

**AUDIT REPORT
OF THE
NEBRASKA PUBLIC EMPLOYEES
RETIREMENT SYSTEMS - STATE AND
COUNTY EMPLOYEES RETIREMENT PLANS**

JANUARY 1, 2002 THROUGH DECEMBER 31, 2002

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

BACKGROUND

The Public Employees Retirement Board (the Board) was created in 1971 to administer Nebraska retirement plans for school employees, State employees, judges, and the State Patrol. The Board assumed administration of the retirement system for Nebraska counties in 1973.

The Board has seven members appointed by the Governor, with legislative approval, to five-year terms. Members include:

- ◆ Three participants of retirement systems administered by the Board;
- ◆ A retired participant of a retirement system administered by the Board;
- ◆ Three public representatives who are not State employees or employees of its subdivisions; and
- ◆ The State Investment Officer as a nonvoting, ex-officio member.

All appointed members must be Nebraska citizens.

The Board meets monthly. Members are not paid, but are reimbursed for their expenses.

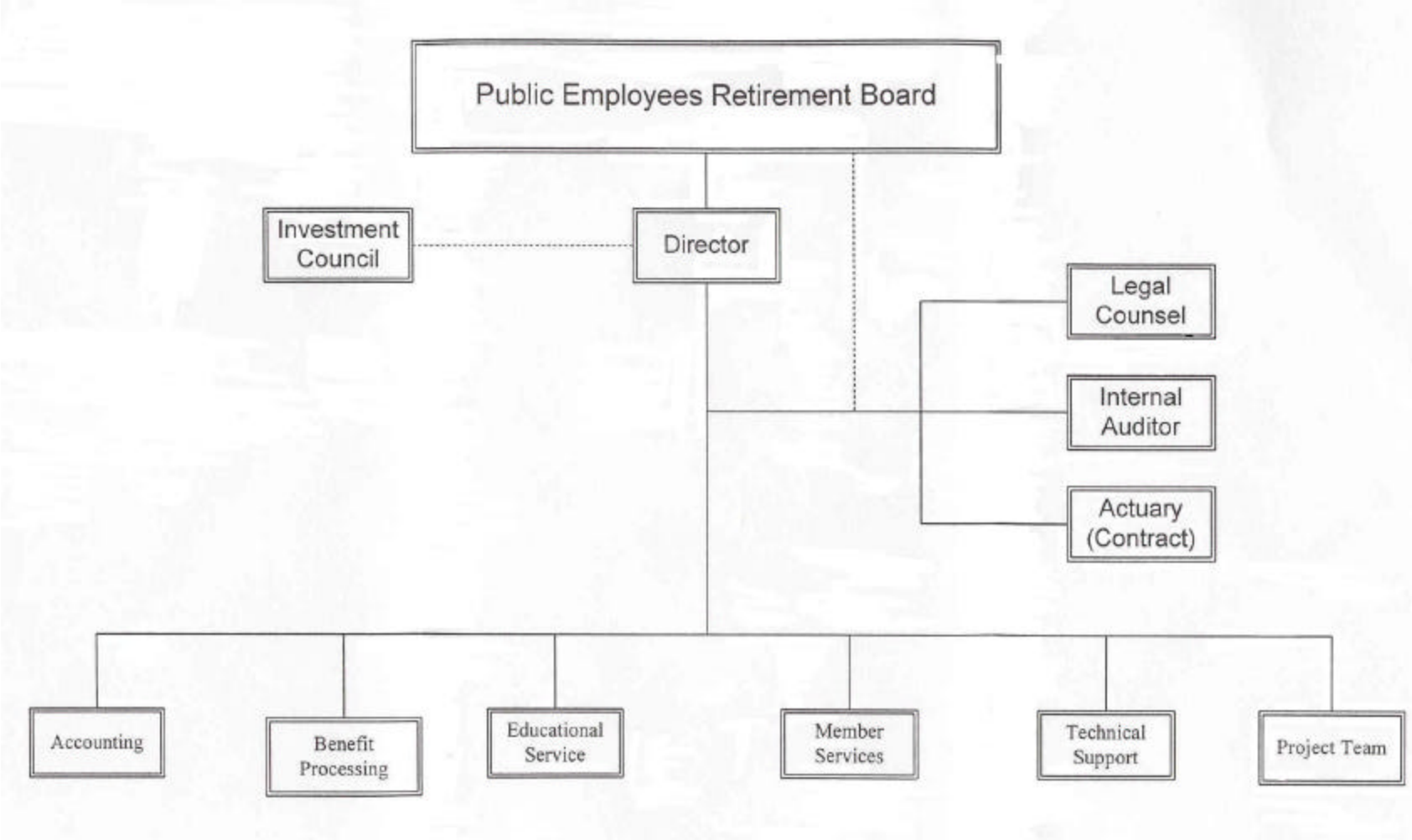
The Board hires a director to manage the day-to-day operations. Expenses are to be equitably distributed among the retirement systems. All expenses must be provided from investment income earned by various retirement funds, unless other fund sources to pay expenses are specified by law.

MISSION STATEMENT

The Nebraska Public Employees Retirement Systems recognizes the importance of a successful retirement and is dedicated to providing the highest quality service necessary to assist members in achieving this goal.

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ORGANIZATIONAL CHART



NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
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SUMMARY OF COMMENTS

During our audit of the Nebraska Public Employees Retirement Systems (NPERS) - State and County Employees Retirement Plans we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***County Plan Payroll Testing:*** There were 5 of 23 counties tested that did not monitor part-time employees to ensure mandatory enrollment requirements were being met. There were 2 of 104 employees tested who were not properly contributing to the Plan. One member's reported salary did not agree to the county payroll records. Additionally, 14 items related to our testing in the counties from calendar year 2001 were not adequately resolved during the current audit.
2. ***Inadequate Resolution of Prior Audit Findings:*** One finding in the audit of the State Plan for calendar year 2000 and four additional items in the audit of the County Plan for calendar year 2001 were not adequately resolved by NPERS during the current audit.
3. ***Missed Retirement Contribution Procedures:*** There were several findings related to the procedures for the identification and follow-up of missed contributions, including failure of agencies to remit the required contribution from final pay, noncompliance with NPERS Rules and Regulations related to insufficient or excess contributions, and documentation of monitoring of the missed contributions.
4. ***Plan Membership Eligibility:*** One county member began participation in the plan prior to being eligible for participation. Additionally, one county member tested did not begin participation in the plan as required by statutes.
5. ***Initial Contributions:*** NPERS' policy was not clear whether contributions should begin during the pay period that included the effective date of enrollment, or for the first full pay period following the effective date of enrollment. We noted 17 of 40 new members tested in the State Plan and 4 of 30 new members tested in the County Plan had initial contributions for a pay period that began prior to the date the employee became eligible for plan participation.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement and does not include our observations on any strong features of the NPERS.

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SUMMARY OF COMMENTS

(Concluded)

Draft copies of this report were furnished to the NPERS to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

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COMMENTS AND RECOMMENDATIONS

1. County Plan Payroll Testing

Neb. Rev. Stat. Section 84-1503(2)(b) R.S.Supp., 2002 states, it shall be the duty of the Board, “To determine the eligibility of an individual to be a member of the retirement system and other questions of fact in the event of a dispute between an individual and the individual’s employer.”

