges acquire tenure with retirement at age 70 as mandated by the State Constitution. For purposes of judicial administration, the State is divided into 15 vicinages, each consisting of a single county or a combination of counties. The Administrative Office of the Courts provides support services. Approximately 6.9 million new cases are filed in New Jersey’s courts every year, including 6.1 million in Municipal Court and 0.8 million in Superior Court. These cases address matters concerning civil, criminal, and family law.

COLLEGES AND UNIVERSITIES

As of July 1, 2018, the higher education system in New Jersey includes four public research universities, seven State colleges and universities, 19 community colleges, 15 independent four-year colleges and universities, 11 proprietary institutions with degree-granting authority, 27 Talmudic institutions and theological seminaries, and one independent two-year religious college. In November 2012, New Jersey voters approved the \$750 million “Building our Future Bond Act” (P.L. 2012, c.141), and in addition to this Act the State has authorized an additional issuance from four higher education funding programs in the aggregate amount of \$925 million. These four programs are the Higher Education Capital Improvement Fund (CIF), the Higher Education Facilities Trust Fund (HEFT), the Higher Education Technology Infrastructure Fund (HETI), and the Higher Education Equipment Leasing Fund (ELF) for a total authorization of \$1.675 billion.

COMPONENT UNITS

In accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, this CAFR for fiscal year ended June 30, 2018, includes the accounts of 20 public authorities and 11 State public colleges and universities. Public authorities are legal, separate entities that are not operating departments of the State. Governing boards are vested with the power to independently manage and set policies for the organization. Each component unit is established for a specific purpose for the benefit of the State’s citizenry. GASB Statement No. 14 provides that the State’s financial statements should emphasize the primary government and permit financial statement users to distinguish between the primary government and its component units. As a result, the transmittal letter, Management’s Discussion and Analysis, and the financial statements focus on the primary government of the State and its activities, although information pertaining to the component units is presented. For additional information, please see Note 18 – Component Units.

Executive Order No. 122, signed on July 23, 2004, was established to direct the Board of Directors for each State authority, commission, board, and council to create an Audit Committee whose members are to assist in the oversight of the financial reporting and audit processes of the entities. Each member of the Audit Committee is independent of the entity, with at least one member having a background in accounting or related financial expertise. The Audit Committee must assist the Board in retaining an independent auditor to conduct an audit. The auditor selection process must be based on public, competitive bidding principles and shall take place no less than once every five years. In order to ensure the independence of the auditor selection process, an evaluation committee shall be established by the Board to conduct the solicitation and evaluation of eligible auditors. The auditor selected shall report directly to the Audit Committee or the Board. At no time shall the auditor report to any staff member of the entity. At least twice a year, the Audit Committee shall hold a private meeting with the auditor. In carrying out these duties, the Audit Committee shall proactively assist the Board in overseeing the integrity and quality of the entity’s financial statements, the entity’s compliance with legal, regulatory, and ethical requirements, the auditor’s performance and ability to perform, and the performance of the entity’s own internal audit and internal control functions.

BUDGET AND ACCOUNTING

Legal Level of Control

The State’s annual Appropriations Act includes the General Fund, as well as certain Special Revenue Funds (Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief). The departments maintain legal control at the appropriation line item level and exercise budgetary control by individual appropriations and allocations within annual appropriations to various programs and major expenditure objects. Program classifications represent a lower level operating program function, consisting of closely related activities with identifiable objectives or goals. Revisions to the annual Appropriations Act, reflecting program changes or interdepartmental transfers of an administrative nature, may be effected during the budget year with certain Executive and Legislative Branch approvals. Language, located in the “General Provisions” section of the State’s annual Appropriations Act, enables management to amend a department’s budget with approval by the Director of the Office of Management and Budget; under specific conditions, additional approval by the Office of Legislative Services is required. Only the State Legislature, however, may transfer appropriations between departments.

Accounting Systems

The Office of Management and Budget directs and supervises a central accounting system, which maintains all accounting records for the various State departments. The State's annual budget provides individual appropriations to departments for specific programs and purposes, while component units maintain separate accounting systems.

