AUDIT REPORT
OF THE NEBRASKA
PUBLIC EMPLOYEES RETIREMENT
SYSTEMS - SCHOOL EMPLOYEES, JUDGES,
AND STATE PATROL RETIREMENT PLANS

JULY 1, 2002 THROUGH JUNE 30, 2003

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

TABLE OF CONTENTS

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

BACKGROUND

The Nebraska Public Employees Retirement Board (NPERB) was created in 1971 to administer Nebraska retirement plans for school employees, State employees, Judges, and the State Patrol. Administration of the retirement system for Nebraska county employees was assumed by the Board 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.

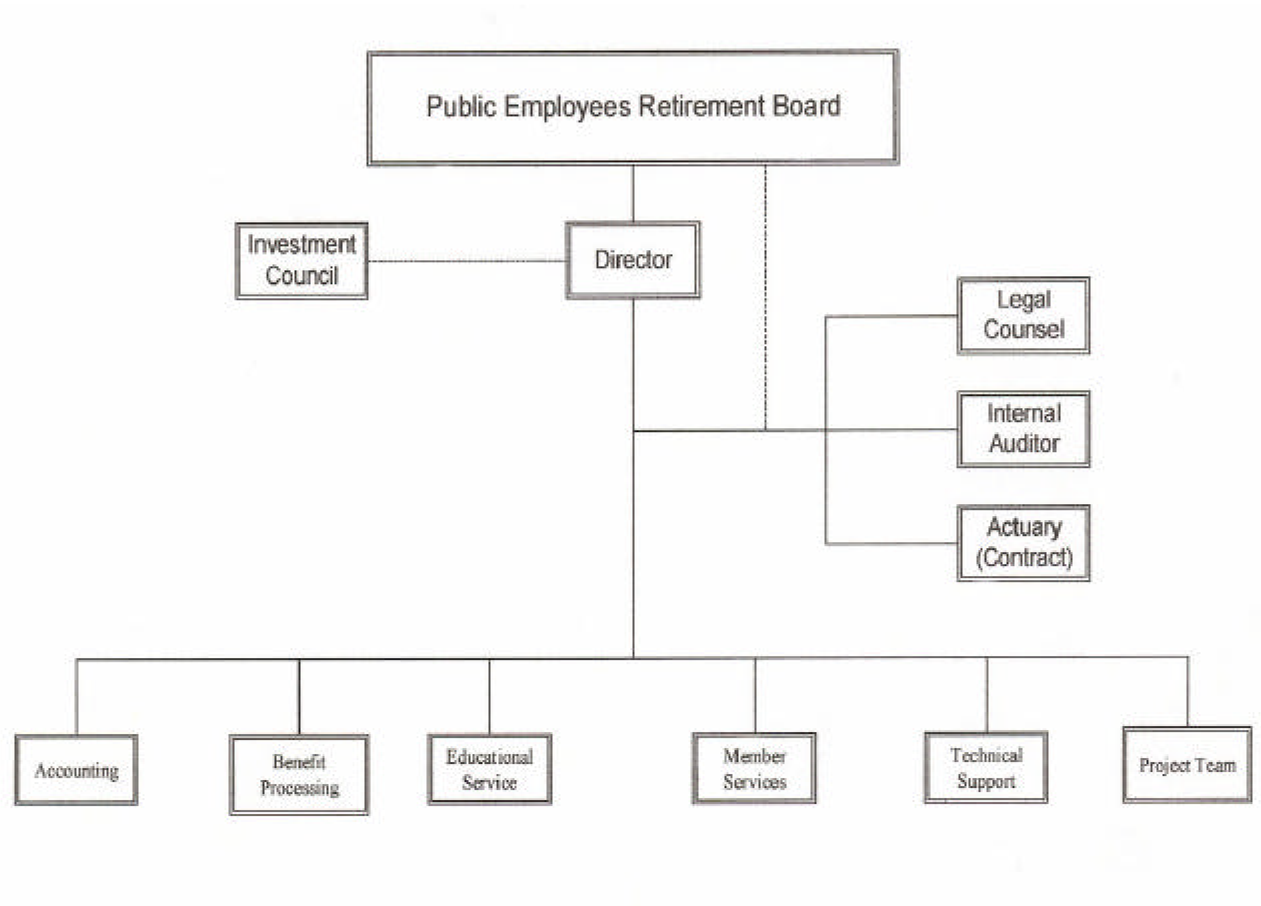
The Board hires a director to equitably distribute expenses among the retirement systems it administers. All expenses must be provided from investment income earned by various retirement funds, unless other fund sources to pay expenses are specified by law.

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.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held May 24, 2004, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our examination. Those in attendance for NPERS were:

NAME	TITLE
Anna Sullivan	Executive Director
Joe Schaefer	Legal Counsel
Randy Gerke	Accounting and Finance Manager
Teresa Zulauf	Internal Auditor
Vicki Stoll	Benefits Processing Manager
Dennis Cooper	Data Services Manager

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

SUMMARY OF COMMENTS

During our audit of the Nebraska Public Employees Retirement Systems (NPERS) - School Employees, Judges, and State Patrol 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. ***Nebraska Information System:*** Significant areas of concern or areas where improvement to the Nebraska Information System (NIS) is needed to ensure NIS integrity and operational efficiency were identified.

2. ***NPERS Information System:*** Areas of concern or areas where improvement to the NPERS Information System is needed to ensure system integrity and operational efficiency were identified.

3. ***Incorrect Reported Compensation from School Districts:*** Five of ten school districts tested reported compensation that was not in compliance with the definition of compensation in the statutes. The errors resulted in overstatements of the members' annual compensation ranging from $76 to $15,627, and excess annual retirement contributions ranging from $11 to $2,277.

4. ***Resolution of Prior Audit Findings:*** NPERS did not adequately address all of the specific findings at school districts tested and identified in prior audit findings.

5. ***Purchase of Service Calculations:*** Two of three purchase of service calculations tested were not accurate. One member overpaid to NPERS in excess of $20,000 and the other member overpaid in excess of $5,700 for the service they purchased.

6. ***COLA Calculation:*** NPERS calculated the COLA increases based on a methodology provided by the actuary. However, the methodology and the statutes did not appear to be in agreement.

7. ***Travel Expenses:*** Four of six travel documents tested contained reimbursements for meal expenses without adequate documentation, or provided reimbursement for a meal when the same meal was paid for and provided by the conference or was an unreasonable meal expense. NPERS also continued to provide lodging for Board members and staff for their annual retreat when the lodging was less than 60 miles from their home or headquarter city.

SUMMARY OF COMMENTS
(Continued)

More detailed information on the above items is provided hereafter. It should be noted that 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 NPERS.

Draft copies of this report were furnished to 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.

COMMENTS AND RECOMMENDATIONS

1. Nebraska Information System

Good internal control requires a plan of organization, procedures, and records, designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data, and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the "Nebraska Information System" (NIS). Two major components were the Payroll component, which went live on January 3, 2003, and the Financial component, which went live on March 1, 2003. All Nebraska Accounting System (NAS) financial data from July 1, 2002 through February 28, 2003 (excluding payroll from January through February as NIS payroll went live January 3, 2003) was converted to NIS as of March 1, 2003. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003 at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA has identified other concerns related to NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. The following are the more significant concerns or areas where improvement is needed to ensure NIS integrity and operational efficiency:

a. The reconciliation between the State Treasurer's actual bank statements and records, the NAS/NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the Department of Administrative Services (DAS) Accounting Division performed some reconciliation procedures. As of April 28, 2004, the June 30, 2003 reconciliation indicates an unknown variance between the bank records and the accounting records of $3,654,783, with the bank being short compared to the accounting records. The monthly reconciliations during the audit period and subsequent months indicate fluctuations in the variance amounts. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be done timely and on a monthly basis to ensure all financial information is correct in NIS.

b. Two key financial reports to be prepared and presented by the DAS Accounting Division were not completed in a timely manner. The Annual Budgetary Report as of June 30, 2003 was not completed until January 2004. The Comprehensive Annual Financial

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System (Continued)

Report has yet to be completed for the fiscal year ended June 30, 2003. Timely reporting of the State's financial information is key to all users of such information, especially State policy makers, when making informed policy decisions.