Attorney General Opinion Number 01021, issued May 16, 2001, stated, in part, “Administration of the retirement systems necessarily involves determining membership eligibility issues. Two of the most important responsibilities of the Retirement Board include determining eligibility for membership and determining entitlement to benefits in the retirement systems administered by the Board . . . We think that the statutory duties of the Retirement Board necessarily require a determination of eligibility for membership on a continuing basis to assure that only employees qualified for membership are participating in the retirement systems administered by the Board. On a continuing and ongoing basis, the Public Employees Retirement Systems applies the statutory qualifications for membership in the retirement systems. Determining eligibility for participation is necessary to safeguard the integrity of the systems and to fulfill the Board’s duty to administer all systems in a manner to maintain each plan’s status as a qualified plan pursuant to the requirements of the Internal Revenue Code.”

Neb. Rev. Stat. Section 23-2306(2) R.S.Supp., 2002 states, “The following employees of member counties are authorized to participate in the retirement system: (a) All full-time employees who have been employees for a period of twelve continuous months shall begin participation in the retirement system, except that full-time elected officials shall begin participation in the retirement system on taking office, (b) all full-time or part-time employees who have attained the age of twenty and have been employed for a total of twelve months within a five-year period may exercise the option to begin participation in the retirement system, and (c) all part-time elected officials may exercise the option to begin participation in the retirement system. An employee who exercises the option to begin participation in the retirement system shall remain in the system until termination or retirement, regardless of any change of status as a permanent or temporary employee.”

Neb. Rev. Stat. Section 23-2301(10) R.S.Supp., 2002 states, “Employee means all persons or officers who are employed by a county of the State of Nebraska on a permanent basis...”

Neb. Rev. Stat. Section 23-2301(14) R.S.Supp., 2002 states, “Full-time employee means an employee who is employed to work one-half or more of the regularly scheduled hours during each pay period.”

Neb. Rev. Stat. Section 23-2301(22) R.S.Supp., 2002 states, “Part-time employee means an employee who is employed to work less than one-half of the regularly scheduled hours during each pay period.”

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COMMENTS AND RECOMMENDATIONS

(Continued)

1. County Plan Payroll Testing (Continued)

In addition to these statutory requirements, good internal control requires procedures to ensure all eligible employees participate in the County Employees Retirement Plan as required by statute; to ensure reported salaries are accurate; and to ensure agreements are on file for missed contributions to ensure accuracy and completeness.

We tested payroll records in 23 counties to determine compliance with Plan eligibility requirements, including determining whether all eligible employees were contributing to the Plan and whether the salary reported to NPERS agreed to the county payroll records. We noted the following:

- 1) 5 of 23 counties tested did not adequately monitor their part-time employees to ensure mandatory enrollment requirements were being met.
- 2) 2 of 104 employees tested were not properly contributing to the Plan as required by statute. The two employees were in two of the twenty-three counties tested.
 - One employee was paid from two different county offices, but only had retirement contributions withheld on salary paid from one of the county offices. The employee worked one-half of the regularly scheduled hours each pay period for both offices.
 - One employee was classified as a part-time employee by the county. However, the employee worked 1,040 hours during calendar year 2002, which was one-half of the regularly scheduled hours in the year, and did not enter the Plan when required by statute.
- 3) 1 of 115 employees' reported salaries did not agree to the county payroll records. The amount reported to NPERS and used to calculate the retirement contribution was more than the employee was actually paid. This county did not process payroll via the Nebraska Association of County Officials (NACO) MIPS computer program at the time; they only remitted their retirement information via MIPS. The MIPS program currently has built in edits to ensure the salary reported to NPERS agrees to the salary the member is paid. There are currently 24 counties that do not use MIPS to process payroll. There is an increased risk for errors in these counties.
- 4) 1 of 115 employees tested did not have an agreement on file with NPERS in order for NPERS to determine if the amount of missed contributions being remitted were accurate. However, contributions were being remitted for one year of missed contributions.

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COMMENTS AND RECOMMENDATIONS

(Continued)

1. County Plan Payroll Testing (Continued)

Furthermore, good internal control requires the timely and thorough resolution of prior audit findings. *Government Auditing Standards* paragraph 5.26j and the *American Institute of Certified Public Accountants (AICPA) Professional Standards* AU 325.21 regard the failure to follow up and correct previously identified internal control deficiencies to be a reportable condition.

A similar comment was noted in the previous audit report. We noted 14 items related to our testing in the counties from the calendar year 2001 audit that were not adequately resolved during the current audit:

- Seven counties did not adequately monitor their part-time employees to ensure mandatory enrollment requirements were being met. There was no documentation provided to indicate whether NPERS contacted these counties.
- There were nine employees who we determined should have been contributing to the Plan in the prior audit. Two of the nine employees have since terminated. There was no documentation provided to indicate whether NPERS had contacted any of the counties for the remaining seven employees noted in the prior audit.

As indicated by the results of testing, without adequate procedures to ensure all eligible employees participate in the County Employees Retirement Plan as required by statute, the risk that employees are not participating in the Plan increases significantly. Additionally, there is an increased risk that salaries reported to NPERS are not the same salaries the members actually were paid without adequate procedures to ensure reported salaries are accurate. Also, if contribution make-up agreements are not on file, NPERS is unable to determine or verify whether missed contributions are accurate and complete.

We continue to recommend NPERS implement procedures to ensure county employees participate in the County Employees Retirement Plan as required by statute. We also recommend NPERS ensure reported salaries are accurate and contribution make-up agreements are on file in order to monitor whether these amounts are accurate. Furthermore, we continue to recommend NPERS implement procedures to ensure prior audit exceptions are adequately followed up and resolved.

NPERS' Response: The first audit Comment relating to County Eligibility actually includes all of the following issues:

- 1) *Properly enrolling employees, particularly part-time and temporary, in the Plan, which is also included in Comment 2 and 4*

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(Continued)

1. County Plan Payroll Testing (Continued)

NPERS' Response, Concluded:

A conclusion was reached that 5 counties did not adequately monitor part-time hours. In our discussions with these counties, many indicated that they have so few part-time employees that they feel they are aware of their hours for eligibility purposes, and most kept notes as to when the employees should be enrolled in the plan. Two eligibility exceptions were noted in a sampling of 104 employees. One exception is a full time employee who was properly enrolled in the Plan, but also received a separate paycheck for 3-5 hours/week of janitorial work which was not included in retirement deductions. This additional amount has now been included in the plan. The second exception is questionable as the County is paying a portion of the salary for an attorney's secretary. Hours are not recorded for this salaried employee, but the attorney estimates that less than 20 hours per week are worked for the County.

Since there possibly is only one unique exception in a sampling size of 104, we do not see a significant problem with County eligibility. This issue will be addressed further in Comment 4.

2) *Ensuring that reported salaries are accurate*

One contribution difference of \$.26 was discovered from review of 115 employees, and this difference would be disregarded by most payroll processors. Therefore, we do not see a need for revising our current procedures as no material exception was discovered.

3) *Ensuring that make-up agreements are on file at NPERS, which is also discussed in Comment 3*

The one exception noted is in error as the auditors did not review our pending file which includes the agreement they are missing. NPERS' staff was not asked for this agreement during field work.

4) *Ensuring that prior audit exceptions, which related to eligibility issues, are adequately followed up and resolved, which is a related issue in Comment 2 and Comment 4*

Our response to that issue will be in Comment 4 which specifically addresses "Plan Membership Eligibility."

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COMMENTS AND RECOMMENDATIONS

(Continued)

1. **County Plan Payroll Testing** (Concluded)

Auditors' Response:

- 1) **Our office visited the counties tested relating to this comment. At the time of the visits, the counties indicated they did not monitor the part-time employees hours worked per pay period. The five counties that did not monitor part-time hours had no fewer than 5 non-contributing employees in the pay period tested and two had more than 10 non-contributing employees in the pay period tested. This seemed to be a significant number of employees to visually monitor without documentation.**

The County Attorney for the second exception confirmed with our office that the employee spent half of her time on county work and half of her time on private law firm work. This seemed to fit the definition of full-time employee under the statutes. We recommend NPERS obtain written documentation from the County indicating the hours the employee worked and the rate of pay to make a proper determination of eligibility.