To ensure expenditures do not exceed appropriations and allocations, the State employs encumbrance accounting. Purchase orders, contracts, and other commitments involving monetary expenditures are encumbrances. Any unencumbered and unexpended non-continuing appropriations lapse at fiscal year's end.

Consideration as to the adequacy of internal controls is paramount in developing and maintaining the State's accounting system. Internal accounting controls are designed to provide reasonable assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, and guarantee that financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from its use, and the evaluation of costs and benefits requires managerial estimates and judgments. All internal control evaluations occur within this framework.

RELEVANT FINANCIAL POLICIES

The New Jersey State Constitution, which mandates an annual balanced budget, directs, in part, that no money shall be drawn from the State Treasury but for appropriations made by law and that no law appropriating money for any State purpose shall be enacted if the appropriations contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of the revenue on hand and anticipated to be available to meet such appropriations during such fiscal period, as certified by the Governor. Accordingly, during the fiscal year, the State may have to make several revenue and expenditure adjustments to ensure a positive fund balance. The State has had a balanced budget in every fiscal year since the adoption of the State Constitution in 1947.

Created as a "rainy day fund," the Surplus Revenue Fund is part of the General Fund's resources and fund balance, and accounts for excess revenues from prior fiscal years that are reserved legislatively and may be used to support current year's appropriations in the event that anticipated revenues in the General Fund are estimated to be less than those certified by the Governor upon approval of the annual Appropriations Act. The Surplus Revenue Fund was designed to build fund balance during economic upswings, and to be expended during economic downturns and emergency situations. Such an example occurred during Fiscal Year 2009 when, in response to the national recession, the State drained its entire Surplus Revenue Fund to help balance its budget. As of June 30, 2018, this Fund continued to have a zero balance.

The State employs a budgetary basis of accounting for all of its annual fiscal transactions. The budgetary basis differs from the GAAP basis, which is used to present fund financial statements, in that the former: 1) recognizes encumbrances as expenditures, 2) recognizes all federal revenues related to such encumbrances, and 3) reflects only current fiscal year transactions. The GAAP basis also requires that certain grants and other financial assistance be recorded as revenues and/or expenditures.

FINANCIAL TRENDS

Lottery Enterprise Contribution Act

In accordance with the Lottery Enterprise Contribution Act, L. 2017, c.98 (LECA), and a Memorandum of Lottery Contribution (MOLC), dated July 5, 2017 and effective as of June 30, 2017, the State's lottery and related assets, including intellectual property, (the "Lottery Enterprise") was contributed to Teachers' Pension and Annuity Fund (TPAF), Public Employees' Retirement System (PERS), and Police and Firemen's Retirement System (PFRS) for a 30-year term (the "Lottery Contribution"). Under LECA, the Department of the Treasury, Division of the State Lottery ("State Lottery Division") will continue to operate the Lottery Enterprise with a goal of maximizing net proceeds for the benefit of the applicable Pension Plans.

Neither LECA nor the MOLC contain a provision permitting the termination of the contribution prior to the end of the 30-year term. However, a future legislature and administration could pass legislation to reverse the contribution prior to the expiration of its term. Any termination of the Lottery Contribution could implicate the exclusive benefit rule of the Internal Revenue Code, which requires the assets of the Pension Plans to exist for the exclusive benefit of their members in order for the

Pension Plans to qualify for the favorable tax treatment under the Internal Revenue Code. The term of the contribution of the Lottery Enterprise will expire at the start of Fiscal Year 2048, and the Lottery Enterprise will revert back to the State.

Pursuant to LECA, the Lottery Enterprise has been contributed to certain eligible State Retirement Systems for a thirty (30) year term. LECA had a neutral budget impact in Fiscal Year 2018. In Fiscal Year 2018, appropriations of State Aid for Education or State Institution Programs which were previously supported by net proceeds of the State Lottery are now funded through appropriations from the General Fund or the Property Tax Relief Fund, as applicable. This is possible because LECA provides for a Special Asset Adjustment to the amount of the annual actuarially recommended contribution to the eligible State Retirement Systems of \$1,000,976,874 for Fiscal Year 2018, alleviating the need for aggregate appropriations from the General Fund and the Property Tax Relief Fund to the eligible State Retirement Systems in that same amount.

