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

JANUARY 1, 2003 THROUGH DECEMBER 31, 2003

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Issued on November 17, 2004

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

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BACKGROUND

The Nebraska 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.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
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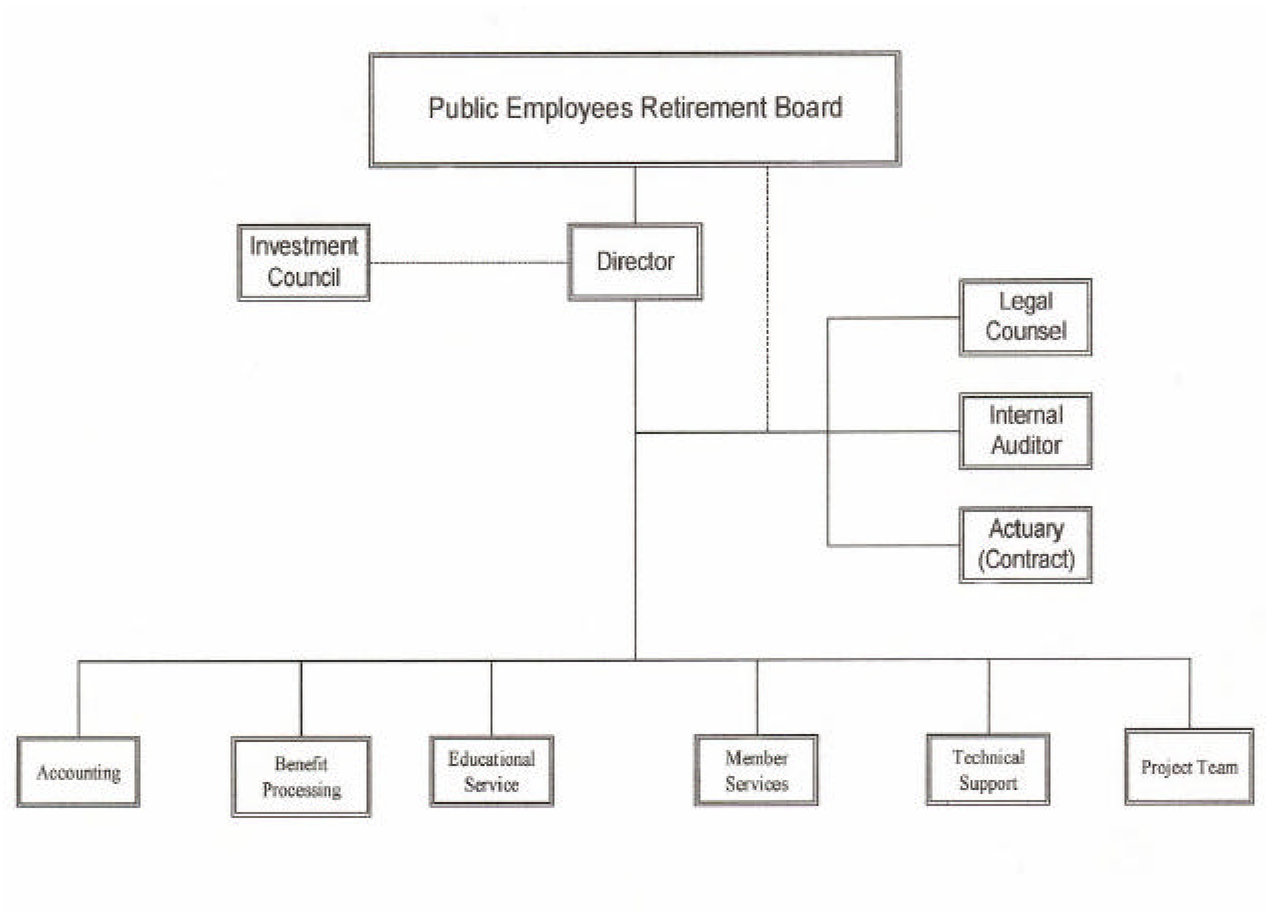
ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held September 23, 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 J. Sullivan	Director
Joe Schaefer	Legal Counsel
Teresa Zulauf	Internal Auditor
Randy Gerke	Accounting and Finance Manager
Dennis Cooper	Data Services Manager
Jane Hansen	Member Services Manager
Jeff Rhode	Manager - Client Services/Business Systems - Ameritas
Mary Klug	Client Service Representative - Ameritas

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. ***Plan Accounting:*** The State and County Plan assets were not accounted for in the State accounting system. The record keeper accounted for the assets in member accounts. The bank accounted for the total funds of the Plans. The difference between the record keeper assets and the bank assets was $38,712,004 for the State cash balance benefit and $11,131,962 for the County cash balance benefit. Additionally, NPERS did not obtain an allocation of the cash balance funds from the bank between State and County Plans.