- 2) **The finding demonstrates the risk that counties can report a different amount to NPERS than the employees actually get paid. We continue to recommend NPERS implement procedures to ensure salaries reported to NPERS are the same as the salaries actually paid to the members.**
- 3) **NPERS did not provide the aforementioned documentation timely. NPERS was given a detail of the findings listed in this report via email on June 12. On June 19 the exit agenda was sent to NPERS also detailing the specific findings in this report. Finally, on June 23, an exit conference was held to discuss the specific findings noted in our audit. In the exit agenda, we indicated that NPERS should notify us prior to the draft report being issued if any findings were in error. The draft report was issued on July 3 to NPERS. NPERS first indicated this finding might be incorrect on July 10. Since we were not made aware of this issue prior to the end of fieldwork for the audit, we could not appropriately address it and will review the finding as follow-up in the next audit.**

2. **Inadequate Resolution of Prior Audit Findings**

Good internal control requires the timely and thorough resolution of prior audit findings. *Government Auditing Standards* paragraph 5.26j and the *AICPA Professional Standards* AU 325.21 regard the failure to follow up and correct previously identified internal control deficiencies to be a reportable condition.

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(Continued)

2. Inadequate Resolution of Prior Audit Findings (Continued)

NPERS Rules and Regulations Title 303 NAC 18-003.01 states, “If NPERS determines that a retirement system has received an excess employee contribution, NPERS shall return the excess employee contribution to the employer, and the employer shall return the excess employee contribution to the employee.”

NPERS Rules and Regulations Title 303 NAC 18-004.01(i) states, “If NPERS determines that a retirement system has received insufficient contributions from an active member or employer, or both, NPERS shall require the member and/or the employer to remit additional contributions.”

We noted one finding from the calendar year 2000 audit of the State Plan that was not adequately resolved during the current audit:

- One employee was required to join the Plan as of June 1, 2000. However, the initial contribution was not made until December 2000. The amount of additional contributions calculated by the auditors did not agree to the amount of additional contributions calculated by the employer. The employee and employer over contributed \$66 and \$103, respectively. NPERS did not follow up on the discrepancy and return the excess contributions to the employer, as required by Rules and Regulations.

We also noted four additional items from the calendar year 2001 audit of the County Plan that were not adequately resolved during the current audit:

- Two members did not begin contributing to the Plan as required by statute because their counties considered them to be part-time employees, although they both worked over one-half of the regularly scheduled hours. One member missed in excess of one year of required contributions. The other member missed just under one year of required contributions. NPERS did not provide documentation they had followed up on either individual.
- Two members began contributing to the Plan prior to being eligible for participation. NPERS did not follow up on the findings and adjust the contributions in accordance with their Rules and Regulations.

We noted a similar comment in each of the previous three audit reports. In the prior audit response, NPERS indicated that in some cases the cost of time spent in follow up by all parties involved is much more than the dollar amount of the adjustment and therefore the amount of the adjustment should be considered before they pursue the deficiency. However, we do not feel there is the authority in the Rules and Regulations or statutes for NPERS to make decisions on individual plan members based on materiality. We feel NPERS has a fiduciary responsibility to these members to adjust their accounts appropriately.

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(Continued)

2. Inadequate Resolution of Prior Audit Findings (Concluded)

We continue to recommend NPERS implement procedures to ensure all audit exceptions are adequately followed up and resolved in accordance with Statutes or Rules and Regulations.

*NPERS' Response: The prior audit findings cited in this section relate to Make-up Contributions, or Over-Contributions. The Rules and Regulations cited begin with the phrase, "If NPERS determines that a retirement system has received an excess (or insufficient) employee contribution." Therefore, NPERS is allowed to make determinations (not merely have the knowledge of) whether an excess or insufficient contribution has been received. We continue with our position that we have a fiduciary duty to the State to assess the cost involved against the dollar amount of the adjustment before we pursue the deficiency. Since 3 of the 5 exceptions noted involve contributions for 1 month or less, we have chosen not to require corrections. Neb. Rev. Stat. Section 84-1322(2)(a) clearly allows a 60-day time period in which to begin contributions for **rehire** situations, which should provide guidance as to what the legislature feels are acceptable enrollment practices. The other 2 exceptions involve disagreements as to when the part-time employee's enrollment was actually mandatory, and we will again discuss this with the counties and try to reach a resolution.*

Auditors' Response: We feel a reasonable determination can be made related to excess contributions when an independent auditor advises management of errors related to contributions. NPERS has a fiduciary responsibility to each member of the Plan to ensure the individual member accounts are maintained and credited in accordance with Plan provisions. We feel NPERS is misapplying the use of materiality in determining compliance with Plan provisions.

It appears NPERS is effectively taking the position that a statute, which does not apply to overcontributions or undercontributions, guides them to ignore a Rule and Regulation that clearly applies to overcontributions and undercontributions. Section 18-003.01 has the force and effect of law, and until it is amended or repealed, or until it is contradicted by subsequent legislation, NPERS has a legal duty to return all excess contributions, to employers or employees, regardless of the amounts.

3. Missed Retirement Contribution Procedures

NPERS Rules and Regulations Title 303 NAC 18-002.08 states, "Insufficient contribution means an employee contribution or employer contribution, or both, which is (a) less than statutorily mandated deduction from compensation, (b) less than the statutorily mandated matching contribution required of an employer, (c) not timely remitted, (d) not remitted due to administrative errors on the part of the

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(Continued)

3. Missed Retirement Contribution Procedures (Continued)

employer, (e) not remitted due to the failure of the employer to enroll the employee in the retirement system when such employee was required to be enrolled, or (f) due to a retroactive salary payment paid pursuant to court order, arbitration, or litigation and grievance settlements.”

NPERS Rules and Regulations Title 303 NAC 18-004.01 (i) states, “If NPERS determines that a retirement system has received insufficient contributions from an active member or employer, or both, NPERS shall require the member and/or the employer to remit additional contributions.”

NPERS Rules and Regulations Title 303 NAC 18-004.01 (v) states, “Any additional employer contribution which is dependent upon an additional employee contribution shall be made in conjunction with the employee contribution.”

Good internal control requires adequate procedures to ensure required contributions begin and begin timely in accordance with statutes. Good internal control also requires procedures to adequately monitor all missed contributions to ensure the missed contributions are properly remitted and are remitted in accordance with NPERS Rules and Regulations. Adequate procedures would include verification of the salary of the employee during the time of missed required contributions. This verification would ensure the time frame and amount of missed contributions calculated by the employer is accurate.

NPERS did not have adequate procedures in the State Plan to ensure all required contributions were properly remitted. NPERS identified State employees who missed required contributions by accessing the State payroll system each month. However, the follow up of those employees identified as missing required contributions was not adequate. The employees’ agencies were not contacted timely and consistently. Three of twenty members tested from NPERS’ query of the payroll system missed required employee and employer contributions. NPERS’ documentation of correspondence with the agencies to follow up on missed contributions was not always maintained. Of these three members, NPERS provided documentation to indicate they had contacted one of the employees’ agencies. However, the correspondence with that agency was not timely. The three employees missed required contributions for 27, 16, and 2 biweekly pay periods. One of the three members terminated in 2003 without making up the missed contributions.

We also noted the following related to missed contribution procedures:

- The four terminated members tested did not properly remit the required contribution from their final pay. All four members were vested in the Plan upon termination and did not receive the required State matching contribution of 156% of their employee contribution since their agencies failed to remit the required contributions. The members did not receive \$526, \$370, \$337, and \$301, respectively for the employer share.