Both the legislation and the MOLC require that retained assets and liabilities of the Lottery existing prior to the transfer date (July 1, 2017), not be transferred to the Pension Plans for a thirty-year term. This requirement compels the Division of State Lottery to maintain two general ledgers. The residual State Lottery Fund ledger accounts for all activity associated with those pre-existing assets and liabilities and a new general ledger accounts for all the obligations and assets resulting from lottery sales and games emanating on and after the July 1, 2017, the transfer date.

NJ Transportation Trust Fund Authority Legislative Reauthorization

On October 14, 2016, legislation was enacted reauthorizing the New Jersey Transportation Trust Fund Authority (TTFA) for a period of eight fiscal years. The eight year plan assumes a \$16.0 billion capital program which includes \$3.2 billion set-aside for Local Aid projects. Combined with anticipated federal funds, the entire capital program is expected to total \$32.0 billion.

The legislation reauthorizing the TTFA capital program impacted several State taxes. They are as follows:

- **Sales and Use Tax**
Effective January 1, 2017, the Sales and Use Tax was reduced to 6.875 percent from its previous 7.00 percent rate. Further, on January 1, 2018, the Sales and Use Tax was reduced to 6.625 percent from the previous 6.875 percent rate.
- **New Jersey's Estate Tax**
The Estate Tax was phased out, replacing the previous \$675,000 threshold with a \$2 million exclusion after January 1, 2017. The Estate Tax rate was reduced to zero percent as of January 1, 2018.
- **New Jersey's Earned Income Tax Credit**
The Earned Income Tax Credit for the working poor rose to 35 percent from 30 percent beginning in tax year 2016. A separate law signed in 2018 by Governor Murphy will gradually increase the credit to 40 percent of the federal Earned Income Credit over the next three years. Under the first step, the state benefit amount has increased to 37 percent for tax year 2018.
- **Gross Income Tax**
The TTFA legislative reauthorization provided a personal exemption on State income taxes for all New Jersey veterans honorably discharged from active service in the military or the National Guard.
- **Petroleum Products Gross Receipts Tax**
Effective November 1, 2016, the tax imposed under the Petroleum Products Gross Receipts Tax (PPGRT) increased in three major components: 1) a 12.85 percent increase in the tax rate on highway fuel with a phase-in of the diesel component; 2) a 4.25 percent increase in the tax rate on non-motor fuels; and 3) an additional four cents per gallon tax on diesel fuels that began in Fiscal Year 2018.

On November 8, 2016 the citizens of New Jersey voted in favor of a constitutional amendment. The amendment had the following effect:

- The amendment dedicated all Motor Fuels Tax revenue and Petroleum Products Gross Receipts Tax to the State transportation system. This amendment includes the Petroleum Products Gross Receipts Tax increase detailed above; and
- The amendment authorized \$12.0 billion of bonding capacity for the TTFA to cover project costs.

Revenue History

The State reported Fiscal Year 2018 revenue collections of \$35.8 billion or 4.9 percent above Fiscal Year 2017 revenue collections of \$34.1 billion. The New Jersey labor market continues to expand and unemployment is at 3.9 percent as of December 2018 with labor force participation fairly stable the last several months. With the current Fiscal Year 2019 revenue estimate projected to be \$37.4 billion, the State's economic recovery trend remains optimistic. The Statistical Section provides a 10-year history of State-budgeted revenue collections.

Pension and Other Postemployment Benefits (OPEB) Obligations

In Fiscal Year 2018 the State funded the various defined benefit pension systems at 5/10th of the full actuarially determined contributions. Employer contributions to the pension plans are calculated per the requirements of the governing State statutes using generally accepted actuarial procedures and practices. The actuarial funding method used to determine the State's contribution is a matter of State law. Any change to the funding method requires the approval of the State Legislature and the Governor. The amount the State actually contributes to the pension plans may differ from the actuarially determined contributions of the pension plans because the State's contribution to the pension plans is subject to the appropriation of the State Legislature and actions by the Governor. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, requires participating employers to recognize their proportionate share of the collective net pension liability. Under the new statement, the calculation of the pension liability was changed to a more conservative methodology and each employer was allocated a proportional share of the pension plans' net pension liability. The State's share of the net pension liability, based on a measurement date of June 30, 2017, which is required to be recorded on the financial statements, is \$99.6 billion.