2. ***County Plan Payroll Testing:*** There were 6 of 22 counties that did not adequately monitor part-time employees to ensure mandatory enrollment requirements were being met. There were 6 of 93 employees that were not properly contributing to the Plan. The reported salary of three members did not agree to the county payroll records. One member tested was not eligible to contribute.

3. ***Inadequate Resolution of Prior Audit Findings:*** Eight findings in the audit of the County Plan and seven findings from the audit of the State Plan for calendar year 2002 were not adequately resolved by NPERS. Eleven findings in the audit of the County Plan for calendar year 2001 were not adequately resolved by NPERS. One finding in the audit of the State Plan for calendar year 2000 was not adequately resolved by NPERS. Two exceptions from the State Plan for calendar year 1999 were not adequately resolved by NPERS.

4. ***Inaccurate Financial Information Provided to Actuary:*** NPERS provided inaccurate financial information to the actuary, which caused the actuary to reissue the actuary reports for the Cash Balance Benefit.

5. ***Incorrect Annuity Payments:*** Two State members tested did not receive an accurate annuity benefit since the balance of prior accumulated contributions was not included in the calculation. The two members' balances of prior accumulated contributions that were not included were $83,791 and $2,586. Additionally, NPERS incorrectly calculated the monthly annuity for one of three county members tested and one of five State members tested.

6. ***Required Contribution Procedures:*** NPERS procedures to ensure all required contributions were remitted were not adequate. NPERS did not adequately ensure all required contributions were remitted after errors in contributions were identified with the new State accounting system. We noted 5 of 30 county employees missed required contributions and the missed contributions were not properly remitted.

SUMMARY OF COMMENTS
(Continued)

7. ***Plan Membership Eligibility:*** We noted 2 of 30 county members tested and one State member tested began contributing to the Plan prior to meeting the eligibility requirements for Plan participation.

8. ***Nebraska Information System and Accounting Procedures:*** Significant areas of concern or areas where improvement is needed to the Nebraska Information System and accounting procedures were identified.

9. ***Initial Contributions:*** NPERS policy was not clear whether contributions should begin during the first full pay period that included the effective date of enrollment, or for the first full pay period following the effective date of enrollment. We noted 6 of 30 new members tested in the State Plan and 6 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.

10. ***Policy Manual Updates Not Timely:*** The Nebraska State Retirement System Manual for State agencies has not been updated since January 1997 although there have been many significant changes. The Nebraska County Retirement System Manual for County Clerks has not been updated since September 1999.

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.

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.

COMMENTS AND RECOMMENDATIONS

1. Plan Accounting

Good internal control and sound accounting practice requires an adequate accounting of the funds of the Retirement System.

Neb. Rev. Stat. Section 84-1503(2)(j) R.S.Supp., 2003 states that it shall be the duty of the Board to administer all retirement system plans in a manner which will maintain each plan's status as a qualified plan pursuant to the Internal Revenue Code.

The Internal Revenue Code 401(a)(2) defines the requirements of a qualified trust: A qualified trust requires the trust agreement to be impossible, at any time prior to the satisfaction of all liabilities with respect to the employees and their beneficiaries under the trust, for any part of the corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of his employees and their beneficiaries.

The cash balance benefit of the State and County Retirement Plans became effective on and after January 1, 2003. We noted the following related to the accounting of the cash balance benefit during the calendar year:

a. There was not an accounting of the State and County funds in the State accounting system, with the exception of administrative expenses and annuity payments. Ameritas, the record keeper, maintained an accounting of the member balances in the State and County Retirement Plans. For the defined contribution plan, the amount recorded by Ameritas reconciled to the amount held by the bank. However, for the cash balance benefit, the member balances recorded by Ameritas did not equal the total value of the fund, since members receive a daily interest credit and the earnings on the fund were significantly higher than the interest credit given to the members. The bank was the only entity with a total accounting of the fund. At December 31, 2003, the difference between the amount recorded by Ameritas and the actual amount of the funds held by the bank were $38,712,004 for the State cash balance benefit and $11,131,962 for the County cash balance benefit. This amount was not accounted for in the State accounting system. These amounts are included in the financial statements.

b. There was not a separate accounting of the State cash balance benefit funds and the County cash balance benefit funds. For efficiency purposes, the cash balance benefit fund held by the bank is accounted for as a pooled account, similar to all of the other defined benefit funds of the State, meaning the State and County share is pooled together. For the other defined benefit plans of NPERS, the bank provided a breakdown of each fund between each retirement plan. However, there was no breakdown of the cash balance benefit fund provided by the bank until an inquiry from the auditors. NPERS had allocated the fund based on the percentage of funds held by Ameritas. However, as previously indicated, Ameritas did not account for the

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Plan Accounting</u> (Concluded)

total fund. Therefore, the allocation used by NPERS was inaccurate. The difference between the NPERS allocation of the fund between the State and County Plans and the actual allocation provided by the bank was $900,975.