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(Continued)

3. Missed Retirement Contribution Procedures (Continued)

- NPERS did not have adequate procedures to ensure the counties or State agencies correctly calculated the time period and amount of missed contributions since NPERS did not verify the missed contributions to the member's salary for the missed period. This was also noted in the prior audit report. One of twenty members tested from NPERS' query of the payroll system remitted contributions for part of the time period contributions were missed, but not for the entire time period of the missed contributions. There were two monthly pay periods that were missed and were not remitted.
- Insufficient employer contributions were not remitted in conjunction with insufficient employee contributions, as required by NPERS Rules and Regulations. The two State Plan members tested, who had missed required contributions for more than one pay period, had the employer portion remitted in one pay period, while the employee portion was remitted in 8 and 3 pay periods. One of three County Plan members tested, who had missed required contributions for more than one pay period, had the employer portion remitted in 12 pay periods, while the employee's portion was remitted in 120 pay periods. The 120 pay periods also exceeded the time frame allowed by NPERS Rules and Regulations by 12 pay periods. There is an increased risk that the employee will terminate and receive the excess employer contributions if the employee is vested, when the employer contribution is remitted prior to the employee contribution. If the employee is not vested at termination, the employer could lose the excess contributions to a forfeiture account.
- One of thirty County Plan members tested did not begin contributions on time. The member missed one biweekly pay period.
- Four of six State Plan members tested and one of three County Plan members tested who had missed contributions did not have an agreement on file at NPERS to document the missed contributions. Therefore, NPERS could not appropriately monitor whether the missed contributions were remitted, or whether the time frame and amount of missed contributions were correct. The five employees had remitted missed contributions for one or two pay periods.
- One of three County Plan members tested had excess contributions to the plan. The county had the employee remit contributions for a time period for which the county did not think the contributions had started. However, the contributions had actually begun on time. The member over-contributed \$61 and the County over-contributed \$91.

Without adequate procedures to ensure required contributions are properly and timely remitted the risk increases that members vested in the Plans will not receive all possible benefits, and that the Plans will not receive all possible forfeiture amounts for members who are not vested at termination. A similar comment was noted in the prior audit report.

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(Continued)

3. Missed Retirement Contribution Procedures (Continued)

We recommend NPERS implement adequate procedures to ensure all required contributions are remitted and remitted timely. We also recommend NPERS implement procedures to adequately monitor missed contributions. We recommend NPERS implement procedures to ensure missed employee and employer contributions are remitted in conjunction with each other, in accordance with Rules and Regulations. Finally, we recommend NPERS take appropriate action, in accordance with their Rules and Regulations, to resolve the situations identified in this finding.

NPERS' Response: This comment also includes various issues which will be difficult to discuss in one paragraph, and therefore are outlined below:

- 1) *Retirement contributions are not being deducted from final pay for terminating state employees*

We will continue to remind payroll personnel that retirement deductions should not be "turned off" as is the case with many other benefit deductions for terminating employees. This has also been discussed with NIS payroll personnel, and as yet no workable controls have been discovered in the payroll system.

- 2) *Employers were remitting their entire make-up contribution in one payment rather than matching employee contributions each period*

This practice was discontinued last year since NPERS determined that it could result in overmatching employee accounts.

- 3) *Contributions did not begin on time*

This is the issue regarding the appropriate date to begin contributions, which will be addressed in Comment 5.

- 4) *Make-up Agreements were not on file for all missed contributions*

NPERS does not require a written Make-Up Agreement in all cases, especially when it involves only one or two months that can easily be corrected through payroll adjustments without a detailed installment arrangement that is included in the Agreement. All 5 exceptions noted involved one month or less of make-up contributions, and therefore no

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(Continued)

3. Missed Retirement Contribution Procedures (Concluded)

NPERS' Response, Concluded:

installment arrangement was required and no Agreement would have been requested by NPERS. We are pleased that the employers are making the necessary adjustments, and that these adjustments are accurate, and therefore certainly would not want to interfere with procedures that appear to be working well.

Auditors' Response:

- 3) This is not the same issue as Comment Number 5. The individual noted in this finding missed a complete pay period. The members referenced in Comment Number 5 were simply handled inconsistently in regard to the date of their initial contribution.**
- 4) The issue in this finding is whether NPERS can appropriately monitor missed required contributions. Without the agreements or other documentation, NPERS is unable to monitor the missed contributions to ensure the amount of the make-up contribution is accurate. We have reported in this audit and in past audits that missed contributions have been inaccurately calculated.**

4. Plan Membership Eligibility

Neb. Rev. Stat. Section 84-1503(2)(b) R.S.Supp., 2002 states it shall be the duty of the Board, "To determine the eligibility of an individual to be a member of the retirement system and other questions of fact in the event of a dispute between an individual and the individual's employer."

Neb. Rev. Stat. Section 23-2306(2) R.S.Supp., 2002 states, "The following employees of member counties are authorized to participate in the retirement system: (a) All full-time employees who have been employees for a period of twelve continuous months shall begin participation in the retirement system, except that full-time elected officials shall begin participation in the retirement system on taking office, (b) all full-time or part-time employees who have attained the age of twenty and have been employed for a total of twelve months within a five-year period may exercise the option to begin participation in the retirement system, and (c) all part-time elected officials may exercise the option to begin participation in the retirement system."

Neb. Rev. Stat. Section 23-2301(14) R.S.Supp., 2002 states, "Full-time employee means an employee who is employed to work one-half or more of the regularly scheduled hours during each pay period."

Neb. Rev. Stat. Section 23-2301(22) R.S.Supp., 2002 states, "Part-time employee means an employee who is employed to work less than one-half of the regularly scheduled hours during each pay period."

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(Continued)

4. Plan Membership Eligibility (Continued)

In addition to these statutory requirements, good internal control requires procedures to ensure all eligible employees participate in the County Employees Retirement Plan as required by statute.

NPERS did not have adequate procedures to ensure all eligible and only eligible employees joined the County Plan as required by statute. We noted the following related to County Plan membership requirements:

- One of thirty members tested did not begin Plan participation as required by statute. The employee missed contributions because the county considered the employee to be part-time. However, per review of the hours worked, it appeared the employee worked over one-half of the regularly scheduled hours back to at least July 2001. Therefore, the employee should have started contributions to the plan at least as early as July 2002, but contributions did not begin until December 2002.
- One of thirty members tested began participation before being eligible. The county started contributions before the employee had completed the requirements for membership in the Plan because of past Plan participation. The past County Plan participation was in excess of five years prior to hiring. Therefore, the employee should have begun again as a new member. The employee also had participation in the State Plan. However, there was no application for vesting credit that allowed the member to join immediately. This employee began participation five months prior to becoming eligible.

As indicated by the results of testing, without adequate procedures to ensure all eligible and only eligible employees participate in the County Employees Retirement Plan as required by statute, the risk that ineligible employees are participating in the Plan increases significantly. The risk that all eligible employees are not participating in the Plan also increases.

We continue to recommend NPERS implement procedures to ensure employees participate in the County Employees Retirement Plan as required by statute. We also recommend NPERS take appropriate action to resolve the specific findings noted.

NPERS' Response: This comment again addresses the issue of making certain all eligible employees are enrolled in the plan. Two county employees appear to have been enrolled at improper times due to their status. One employee was not enrolled until his status changed to full time, and he possibly was working 5 months earlier at more than 20 hours in a part-time status. The second employee may have been enrolled 5 months early because temporary service was included in the eligibility period. These exceptions will be discussed with the counties for proper resolution.