c. As of June 30, 2003 a comprehensive written NIS policy and procedures manual had not been prepared. Subsequent to June 30, 2003, DAS Accounting Division has made some progress in updating the prior Nebraska Accounting System (NAS) and Nebraska Employees Information System (NEIS) policy and procedures manuals to incorporate NIS policies. However, as of the date of this report these policy updates are not complete. With hundreds of users of NIS, it becomes imperative the State has a comprehensive policy and procedure manual to help ensure consistent and accurate accounting of the State's financial transactions.

d. Labor distribution - The NIS payroll application is not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This applies to most agencies' funds, programs, and grants.

e. A detailed analysis has not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. Training provided for the implementation of NIS was limited to navigational training and did not include explanatory informational training.

f. A records retention policy has not been implemented to ensure an adequate audit trail is maintained for NIS information. The records retention schedules only states, "Obsolete with implementation of NIS."

g. The payroll component is not designed to promote an effective segregation of duties.

h. Critical function access rights - Access to sensitive General Accounting functions has been provided to individuals who may not require such access as a part of their job responsibilities.

i. Information security procedures - The State has not documented or formalized comprehensive information security procedures for NIS.

j. Business continuity planning - The State has not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System (Concluded)

The issues identified above are the responsibility of the Department of Administrative Services Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to the Department of Administrative Services, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

NPERS' Response: The Nebraska Public Employees Retirement System (NPERS) is not responsible for the issues the Auditor of Public Accounts (APA) has identified as concerns or the areas for improvement needed for the Nebraska Information System (NIS). The responsibility for resolving these issues lies with the Department of Administrative Services (DAS) and the NIS implementation team. NPERS does not have the authority to address any of these issues.

2. NPERS Information System

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records.

During the fiscal year ended June 30, 2003, NPERS implemented the first phase of a new information system, Pension Information of Nebraska for Efficient and Effective Retirement, or PIONEER. The first phase of this new system went live on January 27, 2003 and included virtually all aspects of NPERS' previous mainframe system, with the exception of benefit payments. All member data from the mainframe was converted to PIONEER effective January 27, 2003.

We have identified concerns and areas where improvement to PIONEER is needed. The following are the more significant concerns or areas where improvement is needed to ensure the integrity of member data:

a. A comprehensive, written PIONEER policy and procedures manual has not been prepared. We are also not aware of a written policy and procedure manual prior to the implementation of PIONEER.

b. Business continuity planning - NPERS has not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both PIONEER and its supporting infrastructure.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>NPERS Information System</u> (Continued)

c. Security concerns - There are no specific, written security procedures. The system does not automatically time-out for users who have been inactive for a period of time. PIONEER users are not required to change passwords after a set period of time.

d. A records retention policy has not been implemented to ensure an adequate audit trail is maintained for PIONEER information.

e. During the audit period, the system did not allow for an adequate segregation of duties over the refund process. One individual was capable of handling all phases of a refund transaction.

f. During the audit period, there was not a formal procedure to review data changes to the system to ensure all changes to data were authorized. Additionally, employees with access to benefit and refund functions in the system could also change member data.

Although NIS is the official accounting system of the State of Nebraska, PIONEER contains critical data used by the actuary to determine actuarial assets and liabilities and to determine whether the Plans are adequately funded. Without written procedures and controls, there is a risk that employees may unintentionally corrupt critical data, and that errors could occur and go undetected.

> We recommend NPERS ensure the issues noted above are appropriately addressed as they work to strengthen the new information system.

NPERS' Response: During the design of Pension Information of Nebraska for Efficient and Effective Retirement (PIONEER), two main sources of user documentation were developed that we believe are sufficient to guide system users. The user training manuals and GAP documents. The user training manuals describe how to enter Information into PIONEER. The GAP documents contain the business rules and process flows for processing in PIONEER. NPERS staff is also guided by the laws of the State of Nebraska, the specific laws governing our agency and the laws governing the various pension plans we administer. In addition, we have policies, procedures and the Rules and Regulations which must be followed.

NPERS provided the APA a copy of the PIONEER / Computer Systems disaster recovery plan. Measures have been taken to ensure backups are done and a plan is in place in the event of a disaster.

2. <u>NPERS Information System</u> (Concluded)

NPERS' Response, Concluded:
The NPERS system forces each personal computer (PC) to lock after 30 minutes of inactivity. No access to PIONEER or any other computer resource is possible without unlocking the PC using a valid user ID and password.

System passwords must be reset every 90 days. There are three levels of security: physical access to the system, access to the network and access to PIONEER. Physical access to the system is restricted via door locks. Access to the network requires a valid user specific user-ID and password that is changed every 90 days. Access to folders/files/functions are restricted based on user. Access to PIONEER requires a separate user-ID and password and is limited by user permission settings.

PIONEER data is maintained indefinitely and backed up daily. We have an offsite location for tape backup of data. The audit trail of each transaction is permanently preserved.

Regarding segregation of duties, this problem has been corrected for refunds. PIONEER currently prohibits the same user from auditing their own work in every process on the system.

An audit is required on every payment before it can be authorized to be paid from PIONEER. Additionally, all critical business functions require an audit. This is enforced by the PIONEER system. PIONEER tracks all data changes and keeps a record of the time, date and user or entity that changed the data. We can trace all changes via database history tables.

Additionally, the actuary audits the critical data changes every year as a part of their yearly valuation. The actuary questions any data changes from one year to the next.

APA's Response: We do not feel the manuals and various documents listed by NPERS equate to a comprehensive, written PIONEER policies and procedures manual. As indicated in the comment, we are not aware of any written policies and procedures related to the various functions within PIONEER.

3. <u>Incorrect Reported Compensation from School Districts</u>

Neb. Rev. Stat. Section 79-902(35)(a) R.S.Supp., 2003 defines compensation under the School Employees Retirement Act: "Compensation means gross wages or salaries payable to the member for personal services performed during the plan year. Compensation does not include amounts which the retirement board determines were fraudulently obtained, compensation for unused sick leave or unused vacation leave converted to cash payments, insurance premiums

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Incorrect Reported Compensation from School Districts</u> (Continued)

converted into cash payments, reimbursement for expenses incurred, fringe benefits, or bonuses for services not actually rendered, including but not limited to, early retirement inducements, cash awards, and severance pay, except for retroactive salary payments paid pursuant to court order, arbitration, or litigation and grievance settlements. Compensation includes overtime pay, member retirement contributions, and amounts contributed by the member to plans under sections 125, 403(b), and 457 of the Internal Revenue Code as defined in section 49-801.01 or any other section of the code which defers or excludes such amounts from income."

Neb. Rev. Stat. Section 84-1503(1)(f) R.S.Supp., 2003 requires NPERB "To adopt and implement procedures for reporting information by the employers, as well as sampling and monitoring procedures."

Good internal control requires procedures and records to ensure contributions remitted under the School Employees Retirement Act are consistent with statutory requirements.

NPERS did not perform adequate sampling and monitoring procedures to determine whether reported compensation was in accordance with the provisions of statutes. We reviewed payroll records at 10 of 556 school districts. The amounts contributed by these ten districts, $65,385,647, represented approximately 39% of the total contributions for all school districts for the fiscal year. We noted the following:

- Five of ten school districts tested reported compensation that was not in compliance with the definition of compensation in the School Employees Retirement Act. This included 27 of 162 contributing members tested. Incorrect components included cash payments in lieu of health insurance, unused leave cash payments, payments for reimbursement of expenses, bonuses for services not actually rendered, and fringe benefits. The fringe benefit amounts included long-term disability payments not covered under a section 125 plan, payment for communications expenses (cell phone), and other significant payments for services not actually performed. These errors resulted in overstatements of the members' annual compensation ranging from $76 to $15,627, and excess annual retirement contributions ranging from $11 to $2,277. A similar finding was noted in previous audit reports.

There is a high risk that errors such as those noted above would remain undetected without procedures by NPERS to ensure amounts are accurately reported by school districts in accordance with the statutes. Additionally, since the benefit amount at retirement is calculated based in part on the reported salary of the member, there is also an increased risk that the benefit amount is not in accordance with statutory requirements.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Incorrect Reported Compensation from School Districts (Concluded)

> We continue to recommend NPERS implement procedures to ensure the compensation reported by school districts is consistent, accurate, and in accordance with statutes. We also recommend NPERS determine whether the current statutory language needs modification due to the varying interpretations by school districts in defining compensation. We also continue to recommend NPERS follow up with the specific exceptions noted during our testing and communicate to the school districts any corrective action necessary.