There is an increased risk for loss or misuse of Plan assets without an adequate accounting of the assets of the Plan. Additionally, if there is not an accurate allocation of Plan assets by the bank, assets of one Plan could be used for the benefit of members in another Plan. Therefore, the risk increases that the requirements of a qualified trust are not met.

> We recommend NPERS implement procedures to ensure the funds maintained by NPERS are adequately accounted for in the State accounting system and that the bank appropriately segregate funds by Plan. NPERS should ensure the segregation of assets by the bank is accurate.

NPERS' Response: We have discussed this issue with the Nebraska Investment Council who holds the contract with State Street Bank, the custodial bank. The Council staff have obtained for us the historical plan accounting allocations for the Cash Balance Benefit for the Nebraska State and County Public Employees back to January 2003, when these benefits were started. We have been assured that this information will be received on a monthly basis in the future.

We have met with the Department of Administrative Services Accounting Division to discuss the accounting of the funds on the State accounting system and are investigating procedures for implementing this recommendation. The State and County assets have never been "booked" on the State Accounting system in the 40 year history of these plans, <u>we will take extra care with this recommendation</u>.

2. <u>County Plan Payroll Testing</u>

Neb. Rev. Stat. Section 84-1503(2)(b) R.S.Supp., 2003 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

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>County Plan Payroll Testing</u> (Continued)

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(1) R.S.Supp., 2002 states, "The membership of the retirement system shall be composed of all persons who are or were employed by member counties and who maintain an account balance with the retirement system."

Neb. Rev. Stat. Section 23-2301(11) R.S.Supp., 2003 states, in part, "Employee means all persons or officers who are employed by a county of the State of Nebraska on a permanent basis, persons or officers employed by or serving in a municipal county formed by at least one county participating in the retirement system . . . all elected officers of a county, and such other persons or officers as are classified from time to time as permanent employees by the county board of the county by which they are employed . . ."

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(16) R.S.Supp., 2003 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(24) R.S.Supp., 2003 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."

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>County Plan Payroll Testing</u> (Continued)

In addition, good internal control requires procedures to ensure all eligible employees participate in the County Employees Retirement Plan as required by statute and to ensure reported salaries are accurate.

We tested payroll records in 22 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 payroll records. We noted the following:

a. 6 of 22 counties tested did not adequately monitor their part-time employees to ensure mandatory enrollment requirements were being met. The six counties were Buffalo, Butler, Furnas, Red Willow, Sheridan, and Thayer. A similar finding was also noted in the prior audit.

b. 6 of 93 employees tested were not properly contributing to the Plan as required by statute. The 6 employees were in 5 of the 22 counties tested. A similar finding was noted in the prior audit.

- One Buffalo County employee earned full-time wages and benefits, but it appears the employee "opted out" of the Plan, which is not permitted under statutes.

- One Furnas County employee was classified as a part-time employee by the County. However, the employee worked 1,092 hours during all 12 months of calendar year 2002 and also appeared to work full-time hours during calendar year 2003. The employee joined the Plan in June 2004, but appears to have missed mandatory contributions.

- One Grant County employee was classified as a part-time employee by the county. However, the employee worked 1,046 hours during all 12 months of calendar year 2002 and 1,126 hours in calendar year 2003. It appears this employee was actually full-time and has missed mandatory contributions.

- One Grant County employee was paid from two different County offices, and became a full-time employee April 1, 2003. At that time, the employee had over twelve continuous months of service. However, the employee did not begin contributing to the Plan until April 1, 2004. It appears the employee has missed one year of mandatory contributions.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>County Plan Payroll Testing</u> (Continued)

- One Sheridan County employee was classified as a part-time employee by the County. However, the employee worked 1,796 hours during all 12 months of calendar year 2002 and 1,684 hours in calendar year 2003. It appears this employee is actually full-time and has missed mandatory contributions.