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(Continued)

4. **Plan Membership Eligibility** (Concluded)

NPERS' Response, Concluded:

Comment 1 also included discussion of previous audit items that had not been adequately resolved. These exceptions also involved proper enrollment of employees based on their status. In most cases, counties classified the individuals as temporary employees, and, since they were not receiving other benefits, did not feel they should be enrolled in the retirement plan. Most of these employees are short term and would never reach a vested status in the Plan. We will continue to monitor the 7 employees to determine if they should be enrolled based on current plan rules.

We will continue to remind the County administrators that they must monitor the hours and employment time for both part-time and temporary employees to make certain they are within their appropriate categories. Copies of these communications will continue to be provided to the auditors. Make-up agreements are always executed if it is determined that members should have entered the Plan at an earlier date.

As a final comment on this point, NPERS' position remains that it is the responsibility of the county to make certain that all eligible employees are enrolled in the Plan. Our agency administers the Retirement Plan and assumes responsibility for educating the counties on the specific requirements of the statutes and assists them with interpretations in the event of dispute. We cannot guarantee total compliance by each county, as we cannot monitor each and every payroll.

Auditors' Response: In response to NPERS repeated claim that, "it is the responsibility of the county to make certain that all eligible employees are enrolled in the Plan," we will repeat that NPERS has numerous statutory duties and internal control responsibilities relating to the administration of the retirement plans, as cited in this Comment.

In addition, as we have referred in previous audit reports, Attorney General Opinion Number 01021, issued May 16, 2001, stated, in part, "Administration of the retirement systems necessarily involves determining membership eligibility issues. Two of the most important responsibilities of the Retirement Board include determining eligibility for membership and determining entitlement to benefits in the retirement systems administered by the Board . . . We think that the statutory duties of the Retirement Board necessarily require a determination of eligibility for membership on a continuing basis to assure that only employees qualified for membership are participating in the retirement systems administered by the Board. On a continuing and ongoing basis, the Public Employees Retirement Systems applies the statutory qualifications for membership in the retirement systems. Determining eligibility for participation is necessary to safeguard the integrity of the systems and to fulfill the Board's duty to administer all systems in a manner to maintain each plan's status as a qualified plan pursuant to the requirements of the Internal Revenue Code."

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

COMMENTS AND RECOMMENDATIONS

(Continued)

5. Initial Contributions

The Nebraska State and County Retirement Systems Manuals each state, “It is your responsibility as the [employer] to ensure that contributions to the retirement plan commence within the first pay period following the effective date of enrollment.” The effective date of enrollment is the first month following the employee’s election to join the plan under voluntary membership, but must be no later than the first of the month following the date the employee satisfies the mandatory participation requirements.

NPERS’ policy was not clear whether contributions should begin during the pay period that included the effective date of enrollment, or the first full pay period following the effective date of enrollment. We noted State agencies and counties handled the first contribution inconsistently. Some allowed employees to begin their initial deduction in the pay period that began before the effective date of enrollment. We noted 17 of 40 new members tested in the State Plan and 4 of 30 new members tested in the County Plan had initial contributions for a pay period that began prior to the date the employee became eligible for plan participation. This was also a comment in the prior audit report.

Without a clear policy defining when the initial contributions should begin, some employees begin contributing the entire pay period that includes their participation date and receive State matching contributions for that full pay period. Other employees are required to wait until the first full pay period after their participation date before they begin contributing and do not receive the same State matching contributions as those who begin participation early.

We recommend NPERS develop a clear policy for initial contributions to ensure the pay period of the initial contribution includes only wages that are eligible for the deduction.

*NPERS’ Response: As noted by the auditors, Statute does not provide guidance as to exactly what date contributions to the plans must commence. It is interesting to note that, as stated previously, Neb. Rev. Stat. Section 84-1322(2)(a) clearly allows a 60-day time period in which to begin contributions on **rehire** situations. Our goal is to make a reasonable and acceptable interpretation of the statute that can easily be followed by all employers involved. Since employer reporting from state agencies and counties represents many different and often very unique payroll periods, we have also attempted to maintain a flexible policy regarding the initial period of contributions in order to accommodate the various payroll periods. If necessary, we may try to define a “tolerance period” similar to the 60 days allowed for rehires, as we do not want employers faced with insignificant make-up contributions. This appears to be consistent with our policy of not requiring adjustments or reimbursements for contribution differences related to one month or less.*

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

COMMENTS AND RECOMMENDATIONS

(Concluded)

5. Initial Contributions (Concluded)

Auditors' Response: The initial contributions policy should clearly guide employers so that initial contribution dates are consistent and legal.

NPERS mentioned their policy of not requiring adjustments or reimbursements for contribution differences related to one month or less. We were not advised of this policy during the audit and disagree with the policy, since it does not comply with the Rules and Regulations of the Board.

NPERS' Overall Response: In conclusion, we are very pleased that no material instances of noncompliance or "material weaknesses in internal control" were disclosed during this audit. Our staff continues to devote a significant amount of time to the Technology Project, and we are pleased that no significant weaknesses were discovered, even in times of excessive workloads.

There does not appear to be recognition of the time and cost constraints our agency is faced with in maintaining the vast amount of data for which we are responsible. We ask for cooperation from the Auditor's Office in attempting to resolve some of these fairly inconsequential findings, especially in light of all the challenges we are facing with a new system.

Auditors' Overall Response: We also disagree that "no significant weaknesses were discovered." Comment Numbers 1 through 4 are listed as reportable conditions. Reportable conditions are defined as relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect NPERS' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Additionally, there were several other findings brought to NPERS' attention during the course of the audit and discussed in the exit conference that were not included in the audit report. We consider all of the findings in our report to be significant.

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

INDEPENDENT AUDITORS' REPORT

Deann Haeffner, CPA
Deputy State Auditor
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We have audited the accompanying Statements of Plan Net Assets of the Nebraska Public Employees Retirement Systems (NPERS) - State and County Employees Retirement Plans as of December 31, 2002, and the related Statements of Changes in Plan Net Assets for the year then ended, as listed in the Table of Contents. These financial statements are the responsibility of the NPERS management. Our responsibility is to express an opinion on these financial statements based on our audit.

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Pat Reding, CPA
Asst. Deputy Auditor
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We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 audit provides a reasonable basis for our opinion.

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As discussed in Note 1, the financial statements present only the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans and are not intended to present fairly the financial position and results of operations of the Nebraska Public Employees Retirement Systems in conformity with generally accepted accounting principles.

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Robert Hotz, JD
Legal Counsel
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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans as of December 31, 2002, and the results of each Plan's operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 23, 2003, on our consideration of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans' internal control over financial reporting and on our tests of each plans compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans taken as a whole. The accompanying supplementary schedule is presented for purposes of additional analysis and is not a required part of the financial statements of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Pat Reding, CPA

Assistant Deputy Auditor

June 23, 2003

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
STATEMENTS OF PLAN NET ASSETS
AS OF DECEMBER 31, 2002

ASSETS	STATE	COUNTY
Deposits with State Treasurer	\$ 8,852	\$ 66,875
Receivables:		
Contributions	8,073	445,899
Interest	912,351	223,786
Investments, at fair value (Note 3)	581,057,039	140,575,845
Guaranteed investment contracts, at contract value (Note 3)	126,218,785	31,098,499
Securities lending collateral (Note 3)	4,165,684	1,022,084
Total Assets	712,370,784	173,432,988
LIABILITIES		
Administration expense payable	68,706	45,495
Accrued compensated absences (Note 6)	26,099	13,704
Investment fees payable	101,138	24,677
Obligations under securities lending (Note 3)	4,165,684	1,022,084
Total Liabilities	4,361,627	1,105,960
Net assets held in trust for pension benefits	\$ 708,009,157	\$ 172,327,028