NPERS' Response: We have been working with the schools on the "compensation" issue for several years. Each year training is conducted for all schools. Recently, regular meetings concerning compensation have been held with an attorney for one of the larger schools in the State of Nebraska. We have also been working with the schools to insure long-term disability deductions and leave pay problems have been corrected. Once the school verifies the amounts and salaries, our staff works with the schools to correct contributions if needed.

Our staff reviews all salary increases that exceed 10% or that look questionable when estimates are being provided. The Legal Counsel and the Director have personally worked with the schools when questions arise concerning compensation. We feel we are making progress on this issue, but it will take time to resolve. In the summer of 2004, a Legislative interim study is planned, as schools still have concerns and questions about compensation.

4. 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 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.

NPERS did not adequately address all of the specific findings at school districts tested and identified in prior audit findings.

- One school district still was not calculating retirement contributions on the correct compensation as noted in the fiscal year 2002 audit.

- Ten school districts had a total of twelve employees who were identified in the fiscal year 2002 audit as employees that should be contributing to the school retirement plan.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Resolution of Prior Audit Findings (Concluded)

- Six of the employees were still not contributing to the Plan during the fiscal year 2003 audit fieldwork.
- Six of the employees subsequently began plan participation, but did not remit contributions that were missed.

There is an increased risk that errors in Plan membership and compensation will remain incorrect without adequate procedures to follow up on prior audit findings.

> We recommend NPERS implement procedures to ensure all audit exceptions are adequately followed up and resolved.

NPERS' Response: The prior audit findings have been reviewed and we are working on correcting the findings. We have been working with the school district from the fiscal year 2002 audit. Some of the individuals have resigned from their part-time positions, while others have begun make-up contributions based on their start date. We are continuing to research the individuals who have been identified by the auditors. If we determine corrections are needed, our staff will insure the school makes the proper changes.

5. Purchase of Service Calculations

Good internal control requires procedures and records to ensure calculations performed by NPERS are accurate and consistent with statutes.

Neb. Rev. Stat. Section 79-921(2) R.S.Supp., 2002 allows the retirement board to reinstate to membership, with the same status as when such membership ceased, a school employee who has withdrawn his or her accumulated contributions under the following conditions: If, more than three years after again becoming an employee and rejoining the system but prior to termination of employment, he or she chooses to repay part or all of the amount he or she has withdrawn, plus an amount as determined equal to the total actual annual return that was earned on assets of the system from the time the amounts were withdrawn until the fiscal year in which the employee makes the election to repay.

Neb. Rev. Stat. Section 79-933.08 R.S.Supp., 2002 allows an employer and a school employee who has completed at least five years of creditable service plus eligibility and vesting credit to purchase service credit for such employee not to exceed five years of creditable service. Such an agreement may be executed up to twelve months prior to the employee's retirement date. Such service credits shall be purchased for an amount equal to the actuarial cost to the retirement system for allowing such additional service credit to the employee.

5. Purchase of Service Calculations (Continued)

Two of three purchase of service calculations tested were not accurate.

- One member had three different types of purchase of service:

  The member paid $200,410 for out-of-state service. We agreed with this calculation.

  The member repaid a refund under Neb. Rev. Stat. Section 79-921. NPERS calculated the cost at $79,707. The auditor calculated the cost at $59,274. The difference was due to the different rate of returns used by NPERS. The rate of returns used by NPERS from the fiscal year 1988 through fiscal year 2001 did not agree to the actual annual return earned on assets as provided by the Nebraska Investment Council. Additionally, during fiscal years 2002 and 2003, NPERS used an actuarial assumed rate of return on assets of 8% in the calculation, when the actual rate of return on assets was negative. NPERS also began the calculation of the refund one year early. The member initially received the refund in August 1989 (the first quarter of fiscal year 1990). NPERS calculated the repayment from the first quarter of fiscal year 1989. The member overpaid NPERS $20,433 for this type of service purchase.

  The member also purchased service credit within 12 months of retirement under Neb. Rev. Stat. Section 79-933.08. NPERS calculated the cost at $403. The auditor calculated the cost at $418. NPERS made an input error into the salary spreadsheet used to calculate the cost of the service. The member underpaid $15 for this type of service.

- One member repaid a refund under Neb. Rev. Stat. Section 79-921. NPERS calculated the cost at $53,488. The auditor calculated the cost at $47,751. The difference is due to different rate of returns used by NPERS. The rate of returns used by NPERS from the fiscal year 1988 through fiscal year 2001 did not agree to the actual annual return earned on assets as provided by the Nebraska Investment Council. Additionally, during fiscal years 2002 and 2003, NPERS used an actuarial assumed rate of return on assets of 8% in the calculation, when the actual rate of return on assets was negative. The member overpaid NPERS $5,737 for the purchase of service.

Without adequate procedures to ensure purchase of service calculations are accurate, members may or may not pay the actual cost of the service purchased. If members pay too little for the service purchased, the rest of the Plan will pay the cost of the service. If the cost is calculated too high, the member will pay too much into the Plan, with no additional benefit.

> We recommend NPERS implement adequate procedures to ensure purchase of service calculations are accurate and in accordance with statutes.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. <u>Purchase of Service Calculations</u> (Concluded)

NPERS' Response: All errors were corrected for the first member tested prior to the first benefit being sent to that member. The member purchased additional air-time with the over payment. In regard to the repayment of refund rates used, these have been corrected and recalculated. We are recalculating purchase of service from April 1, 2003 through April 30, 2004.

6. <u>COLA Calculation</u>

Neb. Rev. Stat. Sections 24-710.07, 79-947.01, and 81-2027.03 R.S.Supp., 2002 each state that each July 1 the current benefits paid to members are to be adjusted to equal a percentage (75% for the School Employees and Judges Plans; 60% for the State Patrol Plan) of the annuity which results when the initial benefit is adjusted by the change in the Consumer Price Index (CPI) between the retirement date and the year the adjustment is made. The initial benefit is the benefit before any cost-of-living adjustments or supplemental adjustments were made.

There were 13 School retirees of 15 retirees tested, 3 Judges retirees of 10 retirees tested, and 1 State Patrol retiree of 7 retirees tested who received the July 1, 2002 COLA increase that did not agree to the language in the statutes. NPERS calculated the COLA increases based on a methodology provided by the actuary. However, the methodology and the statutes did not appear to be in agreement.

COLA increases calculated by NPERS were greater than the increases calculated based on the statutory language. Variances ranged from less than $1 to $4 a month for the July 2002 increase. This has been noted in the previous two audit reports.

It is important to ensure the COLA calculations are in accordance with the statutory requirements. This could be more critical during times when some of the plans have begun to require additional funding from the State.

> We continue to recommend NPERS ensure the calculation of COLA increases and the statutes are in agreement.

NPERS' Response: Nebraska Statute sections 24-710.07, 79-947.01, and 81-2027.03 were amended by LB 1097 (2004) to conform the statutes to the prior intention of the Legislature and the practice of NPERS.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses

Meal Expenses

The State of Nebraska operated under an accountable plan for travel expenses. An accountable plan, defined by the Internal Revenue Service (IRS) in Publication 463, must meet three rules: 1) The expenses must have a business connection; 2) Employees must adequately account to the employer these expenses within a reasonable period of time; and 3) Employees must return any excess reimbursements within a reasonable period of time. Employees can adequately account to employers by providing the employer a statement of expense, account book, a diary, or similar record in which the employee entered each expense at or near the time of occurrence, along with documentary evidence of the travel, mileage, or other expense.

Reimbursements made to employees under an accountable plan are not included in the employees' taxable income. Those expenses that do not meet all three rules of an accountable plan should be treated as having been reimbursed under a nonaccountable plan.