The Fiscal Year 2019 aggregate State contribution to the pension plans of \$3.213 billion represents 6/10th of the full actuarially determined contribution.

The State provides post-retirement medical (PRM) benefits for certain State and other retired employees meeting the service credit eligibility requirements. In Fiscal Year 2018, the State paid PRM benefits for 148,401 State and local retirees.

The State funds post-retirement medical benefits on a "pay-as-you-go" basis, which means that the State does not pre-fund, or otherwise establish a reserve or other pool of assets against the PRM expenses that the State may incur in future years. For Fiscal Year 2018, the State contributed \$1.909 billion to pay for pay-as-you-go PRM benefit costs incurred by covered retirees. The increase in the State's pay-as-you-go contribution between Fiscal Year 2017 and Fiscal Year 2018 is attributed to rising health care costs, an increase in the number of participants qualifying for State-paid PRM benefits at retirement and larger fund balance utilization in Fiscal Year 2017 than in Fiscal Year 2018. The Fiscal Year 2019 Appropriations Act includes \$1.921 billion as the State's contribution to fund pay-as-you-go PRM costs.

In accordance with the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, the State is required to quantify and disclose its obligations to pay Other Postemployment Benefits (OPEB) to retired plan members. This new standard supersedes the previously issued guidance, GASB Statement No. 45, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective for Fiscal Year 2018. The State is now required to accrue a liability in all instances where statutory language names the State as the legal obligor for benefit payments. As such, the Fiscal Year 2017 total State OPEB liability to provide these benefits has been re-measured to \$97.1 billion, an increase of \$60.6 billion or 166 percent from the previous year's \$36.5 billion liability booked in accordance with GASB Statement No. 45. For Fiscal Year 2018, the total OPEB liability for the State is \$90.5 billion, a decrease of \$6.6 billion or 7 percent from the re-measured total OPEB liability in Fiscal Year 2017.

Additional information on Pensions and OPEB can be accessed at <https://www.state.nj.us/treasury/pensions/financial-reports.shtml>.

AUDIT INFORMATION

The principal auditor of the State's reporting entity is the Office of the State Auditor, which resides in the Legislative Branch of State government. The State Auditor's examination was conducted in accordance with generally accepted auditing standards and its opinion precedes the Basic Financial Statements. Private sector public accounting firms have been used for the audits of separately issued component units and college and university financial statements. In addition, the Office of the State Auditor conducts periodic financial and expanded scope audits of various State agencies. Additional information regarding the State's financial status, including prior year budgets, appropriations acts, and financial reports, is available on the State's web site (<http://www.state.nj.us/treasury/omb/>).

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The GFOA awarded the Certificate of Achievement for Excellence in Financial Reporting to the State of New Jersey for its CAFR for the fiscal year ended June 30, 2017. In order to qualify for this certificate, a governmental entity must publish an easily readable and efficiently organized comprehensive annual financial report, of which the contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. The State of New Jersey has received this award every year since 1993.

ACKNOWLEDGEMENTS

Finally, we express our grateful appreciation to the many dedicated professionals in the Office of Management and Budget and the Office of the State Auditor, whose work made possible the preparation of this report. We believe their combined efforts have produced a report that will provide a means for government, the financial community, decision makers, and concerned citizens to better understand and evaluate the State's financial condition.

Sincerely,



Elizabeth Maher Muoio
State Treasurer



David Ridolfino
Acting Director, Office of Management and Budget

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Government Finance Officers Association

Certificate of
Achievement
for Excellence
in Financial
Reporting

Presented to

State of New Jersey

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2017

Christopher P. Morill

Executive Director/CEO

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