The accompanying notes are an integral part of the financial statements.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2002

	STATE	COUNTY
Additions:		
Additions to net assets attributed to:		
Investment income:		
Net income (loss) from investing activities	\$ (52,916,658)	\$ (12,542,035)
Securities lending income	89,684	22,005
Securities lending expense	(70,795)	(17,370)
Total net investment income (loss)	(52,897,769)	(12,537,400)
Contributions:		
Employee	21,581,768	6,053,807
Employer (Note 4)	33,719,733	9,033,006
Total contributions	55,301,501	15,086,813
Total Additions	2,403,732	2,549,413
Deductions:		
Deductions from net assets attributed to:		
Benefits paid to participants	36,121,096	7,510,164
Administrative expenses	1,112,260	636,041
Total Deductions	37,233,356	8,146,205
Net increase (decrease)	(34,829,624)	(5,596,792)
Net assets held in trust for pension benefits:		
Beginning of year	742,838,781	177,923,820
End of year	\$ 708,009,157	\$ 172,327,028

The accompanying notes are an integral part of the financial statements.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2002

1. **Summary of Significant Accounting Policies**

A. **Reporting Entity**

The Nebraska Public Employees Retirement Systems was restructured by the Legislature in 1971 to administer the existing Nebraska retirement systems. Currently, NPERS is responsible for the administration of five retirement plans and the Deferred Compensation Plan. The five retirement plans administered are: the School Employees, State Patrol, Judges, State Employees, and County Employees Retirement Plans.

NPERS is a part of the State of Nebraska reporting entity. The five retirement plans and the Deferred Compensation Plan are classified as pension trust fund types in the State of Nebraska Comprehensive Annual Financial Report.

Separate reports have been issued for the School Employees, Judges, and State Patrol Retirement Plans for the fiscal year ended June 30, 2002 and the Deferred Compensation Plan for the fiscal year ended December 31, 2001.

The financial statements reflect only the two defined contribution plans, the State and County Employees Retirement Plans and do not reflect all activity of the Nebraska Public Employees Retirement Systems.

- B. **Basis of Presentation.** The accompanying financial statements of NPERS - State and County Employees Retirement Plans, have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of Accounting. The State and County Employees Retirement Plans' financial statements were prepared on the accrual basis. Investments are presented at fair value or contract value, as noted below, revenues are recorded when earned, and expenditures are recorded at the time liabilities are incurred.

Deposits with State Treasurer. Cash in the State Treasury represents the cash balance of a fund as reflected on the Nebraska Accounting System (NAS). Investment of all available cash is made by the State Investment Officer, on a daily basis, based on total bank balances. Investment income is distributed based on the average daily book cash balance of funds designated for investment. Determination of whether a fund is considered designated for investment is done on an individual fund basis. The cash funds of the State and County Plans were designated for investment during 2002.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. **Summary of Significant Accounting Policies (Concluded)**

Investments. Neb. Rev. Stat. Section 72-1239.01(1) R.S.Supp., 2002 states, “The appointed members of the Nebraska Investment Council shall have the responsibility for the investment management of the assets of the retirement systems administered by the Public Employees Retirement Board as provided in section 84-1503. The appointed members shall be deemed fiduciaries with respect to the investment of assets of the retirement systems and shall be held to the standard of conduct of a fiduciary specified in subsection (3) of this section.” Neb. Rev. Stat. Section 72-1239.01(3) R.S.Supp., 2002 states, “The appointed members of the council shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use”

2002 Neb. Laws LB 407, Section 19, effective April 18, 2002, authorizes the State Investment Officer to invest the State’s funds in investments of the nature which individuals of prudence, discretion, and intelligence acquire or retain in dealing with the property of another, and if the State Investment Officer has special skills or is named on the basis of representations of special skills or expertise, he or she is under a duty to use such skills, subject to the direction of the Nebraska Investment Council. LB 407, Sections 4 and 56 detail investment options for the County Employees Retirement Plan and the State Employees Retirement Plan, respectively, and require the stable return account to be in one or more guaranteed investment contracts. Under Neb. Rev. Stat. Sections 23-2301(16) R.S.Supp., 2002, and 84-1301(15) R.S.Supp., 2002, guaranteed investment contract means “an investment contract or account offering a return of principal invested plus interest at a specified rate.”

Investments, which are held by outside investment firms, are carried at fair value to properly reflect the asset values of the funds at December 31, 2002. Investments are valued at quoted market price (closing price) on the last business day of the calendar year. Guaranteed investment contracts are carried at contract value as reported to the Nebraska Investment Council by the investment fund manager.

Although the assets of the plans are commingled for investment purposes, each plan’s assets may be used only for the payment of benefits to the members of that plan, in accordance with the terms of the plan.

2. **Plan Descriptions**

The following summary description of the NPERS is provided for general information purposes. Participants should refer to Neb. Rev. Stat. Sections 84-1301 through 84-1333, R.R.S. 1999 and R.S.Supp., 2002 for the State Employees Retirement Plan, and Neb. Rev. Stat. Sections 23-2301 through 23-2335, R.R.S. 1997, and R.S.Supp., 2002, for the County Employees Retirement Plan for more complete information.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. **Plan Descriptions** (Continued)

A. **Nebraska State Employees Retirement Plan - Defined Contribution**

This single employer plan became effective by statute on January 1, 1964, and is a defined contribution plan that covers State employees.

Prior to April 18, 2002, participation in the State Employees Retirement Plan was required for all permanent full-time employees (working one-half or more of the regularly scheduled hours) upon reaching the age of 30 and completion of 24 months of continuous service. Voluntary participation was permitted upon reaching age 20 and 12 months of permanent, full or part-time (less than one-half of regularly scheduled hours) service within a five-year period.

2002 Neb. Laws LB 687, Section 20, effective April 18, 2002, requires all permanent full-time employees who have 12 continuous months of service to begin participation in the retirement system. All permanent full-time or permanent part-time employees who have 12 months of service within a five-year period, and who have attained the age of 20, may exercise the option to begin participation in the retirement system.

Each member contributes 4.33 percent of his or her monthly compensation until \$864 has been contributed and 4.8 percent of pay for the rest of the calendar year. The State matches a member's contribution at a rate of 156 percent. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. Prior to April 18, 2002, the employer's account was fully vested after five years plan participation plus eligibility and vesting credit, or at retirement. Legislative Bill 687 changed the vesting requirement to a total of three years of participation in the system, including the twelve month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

The amount contributed by the State for terminated employees who are not fully vested is forfeited and used to reduce NPERS expenses and then reduce employer contributions. As of December 31, 2002, there were 14,349 active members and 2,002 inactive members.

The NPERS employees are employees of the State of Nebraska and contributed \$60,730. NPERS, as part of the State of Nebraska, contributed \$94,739.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. **Plan Descriptions (Concluded)**

B. Nebraska County Employees Retirement Plan - Defined Contribution

In 1973 the State Legislature brought the County Employees Retirement Plan under the administration of the Board. This multiple-employer plan is a defined contribution plan that covers employees of 91 of the State's 93 counties, in addition to the Niobrara Council. Douglas and Lancaster counties have separate retirement plans for their employees as listed in Neb. Rev. Stat. Section 23-2301(10) R.S.Supp., 2002.

Participation in the County Employees Retirement Plan is required of all full-time employees upon the completion of 12 months of continuous service and of all full-time elected officials upon taking office. Full-time or part-time employees (working less than one-half of regularly scheduled hours) may elect voluntary participation upon reaching age 25 and completing a total of 12 months service within a five-year period. Part-time elected officials may exercise the option to join.