IRS Publication 463 describes the records needed to prove certain travel expenses. This publication generally indicated that documentary evidence, such as receipts, must be maintained to support expenses. Documentary evidence is considered adequate if it shows the amount, place, date, and essential character of the expense. A restaurant receipt is enough to prove an expense for a business meal if it has the name and location of the restaurant, the number of people served, and the date and amount of the expense.

Good internal control requires procedures to ensure requirements of the State's accountable plan are met and that reimbursements are in compliance with guidelines set through the Federal Travel Regulation. Good internal control also requires procedures to ensure meals are not reimbursed to employees when the same meal has been paid for and provided by a conference or seminar.

Four of six travel documents tested contained reimbursements for meal expenses without adequate documentation, or provided reimbursement for a meal when the same meal was paid for and provided by the conference or was an unreasonable meal expense, as follows:

- One employee was reimbursed for three meals when the same meals were provided by the conference attended. NPERS paid for the cost of the meals in the conference registration and also reimbursed the employee for the same meals. The total cost of the three meals was $30. The same employee was also reimbursed an unreasonable amount for one meal. Amendment 109 of the Federal Travel Regulation provided $24 as a

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Continued)

Meal Expenses (Concluded)

reasonable breakdown for dinner at the location of this conference. The employee was reimbursed $40 for one meal. A similar comment has been noted in previous audit reports.

- One Board member did not have adequate documentation to support meal expenses in accordance with the State's accountable plan. The member was reimbursed $14 for two meals, but did not have a receipt or adequate log for the meals. In an email to NPERS, the Board member indicated the name of the restaurants, but did not give the city for one location. The member also did not separately identify the amounts for each meal, and instead indicated the total of the two was in the range of $14.

- Another Board member was reimbursed for one meal without adequate documentation. The member was reimbursed $8 for a meal and only provided a credit card receipt, which did not indicate the "essential character" of the expense. The member also was reimbursed for another meal in which the restaurant receipt would not be considered adequate accounting. It did not list the date, location, or name of the restaurant. The total for this meal was $7. A similar comment has been noted in previous audit reports.

- One employee was reimbursed for two meals without adequate documentation. For one meal, the receipt did not indicate the date or city of the restaurant. For the other meal, a credit card receipt was provided. The total for the meals was $16.

Without an adequate accounting of meal expenses from the employee to the employer, the State could lose its accountable plan status. If the State does not have an accountable plan, the amounts reimbursed to employees for meal expenses would be considered as taxable income.

> We recommend the Board implement procedures to ensure provisions of the State's accountable plan are met within their travel reimbursement policy.

Lodging Expenses

The Nebraska Department of Administrative Services (DAS) Nebraska Accounting System (NAS) Manual was the official policy over the State accounting system for the fiscal year, even after the implementation of the new State accounting system.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Travel Expenses (Concluded)

Lodging Expenses (Concluded)

NAS Manual, Concept 5, stated, "It is DAS Accounting policy that a person must be more than 60 miles from his or her workplace in order to be eligible for lodging. We realize there may be reasons to pay for lodging for distances less than 60 miles. Such reasons include, but are not limited to work requirements, medical conditions or weather; in those instances the reason must be clearly stated on the disbursement document."

NPERS continued to have an annual Board retreat at the Lied Conference Center in Nebraska City, Nebraska in August 2002. Six Board members or employees who attended the conference overnight had a headquarter city of Lincoln, which is 50 miles from Nebraska City, and two members were from Omaha, which is 49 miles from Nebraska City. The cost of lodging for these employees was $520.

Without following the recommended policy of DAS Accounting, NPERS continues to charge the Plans for these overnight expenses of this annual retreat.

> We recommend NPERS follow DAS guidelines regarding overnight travel to ensure the Plans are charged only reasonable and necessary expenses.

NPERS' Response: The Public Employees Retirement Board (PERB) will consider any changes needed to the travel reimbursement policy to ensure the provisions of the State's accountable plan will be met.

The PERB votes each year to have the Annual Board Retreat in Nebraska City, Nebraska. There is a business need for overnight stay in Nebraska City, as the Board meets into the evening hours. The meetings resume at the breakfast hour the following day. The Board has determined it is an unreasonable imposition to expect a Board member to commute in the late evening hours and then again in the morning. The Board agenda is attached to the Board members expense reimbursement forms.

NPERS' Overall Response: Thank you for the time and cooperation provided by your staff during this effort, and in attempting to resolve differences in understandings of the processes required for efficient and effective administration of the Plans. Open lines of communication and a recognition of the time and cost constraints our agency is faced with in maintaining the vast amount of data for which we are responsible have proven to be valuable throughout the audit process.

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying Statements of Plan Net Assets and the related Statements of Changes in Plan Net Assets of the Nebraska Public Employees Retirement Systems (NPERS) – School Employees, Judges, and State Patrol Retirement Plans as of and for the fiscal year ended June 30, 2003, as listed in the Table of Contents. These financial statements are the responsibility of NPERS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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.

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 – School Employees, Judges, and State Patrol Retirement Plans as of June 30, 2003, 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 May 24, 2004 on our consideration of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

The "Schedules of Funding Progress" and "Schedules of Contributions from Employers and Other Contributing Entities" are not a required part of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying supplementary schedule of Service Efforts and Accomplishments and related graphs are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 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

May 24, 2004 Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS
STATEMENTS OF PLAN NET ASSETS
June 30, 2003

	School Employees	Judges	State Patrol
ASSETS			
Cash in State Treasury (Note 3)	$ 3,089,902	$ 19,325	$ 91,606
Receivables:			
Contributions	29,632,079	257,142	738,388
Interest and Dividend Income	13,384,662	245,662	577,805
Total Receivables	43,016,741	502,804	1,316,193
Pooled Investments, at fair value (Note 3):			
U.S. Government Securities	609,964,621	11,199,827	26,273,465
Corporate Bonds	450,683,139	8,275,190	19,412,614
Equity Securities	909,734,084	16,704,025	39,185,661
Foreign Government Securities	36,024,363	661,459	1,551,705
Municipal Bonds	7,695,253	141,296	331,463
Mutual Funds and Cash Equivalents	2,224,763,736	40,849,858	95,828,923
Total Investments	4,238,865,196	77,831,655	182,583,831
Invested Securities Lending Collateral	295,738,206	5,430,178	12,738,554
Capital Assets:			
Equipment	5,798,855	1,543,800	1,518,070
Less: Accumulated Depreciation	(709,597)	(189,043)	(185,892)
Total Capital Assets	5,089,258	1,354,757	1,332,178
TOTAL ASSETS	4,585,799,303	85,138,719	198,062,362
LIABILITIES			
Compensated Absences	180,355	4,590	4,944
Accounts Payable and Accrued Liabilities	2,458,773	69,208	126,606
Obligations under Securities Lending	295,738,206	5,430,178	12,738,554
Capital Lease Obligations	5,229,345	1,391,400	1,368,210
Contributions for Omaha Public Schools (Note 5)	2,400,906	-	-
TOTAL LIABILITIES	306,007,585	6,895,376	14,238,314
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A schedule of funding progress for each plan is presented on page 35.)	$ 4,279,791,718	$ 78,243,343	$ 183,824,048

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	School Employees	Judges	State Patrol
ADDITIONS:			
Contributions:			
Employee	$ 86,660,634	$ 761,096	$ 2,323,933
Employer	84,467,330	-	2,319,121
Court Fees	-	579,145	-
State	15,520,794	72,244	333,736
Total Contributions	186,648,758	1,412,485	4,976,790
Investment Income:			
Net appreciation (depreciation) in fair value of investments	126,769,458	2,175,491	5,190,116
Interest & Dividends	94,760,655	1,778,470	4,149,719
Securities Lending Income	7,121,804	130,767	306,763
Total Investment Income	228,651,917	4,084,728	9,646,598
Investment Expenses	(9,642,552)	(179,080)	(418,736)
Securities Lending Expenses	(5,625,901)	(103,300)	(242,329)
Net Investment Income	213,383,464	3,802,348	8,985,533
Other Additions	20,602	22	22
Total Additions	400,052,824	5,214,855	13,962,345
DEDUCTIONS:			
Benefits	146,337,041	3,700,867	8,697,575
Refunds of Contributions	10,403,353	-	29,829
Administrative Expense	2,995,158	373,723	378,697
Total Deductions	159,735,552	4,074,590	9,106,101
Net Increase	240,317,272	1,140,265	4,856,244
Net assets held in trust for pension benefits			
Beginning of year	4,039,474,446	77,103,078	178,967,804
End of year	$ 4,279,791,718	$ 78,243,343	$ 183,824,048

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

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2003

Background

The Nebraska Public Employees Retirement Systems (NPERS) 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 as follows:

Name	Type
School Employees Retirement	Defined Benefit
State Patrol Retirement	Defined Benefit
Judges Retirement	Defined Benefit
State Employees Retirement	Defined Contribution and Cash Balance
County Employees Retirement	Defined Contribution and Cash Balance

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 State Employees and County Employees Retirement Plans.