County employees and elected officials contribute 4 percent and commissioned law enforcement personnel (for participating counties with an excess of eighty-five thousand inhabitants) contribute 6 percent of their total compensation, respectively. In addition, the County contributes 150 percent. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. Prior to April 18, 2002, the employer's account was fully vested after five years of plan participation plus eligibility and vesting credit, or at retirement. Legislative Bill 687 changed the vesting requirement to a total of three years of participation in the system, including the twelve month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

The amount contributed by the County for terminated employees who are not fully vested is forfeited and used to reduce NPERS expenses and then reduce employer contributions. As of December 31, 2002, there were 6,162 active members and 1,032 inactive members.

3. **Investments and Securities Lending**

Upon enrollment in the plans, a participant may direct employee contributions in five- percent increments in any of several investment options. Employer contributions are required by statute to be invested in the Employer Fund. There are three pre-mixed funds in which the members could allocate their employer account.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. **Investments and Securities Lending (Continued)**

GASB Statement Number 3 requires government entities to categorize investments for the purpose of giving an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered, or for which securities are held by the System or its agent in the name of the System. Category 2 includes uninsured or unregistered investments for which securities are held by the bank's trust department or agent in the name of the System. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer but not in the System's name.

Neb. Rev. Stat. Section 72-1243 R.R.S. 1996, authorizes the State Investment Officer to direct the investment and reinvestment of money in all State funds not currently needed and order the purchase, sale, or exchange of securities for such funds. The State Investment Officer participates in securities lending transactions, where securities are loaned to broker-dealers and banks with a simultaneous agreement to return the collateral for the same securities in the future. The NPERS custodial bank administers the securities lending program and receives cash, United States Government or government agency obligations, or convertible bonds at least equal in value to the market value of the loaned securities as collateral for securities of the type of loan at year end. Securities lent at year end for cash collateral are presented as unclassified in the following schedule of custodial risk. Securities lent for securities collateral are classified according to the category for the collateral. At year end NPERS had no credit risk exposure to borrowers because the amounts NPERS owes the borrowers exceed the amount the borrowers owe NPERS. There are no restrictions on the amount of securities that can be loaned, and there were no losses resulting from borrower default during the year.

Generally, either NPERS or the borrowers can terminate securities loans on demand. Cash collateral is invested in one of the lending agent's short-term investment pools that had average durations of 53 and 63 days. Because loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. There is no loss indemnification provided to NPERS by the contract with the custodian.

Short-term investments are invested in State Street Global Advisors Short Term Investment Fund, which is a money market fund. Mutual funds are not categorized securities and are not required to be categorized for GASB Statement Number 3.

State and County Employees Retirement Plans have several contracts with insurance companies. The accounts are credited with interest earnings and charges for plan withdrawals and expenses as stated in the contract. The contracts are included in the financial statements at December 31, 2002 at contract value as reported to the Nebraska Investment Council by

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. Investments and Securities Lending (Concluded)

the investment fund manager. Contract value represents contributions made under the contract, plus earnings, less withdrawals, and expenses. The December 31, 2002, balance was \$126,218,785 for the State Employees Retirement Plan and \$31,098,499 for the County Employees Retirement Plan. Activity is recorded in the Stable Fund. Guaranteed investment contracts are not required to be categorized per GASB 3.

The S & P 500 Stock Index Fund, International Stock Fund, Money Market Fund, Bond Market Index Fund, Large Company Growth Stock Index Fund, Large Company Value Stock Index Fund, and Small Company Stock Fund are investments held in external pools.

The International Stock Fund is registered with the Securities and Exchange Commission (SEC). The other external pools are bank-registered funds regulated by bank examiners. The fair value of their position in the pool is the same as the value of the pool shares.

The following is a summary of the type of investments at carrying value at December 31, 2002:

Not Categorized

Investments held in external pools	\$ 721,632,884
Guaranteed Investment Contracts	55,526,666
Synthetic Investment Contracts	96,694,200
Investments held by broker-dealers Under Securities	
Loan with Cash Collateral:	
Synthetic Investment Contracts	5,096,418
Securities Lending Short-Term Collateral Investment Pool	5,187,768
TOTAL	<u>\$ 884,137,936</u>

	State	County	Total
Investments, at fair value	\$ 581,057,039	\$ 140,575,845	\$ 721,632,884
Guaranteed Investment Contracts	126,218,785	31,098,499	157,317,284
Securities Lending Collateral	4,165,684	1,022,084	5,187,768
Total Investments	<u>\$ 711,441,508</u>	<u>\$ 172,696,428</u>	<u>\$ 884,137,936</u>

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

4. Employer Contributions

Historically, employer contributions have been reported net of forfeitures. Forfeitures result when a member terminates prior to vesting in the employer contribution portion of his or her account. In accordance with Neb. Rev. Stat. Sections 23-2319.01(1) R.S.Supp., 2002, and 84-1321.01(1) R.S.Supp., 2002, forfeitures are first used to pay administrative expenses of the Board. The remaining balance, if any, shall then be used to reduce State and County employer contributions respectively. During 2002, there were no forfeitures used to offset the State and County employer contributions. The balance of the forfeiture accounts at December 31, 2002 was \$1,032,816 for the State Plan and \$78,091 for the County Plan.

5. Capital Lease Commitments

The State of Nebraska, through the Department of Administrative Services (DAS) – Accounting Division, has a Master Lease Agreement to be used by various agencies to purchase equipment. In December 2000, the Board first used this financing arrangement to finance the acquisition and installation of certain information technology equipment.

The second Master Lease Agreement, dated November 1, 2001, was for \$2,166,847 including interest costs of \$241,847, a rate of 3.245%. The third Master Lease Agreement, in July 2002, was for \$6,029,861 including interest costs of \$644,861, a rate of 3.129%. The first Master Lease Agreement was integrated into the third Master Lease Agreement. As a result, the first Master Lease Agreement no longer exists. The minimum annual lease payments and the present value of future minimum payments for capital leases as of December 31, 2002 are as follows:

Year	State	County
2003	\$ 210,448	\$ 93,532
2004	212,191	94,307
2005	211,418	93,964
2006	211,609	94,048
2007	210,211	93,427
2008-2009	287,256	127,669
Total Minimum Payments	1,343,133	596,947
Less: interest and executory costs	138,033	61,347
Present value of net minimum payments	\$ 1,205,100	\$ 535,600

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. Capital Lease Commitments (Concluded)

Litigation. The potential amount of liability involved in litigation pending against the Board, if any, could not be determined at this time. However, it is the Board's opinion that final settlement of those matters should not have an adverse effect on the Board's ability to administer current programs. Any judgment against the Board would have to be processed through the State Claims Board and be approved by the Legislature.

6. Compensated Absences

All permanent employees working for NPERS earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees and Board members are not eligible for paid leave.

NPERS employees accrue vested annual leave at a variable rate based on years of service. Generally, accrued annual leave cannot exceed 35 days at the end of a calendar year.

Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days for employees under the Nebraska Classified System Personnel Rules and Regulations. In general, there is no maximum limit on the accumulation of sick days for employees under a labor contract. Sick leave is not vested except upon death or upon reaching the retirement eligibility age of 55, at which time the State is liable for 25 percent of the employee's accumulated sick leave. Employees under labor contracts can be paid a maximum of 50 days.

Both plans recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave becomes vested.