1. Summary of Significant Accounting Policies

Basis of Accounting. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

Pension funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet.

The accrual basis of accounting is utilized by the Plans. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Method Used to Value Investments. Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

Capital Assets. Capital assets consist of computer software and equipment. All capital assets are valued at cost where historical records are available and at estimated historical cost here no historical records exist.

Generally, equipment that has a cost in excess of $5,000 at the date of acquisition and has an expected useful life of two or more years is capitalized. Purchased software that is financed with long-term debt or capitalized lease financing is also capitalized. The amount capitalized includes the cost of the software and related expenses necessary to put the software into place. The useful life is determined based on the system and will be depreciated over 7 years, the same period as the lease financing arrangement used to purchase the software. Equipment is depreciated using the straight-line method.

2. Plan Descriptions and Contribution Information

Membership of each plan consisted of the following at June 30, 2003, the date of the last actuarial valuation:

	School Employees	Judges	State Patrol
Retirees and beneficiaries receiving benefits	11,837	160	288
Terminated plan members entitled to but not yet receiving benefits	14,531	13	13
Active plan members	36,779	162	486
Total	63,147	335	787

The NPERB was created in 1971 to administer the Nebraska retirement plans. The School Employees, Judges, and State Patrol plans have been created in accordance with Internal Revenue Code, Sections 401(a) and 414(h). Participants should refer to Neb. Rev. Stat. Sections 79-901 through 79-977.03 for the School Employees Retirement Plan, Neb. Rev. Stat. Sections 24-701 through 24-714 for the Judges Retirement Plan and Neb. Rev. Stat. Sections 81-2014 through 81-2040 for the State Patrol Retirement Plan. Benefit and contribution provisions are established by State law and may be amended only by the Nebraska Legislature.

By State law, there is to be an equitable allocation of expenses among the retirement systems administered by the NPERB, and all expenses shall be provided from the investment income earned by the various retirement funds. Following is a summary of the School Employees, Judges, and State Patrol Retirement Plans.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions and Contribution Information (Continued)

School Employees Retirement

Plan Description. The School Employees Retirement Plan is a cost-sharing multiple-employer defined benefit pension plan. The Legislature in 1945 enacted the law establishing a retirement plan for school employees of the State. As of June 30, 2003, there were 556 participating school districts. All regular public school employees in Nebraska, other than those who have their own retirement plan (Class V school districts, Nebraska State Colleges, University of Nebraska, Nebraska Community Colleges), are members of the plan. The benefits are based on both service and salary.

Normal retirement is at age 65. The monthly benefit is equal to the greater of: 1) The sum of a savings annuity which is the actuarial equivalent of the member's accumulated contributions and a service annuity equal to $3.50 per year of service, or 2) The average of the three 12-month periods of service as a school employee in which such compensation was the greatest, multiplied by total years of creditable service, multiplied by a formula factor set by statute, and an actuarial factor based on age. The calculation varies with early retirement. Employees' benefits are vested after five years of plan participation, or when termination occurs at age 65 or later.

Contributions. The State's contribution is based on an annual actuarial valuation. In addition, the State contributes an amount equal to 0.7 percent of the compensation of all members. The employees' contribution is equal to 7.25 percent of their compensation. The school district's (employer) contribution is 101 percent of the employees' contribution.

Judges Retirement

Plan Description. The Judges Retirement Plan is a single-employer defined benefit pension plan which was established by the 1955 Legislature. The membership includes judges and associate judges employed by the State for the Supreme Court, Court of Appeals, District Courts, Workers' Compensation Court, County Courts, and Juvenile Courts.

Retirement is age 65 with benefits calculated using the compensation for the three 12-month periods of service as a judge in which compensation was the greatest, or the average monthly compensation, multiplied by the total years of service and the formula factor of 3.5%; subject to a maximum of 70 percent of final average salary. The calculation varies with early retirement. Benefits vest when the judge takes office.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions and Contribution Information (Concluded)

Contributions. The plan is funded by members' contributions, a portion of the court fees and the State's contributions. A one dollar fee for each case was collected from District and County courts plus a ten percent charge on certain fees collected in the County Courts prior to May 24, 2003. After May 24, 2003, the fee was changed to five dollars. The State's contribution is based on an annual actuarial valuation. Judges contributed six percent of their salary during their first 20 years of service during the fiscal year.

State Patrol Retirement

Plan Description. The State Patrol Retirement Plan is a single-employer defined benefit pension plan which was created in 1947 for officers of the patrol. The benefits are based on a percentage of the final average salary multiplied by years of service, not to exceed 75 percent of the final average salary. To receive maximum benefits officers are required to have 25 years of service and be at least 50 years old. Normal benefits are calculated using the average monthly salary for the three twelve month periods of service in which compensation was the greatest multiplied by years of service and the formula factor of 3%. Calculation will vary with early retirement. Benefits vest after ten years of service.

Contributions. Members are required to contribute 11 percent of their annual pay plus, for a State Patrol officer employed on or before January 4, 1979, 11 percent of pay received at termination for unused sick leave and vacation leave. The member contribution is matched by the State Patrol (employer). The State's contribution is based on an annual actuarial valuation.

3. Cash, Investments, and Securities Lending

Neb. Rev. Stat. Section 72-1246 R.R.S. 2003, authorized the State Investment Officer to invest 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. The two categories of investments on the Statements of Plan Net Assets are Cash in State Treasury and Pooled Investments. The Nebraska Investment Council has contracted with outside managers to manage all of the funds of the School Employees, Judges, and State Patrol Retirement Plans, except for the funds in the State Treasury.

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.

3. Cash, Investments, and Securities Lending (Continued)

Governmental Accounting Standards Board (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 NPERS or its agent in the name of NPERS. Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty trust department or agent in the name of NPERS. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department but not in the NPERS' name.

The State Investment Officer participated 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 on 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 amounts the borrowers owe NPERS. The collateral securities cannot be pledged or sold by NPERS unless the borrower defaults. 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 67 and 70 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.

Derivative instruments are financial contracts in which underlying values depend on the values of one or more underlying assets, reference rates, or financial indices. Futures represent commitments to purchase or sell securities or money market instruments at a future date and at a specific price. NPERS invests in futures contracts related to securities of the U.S. Government, Government Agency obligations, and equity indices which are traded on organized exchanges, thereby minimizing NPERS' credit risk. The net change in the futures contract value is settled daily in cash with the exchanges. At June 30, 2003, NPERS held futures contracts with a par value of $344,062,800 and a market value of $0.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Cash, Investments, and Securities Lending (Continued)

Cash in State Treasury. Cash in State Treasury monies are pooled with other agencies' cash accounts to form the State Treasurer's Short-Term Investment Pool (STIP) which is invested by the Nebraska Investment Council. The STIP consisted of a short-term investment group and a medium-term investment group. The short-term investment group is shown at cost which approximates market. The medium-term investment group is presented at market. GASB Statement Number 3 does not require that these pooled investments be categorized as noted above.

Investments. The Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans each own a portion of pooled investments which are managed by the Nebraska Investment Council. These investments meet the criteria of GASB Statement Number 3, Category 1.