The liability for the vested portion of compensated absences for each plan at December 31, 2002, is as follows:

	State Employees	County Employees
Annual Leave	\$ 16,662	\$ 8,749
Sick Leave	9,296	4,881
Compensatory Leave	141	74
	\$ 26,099	\$ 13,704

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

7. Subsequent Events

Cash Balance Plan

2002 Neb. Laws LB 687, Sections 1, 3, and 6 discuss changes to the State and County Plans. In January 2000, the Public Employees Retirement Board and the Nebraska Retirement Systems Committee of the Legislature recommended a coordinated strategy be developed for long-term management of the Nebraska Public Employees Retirement Systems. The strategy included a review of benefits, funding, and investment management. Among other things, the study found that State and county retirement systems do not meet adequacy needs and that such systems rank below median in the amount of initial normal retirement benefit and that, as defined contribution plans, such plans are dependent upon significant investment performance and substantial contributions, even though such plans are also subject to significant volatility in the delivery of such benefits.

Legislative Bill 687 made the following changes (in addition to changes mentioned previously), effective January 1, 2003:

State and county employees are provided with a choice between a traditional defined benefit plan or cash balance plan, and the current defined contribution plan. The cash balance benefit means a member's retirement benefit that is equal to an amount based on annual employee contribution credits plus interest credits and, if vested, employer contribution credits plus interest credits.

Members of the State and County Employees Retirement Plans were required to make an election whether to enter the new cash balance plan or remain in the defined contribution plan prior to January 1, 2003. All new members of the Plans on and after January 1, 2003, must join the cash balance plan.

County Plan Contribution Rates

Neb. Rev. Stat. Section 23-2307 R.S.Supp., 2002 changed the contribution percentages for members of the County Employees Retirement Plan. Effective January 1, 2003, each employee who is a member of the retirement system pays to the county or has picked up by the county a sum equal to four and one-half percent of his or her compensation for each pay period.

Additionally, commissioned law enforcement personnel (for participating counties with less than eighty-five thousand inhabitants) and their counties shall each contribute an additional one percent of compensation.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

(Continued)

7. **Subsequent Events (Concluded)**

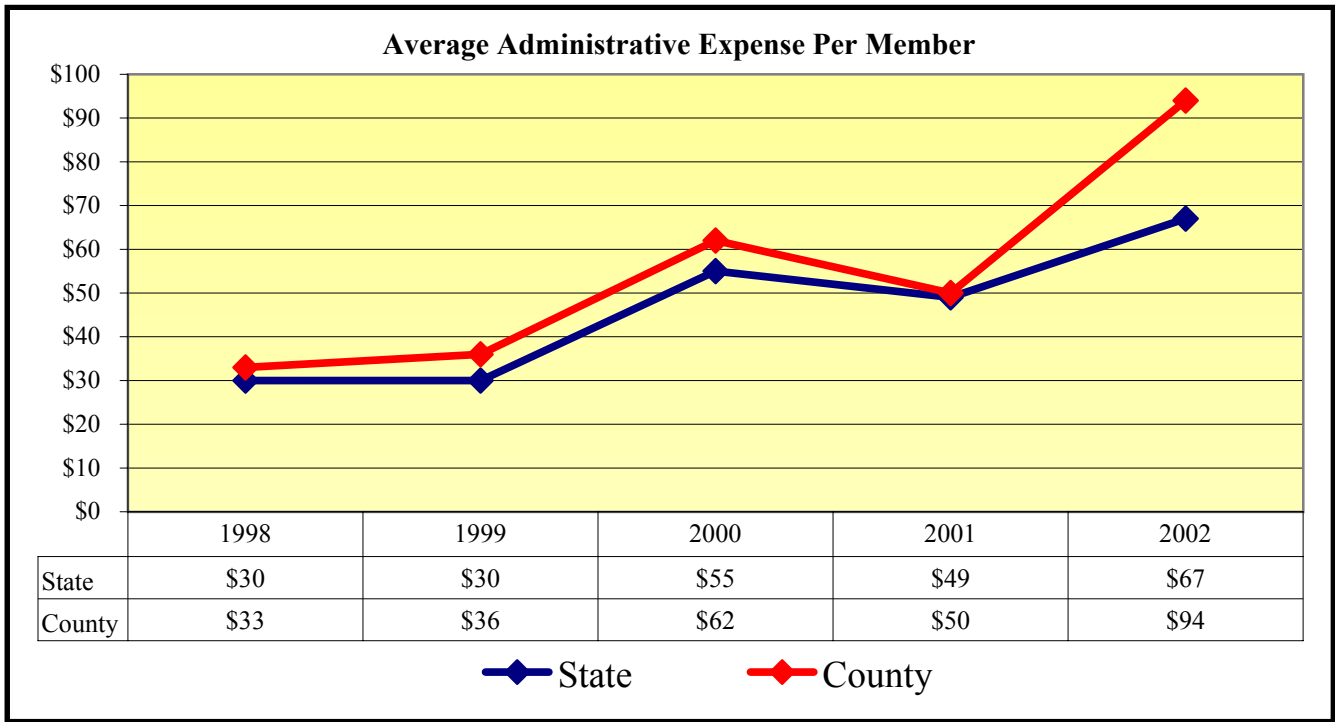
Capital Lease Commitment

A fourth Master Lease Agreement was entered into by NPERS in February 2003. The contracted amount of \$5,915,227 includes interest payments of \$525,227. The interest rate is 2.757%.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
Average Administrative Expense Per Member

STATE	1998	1999	2000	2001	2002
Members:					
Active	13,025	12,840	12,861	12,750	14,349
Inactive	1,438	1,656	1,828	2,070	2,002
Total Members	<u>14,463</u>	<u>14,496</u>	<u>14,689</u>	<u>14,820</u>	<u>16,351</u>
Administrative Expenses: (1)					
PERS	\$249,879	\$263,287	\$523,675	\$342,389	\$688,714
Total Expenses (3)	\$435,124	\$440,278	\$804,471	\$727,002	\$1,093,376
Average Administrative Expense					
Per Member (2)	\$30	\$30	\$55	\$49	\$67
COUNTY					
Members:					
Active	6,071	5,840	5,921	5,983	6,162
Inactive	810	877	951	1,083	1,032
Total Members	<u>6,881</u>	<u>6,717</u>	<u>6,872</u>	<u>7,066</u>	<u>7,194</u>
Administrative Expenses: (1)					
PERS	\$137,693	\$158,164	\$292,074	\$167,475	\$482,349
Total Expenses (3)	\$224,447	\$241,613	\$425,022	\$351,980	\$676,569
Average Administrative Expense					
Per Member (2)	\$33	\$36	\$62	\$50	\$94

- (1) Administrative Expenses are on a Cash Basis.
 (2) Calculated: Total Administrative Expenses/Total Members=Avg. Administrative Expense
 (3) Total Administrative Expenses includes PERS expenses and record keeper fees charged to plan members.



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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS STATE AND COUNTY EMPLOYEES RETIREMENT PLANS **REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Deann Haeffner, CPA
Deputy State Auditor
haeffner@mail.state.ne.us

We have audited the financial statements of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans as of and for the year ended December 31, 2002, and have issued our report thereon dated June 23, 2003. The report was modified to emphasize that the financial statements present only the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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Compliance

As part of obtaining reasonable assurance about whether the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. We noted certain immaterial instances of noncompliance that we have reported to management of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans in the Comments Section of this report as Comment Number 1 (County Plan Payroll Testing), Comment Number 3 (Missed Retirement Contribution Procedures), and Comment Number 4 (Plan Membership Eligibility).

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans'

internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Comments Section of the report as Comment Number 1 (County Plan Payroll Testing), Comment Number 2 (Inadequate Resolution of Prior Audit Findings), Comment Number 3 (Missed Retirement Contribution Procedures), and Comment Number 4 (Plan Membership Eligibility).

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider none of the reportable conditions described above to be material weaknesses.

This report is intended for the information of management and State regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Pat Reding, CPA

Assistant Deputy Auditor

June 23, 2003