The carrying amount of these pooled investments at June 30, 2003, is at market value as set forth below:

Investments - Category 1	
US Government Securities	$ 451,374,532
Corporate Bonds	459,022,299
Equity Securities	
Not on Securities Loan	874,388,056
On Securities Loan	691,843
Municipal Bonds	8,168,012
Foreign Government Securities	38,237,527
Subtotal	1,831,882,269
Not Categorized	
Investments held by broker-dealers	
Under Securities Loan With Cash Collateral	
US Government Securities	196,063,381
Corporate Bonds	19,348,644
Equity Securities	90,543,871
Securities Lending Short-Term Collateral	
Investment Pool	313,906,938
Mutual Funds	2,134,698,559
Cash Equivalents	226,743,958
Total	$ 4,813,187,620

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Cash, Investments, and Securities Lending (Concluded)

Carrying Amount at Market Value		
School Employees	$ 4,238,865,196	
Judges	77,831,655	
State Patrol	182,583,831	$ 4,499,280,682
Invested Securities Lending Collateral		
School Employees	295,738,206	
Judges	5,430,178	
State Patrol	12,738,554	313,906,938
Total Investments		$ 4,813,187,620

4. Compensated Absences

All permanent employees working for the retirement systems 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.

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. 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.

All 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 June 30, 2003, is as follows:

	School Employees	Judges	State Patrol
Annual Leave	$ 100,683	$ 2,562	$ 2,760
Sick Leave	78,342	1,994	2,148
Compensatory Leave	1,330	34	36
	$ 180,355	$ 4,590	$ 4,944

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. Contribution for Omaha Public Schools

Neb. Rev. Stat. Section 79-916, R.S.Supp., 2002 required an annual payment to be made to Omaha Public Schools as a result of that school system having a separate retirement system. The contribution amount represents the July payment to Omaha Public Schools. This amount is included in State Contributions Additions and recorded as benefits when payment is made.

6. Six-Year Historical Trend Information

Six-year historical trend information designed to provide information about NPERS' progress made in accumulating sufficient assets to pay benefits when due is presented as required supplementary information following these Notes to Financial Statements.

7. Contingencies and Commitments

Risk Management. NPERS is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. NPERS, as part of the primary government for the State, participates in the State's risk management program. The DAS Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

A. Motor vehicle liability, which is insured for the first $5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.

B. The DAS Personnel Division maintains health care and life insurance for eligible employees.

C. Crime coverage, with a limit of $1 million for each loss, and a $10,000 retention per incident.

D. Real and personal property on a blanket basis for losses up to $250,000,000, with a self-insured retention of $200,000 per loss occurrence. Newly-acquired properties are covered up to $1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to $10,000,000.

7. Contingencies and Commitments (Continued)

E. State agencies have the option to purchase building contents and inland marine coverage.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Compensation Insurance Trust Fund through a combination of employee and State contributions. Workers' compensation is funded in the Workers' Compensation Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, or destruction of assets, errors or omissions, and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Public Employee's Retirement Systems' financial statements.

Obligations Under Other Financing Arrangements. The State of Nebraska, through the 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 information on obligations disclosed in this footnote represent total obligations of the Board, including Plans not included in this report. The information in the financial statements were broken out by Plan

The first Master Lease Agreement was refinanced during fiscal year 2003 and is now included with the third issue.

The second Master Lease Agreement in November 2001 was for $2,166,847 including interest costs of $241,847. A summary of future minimum contractual obligations for the second agreement, including interest at a rate of 3.245% as of June 30, 2003, is as follows:

Fiscal Year	Principal	Interest	Total
2004	$ 263,672	$ 47,378	$ 311,050
2005	272,765	38,285	311,050
2006	282,172	28,878	311,050
2007	291,904	19,146	311,050
2008	301,971	9,079	311,050
Thereafter	102,954	729	103,683

The third Master Lease Agreement in July 2002 was for $6,029,861 including interest costs of $644,861. A summary of future minimum contractual obligations for the third agreement, including interest at a rate of 3.129% as of June 30, 2003, is as follows:

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Contingencies and Commitments (Concluded)

Fiscal Year	Principal	Interest	Total
2004	$ 732,500	$ 130,337	$ 862,837
2005	750,833	112,004	862,837
2006	766,667	96,170	862,837
2007	786,667	76,170	862,837
2008	684,167	50,946	735,113
Thereafter	879,167	32,998	912,165

The fourth Master Lease Agreement in February 2003 was for $5,915,227 including interest costs of $525,227. A summary of future minimum contractual obligations for the third agreement, including interest at a rate of 2.757% as of June 30, 2003, is as follows:

Fiscal Year	Principal	Interest	Total
2004	$ 719,220	$ 127,312	$ 846,532
2005	738,619	107,913	846,532
2006	758,540	87,992	846,532
2007	778,999	67,533	846,532
2008	800,009	46,523	846,532
Thereafter	1,311,040	29,302	1,340,342

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

8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended June 30, 2003 are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
School:					
Compensated Absences	$ 142,155	$ 38,200	$ -	$ 180,355	$ 26,025
Capital Lease Obligations	1,339,470	4,331,855	441,980	5,229,345	777,975
Totals	$ 1,481,625	$ 4,370,055	$ 441,980	$ 5,409,700	$ 804,000
Judges:					
Compensated Absences	$ 2,114	$ 2,476	$ -	$ 4,590	$ 662
Capital Lease Obligations	356,400	1,152,600	117,600	1,391,400	207,000
Totals	$ 358,514	$ 1,155,076	$ 117,600	$ 1,395,990	$ 207,662

NOTES TO FINANCIAL STATEMENTS
(Continued)

8. Changes in Long-Term Liabilities (Concluded)

Patrol:					
Compensated Absences	$ 2,289	$ 2,655	$ -	$ 4,944	$ 713
Capital Lease Obligations	350,460	1,133,390	115,640	1,368,210	203,550
Totals	$ 352,749	$ 1,136,045	$ 115,640	$ 1,373,154	$ 204,263

9. School Employee Contributions

Employee contributions for the School Plan exceeded employer contributions due to purchase of service payments totaling $3,029,401. Members can purchase service credit for reinstatement of service, out-of-state service, for a leave of absence, or within twelve months of retirement in accordance with Neb. Rev. Stat. Sections 79-921 R.S.Supp., 2002, 79-933.05 R.S.Supp., 2002, 79-933.06 R.S.Supp., 2002, and 79-933.08 R.S.Supp., 2002.

10. Capital Assets

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
School:				
Equipment	$ 1,467,000	$ 4,331,855	$ -	$ 5,798,855
Less: Accumulated Depreciation	190,607	518,990	-	709,597
Total Capital Assets, Net	$ 1,276,393	$ 3,812,865	$ -	$ 5,089,258
Judges:				
Equipment	$ 391,200	$ 1,152,600	$ -	$ 1,543,800
Less: Accumulated Depreciation	50,829	138,214	-	189,043
Total Capital Assets, Net	$ 340,371	$ 1,014,386	$ -	$ 1,354,757
Patrol:				
Equipment	$ 384,680	$ 1,133,390	$ -	$ 1,518,070
Less: Accumulated Depreciation	49,981	135,911	-	185,892
Total Capital Assets, Net	$ 334,699	$ 997,479	$ -	$ 1,332,178

11. Subsequent Events

Master Lease Agreement

A fifth Master Lease Agreement was entered into by NPERS in February 2004. The total amount of $4,062,231 includes interest payments of $326,708 at an interest rate of 2.53%.

NOTES TO FINANCIAL STATEMENTS
(Continued)

11. Subsequent Events (Concluded)

Judges Contributions
2003 Neb. Laws LB 320 was signed into law May 29, 2003. The bill increased the contribution rate for judges, effective July 1, 2003, from six percent to eight percent until the maximum benefit has been earned. Prior to July 1, 2003, there was no contribution required from members who had earned the maximum benefit. Effective July 1, 2003, the members were required to contribute four percent of his or her monthly compensation to the fund after the maximum benefit has been earned.

Several judges filed a lawsuit challenging the constitutionality of LB 320 and a temporary restraining order was issued. On August 5, 2003, the parties in the lawsuit agreed to extend the effective date of the temporary restraining orders entered in the cases until a final order is entered in the cases. Therefore, the judges contributed at contribution rates set prior to LB 320.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULES OF FUNDING PROGRESS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

UNAUDITED

SCHEDULE 1

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
SCHOOL EMPLOYEES						
6/30/2003	$4,952,902,870	$5,464,572,876	$511,670,006	90.6%	$1,138,776,241	44.9%
6/30/2002	4,799,789,893	5,055,867,993	256,078,100	94.9%	1,065,515,857	24.0%
6/30/2001	1,486,008,665	1,704,201,512	218,192,847	87.2%	995,348,331	21.9%
6/30/2000	1,348,542,467	1,526,061,507	177,519,040	88.4%	933,339,432	19.0%
6/30/1999	1,129,546,860	1,345,494,742	215,947,882	84.0%	893,801,152	24.2%
6/30/1998	892,780,966	865,412,669	(27,368,297)	103.2%	882,963,179	(3.1%)

The Schedule of Funding Progress prior to June 30, 2002 excluded liabilities and assets for the Excess Formula Annuity benefit because funding for this benefit was based on the Aggregate Actuarial Cost Method. As of June 30, 2002, per LB 407, the cost method was changed to the Entry Age Actuarial Cost Method for the total Formula Annuity, and thus, from June 30, 2002 forward, the Schedule of Funding Progress under Governmental Accounting Standards Board Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, will include total liabilities and assets for the School Retirement System.

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
JUDGES						
6/30/2003	$ 91,863,620	$ 85,387,839	$ (6,475,781)	108%	$ 16,402,342	(39.5%)
6/30/2002	92,596,279	81,191,724	(11,404,555)	114%	16,062,274	(71.0%)
6/30/2001	90,685,851	90,685,851	-	100%	15,188,085	0.0%
6/30/2000	84,483,073	84,483,073	-	100%	13,913,264	0.0%
6/30/1999	75,521,517	75,521,517	-	100%	13,462,643	0.0%
6/30/1998	67,541,962	67,541,962	-	100%	12,729,379	0.0%
STATE PATROL						
6/30/2003	$ 214,657,454	$ 210,930,784	$ (3,726,670)	101.8%	$ 21,929,399	(17.0%)
6/30/2002	214,527,994	197,615,091	(16,912,903)	108.6%	18,846,776	(89.7%)
6/30/2001	208,372,640	187,284,490	(21,088,150)	111.3%	16,727,477	(126.1%)
6/30/2000	193,019,673	169,545,801	(23,473,872)	113.8%	15,789,104	(148.7%)
6/30/1999	171,124,224	162,222,559	(8,901,665)	105.5%	14,986,973	(59.4%)
6/30/1998	150,958,315	108,660,934	(42,297,381)	138.9%	13,995,091	(302.2%)

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
RETIREMENT PLANS
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF CONTRIBUTIONS FROM EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2003
UNAUDITED

SCHEDULE 2

SCHOOL EMPLOYEES

Year Ended	Annual Required Contribution (1)		Percentage
June 30	State (2)	School	Contributed
2003	$ 13,119,888	$ 84,467,330	100%
2002	12,659,281	80,288,662	100%
2001	12,225,219	77,062,544	100%
2000	11,948,451	69,990,565	100%
1999	11,853,757	65,672,654	100%
1998	11,687,572	65,331,264	100%

JUDGES

Year Ended	Annual Required Contribution		Percentage
June 30	State	Court Fees (3)	Contributed
2003	$ 712,518 (4)	$ 579,145	50%
2002	72,244	492,613	100%
2001	72,244	487,012	100%
2000	72,244	473,838	100%
1999	72,244	442,802	100%
1998	72,244	445,115	100%

STATE PATROL

Year Ended June 30	Annual Required Contribution	Percentage Contributed
2003	$ 2,652,857 (5)	100%
2002	2,428,025	100%
2001	2,257,609	100%
2000	2,203,735	100%
1999	2,294,332	100%
1998	1,891,043	100%

The actuarial determination of the Annual Required Contribution was based on actual covered payroll for the period.

(1) Includes funding for the Excess Formula Annuity, the Service Annuity, and the supplemental funds. Includes contributions for plan year ended June 30 paid after end of plan year.

(2) Does not include contribution to Omaha Public Schools.

(3) As of May 24, 2003, a five dollar fee for each case is collected from District and County Courts plus a ten percent charge on certain fees collected in the County Courts. Prior to May 24, 2003, the fee was one dollar for each case in the District and County Courts plus a ten percent charge on certain fees collected in the County Courts.

(4) The prior actuarial valuation indicated additional State funding of $726,806 was required for this fiscal year. LB 320 was passed on May 29, 2003 which would have increased the payroll contribution from 0% to 4% for judges who had ceased contributions to the plan after 20 years of service and also would have increased the payroll contribution from 6% to 8% for judges with less than 20 years of service, effective July 1, 2003. A lawsuit was filed in District Court by several judges related to the changes. A temporary restraining order was entered on August 5, 2003 until a final order is entered. APA used audited financial statements for the court fees in this schedule, which differed from the actuarial valuation which used estimated court fees. Therefore, the additional funding required was $640,274, using the actual court fees.

(5) Additional State funding is required in the amount of $434,202 for the next fiscal year.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
UNAUDITED

The information presented in the required supplementary Schedules 1 and 2 was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows.

	School Employees	Judges	State Patrol
Valuation Date	June 30, 2003	June 30, 2003	June 30, 2003
Actuarial Cost Method	Entry Age	Entry Age	Entry Age
Amortization Method	Level Dollar Closed	Level Dollar Closed	Level Dollar Closed
Remaining Amortization Period	25 Years	25 Years	25 Years
Mortality	1994 Group Annuity Table Set Back 2 Years	1994 Group Annuity Table Set Back 2 Years	1994 Group Annuity Table
Asset Valuation Method	5 year smoothing	5 year smoothing	5 year smoothing
Actuarial Assumptions:			
Investment Rate of Return (1)	8.0%	8.0%	8.0%
Projected Salary Increases (1)	Graded 9.1% to 4.5%	5.0%	Graded 12% to 4.5%
Cost-Of-Living Adjustments (COLA)	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 60% purchasing power of original benefit

(1) Includes assumed inflation of 3.5% per year.

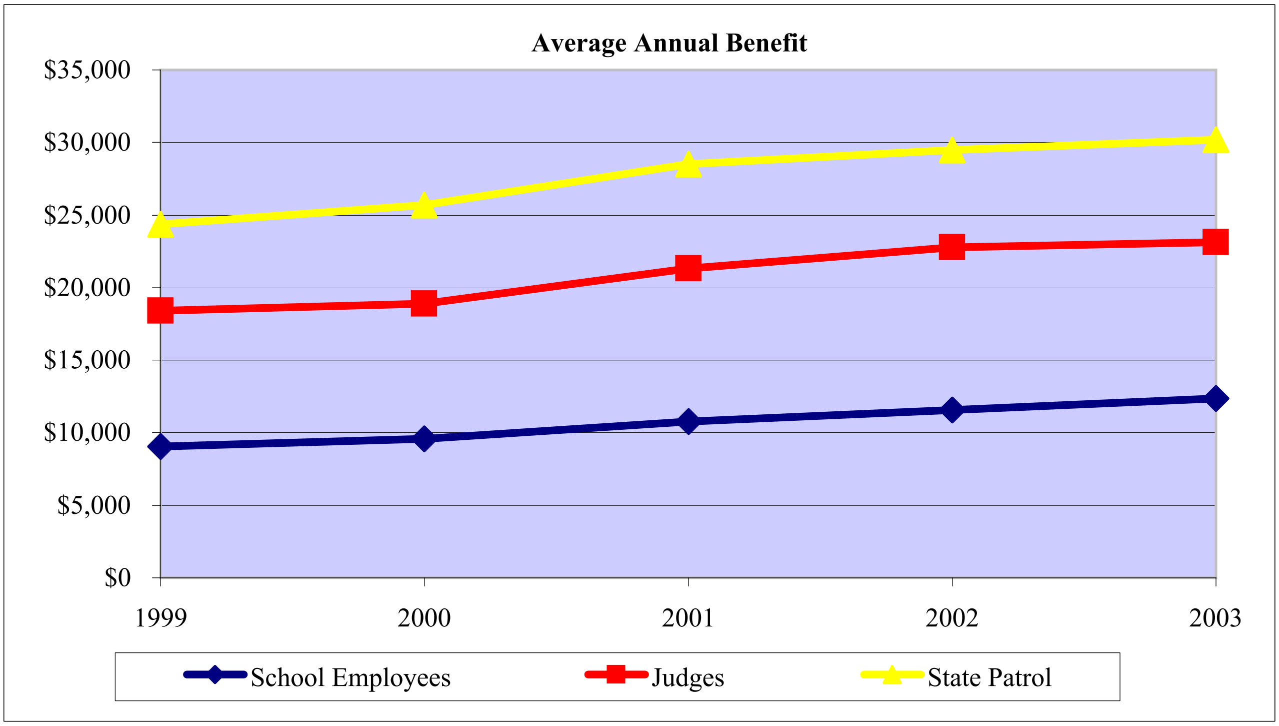
Changes in methods and assumptions:

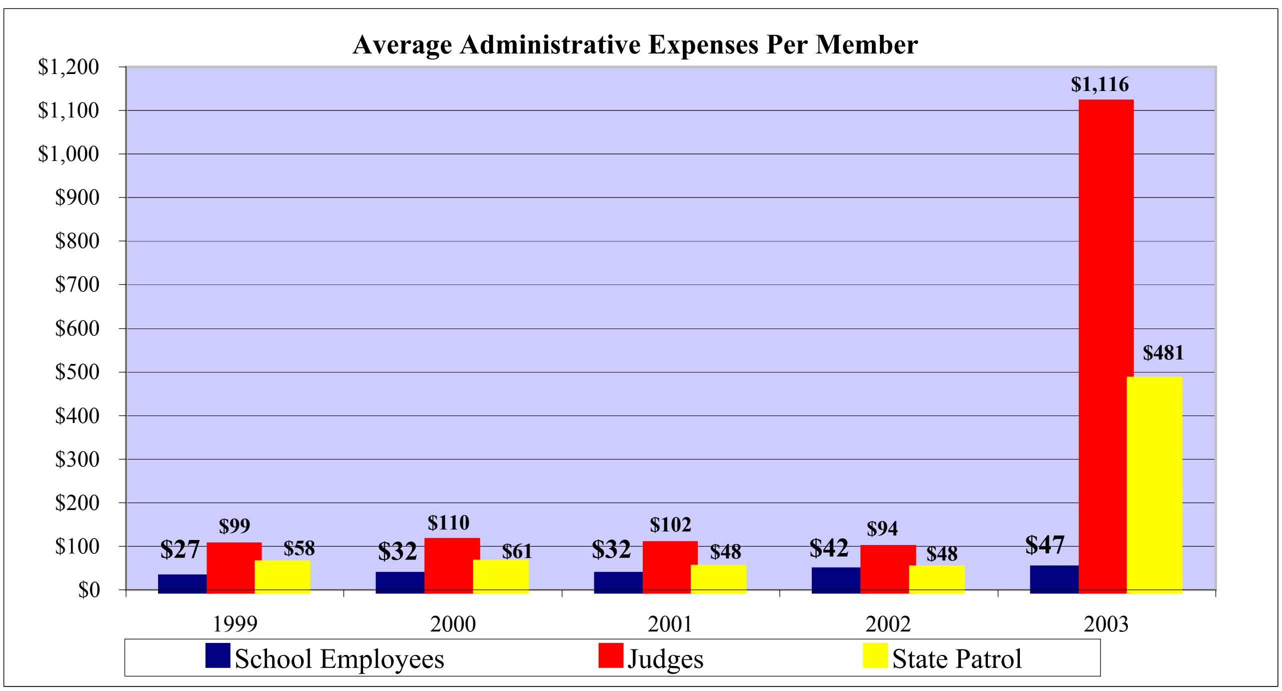
Judges
LB 760, effective May 24, 2003, increased the court fees from $1 per case to $5 per case.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
SCHEDULE OF SERVICE EFFORTS AND ACCOMPLISHMENTS
Fiscal Years Ended June 30, 1999 through 2003

	1999	2000	2001	2002	2003
SCHOOL EMPLOYEES					
Active Members	34,047	34,718	35,589	35,974	36,779
Inactive Members	10,605	13,918	15,158	14,302	14,531
Retirees	9,911	10,371	10,925	11,360	11,837
Total Benefits Paid (3)	$ 89,882,287	$ 99,501,638	$117,809,712	$ 131,499,136	$ 146,337,041
Average Annual Benefit (1)	$ 9,069	$ 9,594	$ 10,783	$ 11,576	$ 12,363
Average Monthly Benefit (4)	$ 756	$ 800	$ 899	$ 965	$ 1,030
Administrative Expenses	$ 1,478,766	$ 1,891,100	$ 1,983,883	$ 2,601,071	$ 2,995,158
Average Admin. Expense Per Member (2)	$ 27.10	$ 32.05	$ 32.17	$ 42.20	$ 47.43
JUDGES					
Active Members	166	159	164	166	162
Inactive Members	14	22	13	12	13
Retirees	160	163	165	163	160
Total Benefits Paid (3)	$ 2,946,584	$ 3,080,021	$ 3,515,798	$ 3,709,728	$ 3,700,867
Average Annual Benefit (1)	$ 18,416	$ 18,896	$ 21,308	$ 22,759	$ 23,130
Average Monthly Benefit (4)	$ 1,535	$ 1,575	$ 1,776	$ 1,897	$ 1,928
Administrative Expenses	$ 33,753	$ 37,783	$ 34,935	$ 31,934	$ 373,723
Average Admin. Expense Per Member (2)	$ 99.27	$ 109.83	$ 102.15	$ 93.65	$ 1,115.59
STATE PATROL					
Active Members	382	386	403	415	486
Inactive Members	11	16	6	11	13
Retirees	252	269	274	280	288
Total Benefits Paid (3)	$ 6,140,771	$ 6,908,835	$ 7,806,983	$ 8,254,431	$ 8,697,575
Average Annual Benefit (1)	$ 24,368	$ 25,683	$ 28,493	$ 29,480	$ 30,200
Average Monthly Benefit (4)	$ 2,031	$ 2,140	$ 2,374	$ 2,457	$ 2,517
Administrative Expenses	$ 37,480	$ 40,845	$ 32,763	$ 33,578	$ 378,697
Average Admin. Expense Per Member (2)	$ 58.11	$ 60.87	$ 47.97	$ 47.56	$ 481.19

Notes:
(1) Calculated: Total Benefits Paid/#Total Retirees=Avg Annual Benefit
(2) Calculated: Administrative Expenses/Total Members=Avg Admin Expense per Member
(3) Total benefits paid does not include refunds
(4) Calculated: Average Annual Benefit/12





Note: Effective December 2002, NPERS reallocated expenses related to the technology plan using a different allocation method than in past years. At June 30, 2003, NPERS allocated 45.1%, 12%, and 11.8% of the technology project expenses to the School, Judges, and Patrol Plans, respectively. NPERS reallocated technology expenses back to December 2001 using these percentages. Prior to December 2002, NPERS allocated 69%, 1%, and 1% of the technology project expenses to the School, Judges, and State Patrol Plans, respectively.

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL
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

We have audited the financial statements of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans as of and for the year ended June 30, 2003, and have issued our report thereon dated May 24, 2004. The Independent Auditors' Report was modified to disclose that the Required Supplementary Information was unaudited. 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.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, 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 - School Employees, Judges, and State Patrol Retirement Plans in the Comments Section of this report as Comment Number 3 (Incorrect Reported Compensation from School Districts), Comment Number 5 (Purchase of Service Calculations), Comment Number 6 (COLA Calculation), and Comment Number 7 (Travel Expenses).

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol 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 a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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 - School Employees, Judges, and State Patrol 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 (Nebraska Information System), Comment Number 2 (NPERS Information System), Comment Number 3 (Incorrect Reported Compensation from School Districts), and Comment Number 4 (Resolution of Prior Audit Findings).

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 believe none of the reportable conditions described above are material weaknesses. We also noted other matters involving internal control over financial reporting that we have reported to management of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans in the Comments Section of the report as Comment Number 5 (Purchase of Service Calculations) and Comment Number 7 (Travel Expenses).

This report is intended solely for the information and use of NPERS, the appropriate Federal and regulatory agencies and citizens of the State of Nebraska and is not intended to be and should not be used by anyone other than these specified parties.

Pat Reding, CPA

May 24, 2004 Assistant Deputy Auditor