- One Thayer County employee was classified as a part-time employee by the County. However, the employee worked 1,470 hours during all 12 months of calendar year 2002 and 1,292 hours during calendar year 2003. It appears this employee is actually full-time and has missed mandatory contributions.

c. 3 of 111 employees' reported salaries did not agree to the county payroll records. All three employees were from Furnas County. The amount reported to NPERS and used to calculate the retirement contribution was less 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, which means they manually entered their payroll information into the program. The MIPS program currently has built in edits to ensure the salary reported to NPERS agrees to the salary the member is paid. There were 22 counties that did not use MIPS to process payroll, as of December 31, 2003. There is an increased risk for errors in these counties. A similar finding was noted in the prior audit.

d. One employee contributing to the Plan was ineligible to contribute. The employee was employed by the Niobrara Council. The Council is not entitled to participate in the County Retirement Plan under current statutes. The employee contributed to the Plan from 1999 to March 31, 2003, when he resigned.

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 all eligible employees are not participating in the Plan increases significantly. The risk that ineligible employees are participating in the Plan also increases. 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.

> We continue to recommend NPERS implement procedures to ensure county employees participate in the County Employees Retirement Plan as required by statute. NPERS has the authority to implement sampling and monitoring procedures on information reported by the counties.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>County Plan Payroll Testing</u> (Concluded)

We also recommend NPERS ensure reported salaries are accurate and that only eligible employees contribute to the Plan. Finally, we recommend NPERS resolve the issues noted in this finding with the counties.

NPERS' Response: Neb. Rev. Stat. Section 23-2306(7) R.S.Supp., 2002 states, "Counties shall ensure that employees authorized to participate in the retirement system pursuant to this section shall enroll and make required contributions to the retirement system within sixty days under rules and regulations adopted and promulgated by the board. Information necessary to determine membership in the retirement system shall be provided by the employer."

It is the county which hires employees and determines whether those employees are full- or part-time. Counties have an independent duty to enroll their eligible employees. NPERS will work with the counties in the identified instances to correct errors. NPERS has insufficient resources to individually monitor county payrolls and is unable to provide oversight on an individual county basis. NPERS has adopted a materiality policy under which some discrepancies would fall. NPERS does not believe a sampling and monitoring procedure would be effective to ensure participation and contribution by all eligible participants, but it will continue to provide assistance, education, and other resources to counties to help them properly enroll and make contributions for those employees eligible for membership in the plan.

a. NPERS will examine the possibility whether reports of all part- and full-time employees would facilitate reporting procedures.
b. See comment "a" above.
c. NPERS will continue to encourage counties to utilize payroll software compatible with current information systems.
d. The ineligible employee is no longer in the system.

Auditors' Response: The Auditor of Public Accounts feels sampling and monitoring procedures would be an effective way to ensure proper participation and contributions to the Plan, especially since NPERS current assistance, education, and other resources to counties is clearly not adequate, as indicated by the many exceptions we have noted in the past several years.

3. <u>Inadequate Resolution of Prior Audit Findings</u>

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

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Inadequate Resolution of Prior Audit Findings (Continued)

a. Eight findings from the calendar year 2002 audit of the County Plan were not adequately resolved during the current audit. NPERS did not provide documentation to support whether the counties in question were contacted:

- Five counties tested did not adequately monitor their part-time employees to ensure mandatory enrollment requirements were being met. The five counties were Boyd, Frontier, Merrick, Nance, and Otoe.

- Six employees missed required contributions to the Plan. The six were employed by Saline, Furnas, Keya Paha, Howard, Frontier, and Perkins counties. There was no documentation to determine whether missed contributions were remitted for five of the six employees. There was documentation to determine that one employee was remitting missed contributions. However, the agreement exceeded the number of pay periods allowed per Rules and Regulations.

- One Polk County employee began contributing to the Plan prior to meeting the eligibility requirements for Plan participation. NPERS did not adjust the contributions in accordance with their Rules and Regulations.

b. Seven exceptions from the calendar year 2002 audit of the State Plan were not adequately resolved. NPERS did not provide documentation to support whether the State agencies in question were contacted:

- One employee missed required contributions for 27 biweekly pay periods. The employee has not remitted the missed contributions.

- One employee missed required contributions for 16 biweekly pay periods. The employee has not remitted the missed contributions.

- One employee missed required contributions for two months. The employee was enrolled in the Plan, but has not remitted the missed contributions.

- Four members did not have retirement deductions taken from their final gross pay at termination. NPERS did not contact the agencies involved to prevent reoccurrence.

c. Eleven findings from the calendar year 2001 audit of the County Plan were not adequately resolved. NPERS did not provide documentation to support whether the counties in question were contacted:

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Inadequate Resolution of Prior Audit Findings (Concluded)

- Seven counties tested did not adequately monitor their part-time employees to ensure mandatory enrollment requirements were being met. The seven counties were Cass, Dodge, Hall, Polk, Burt, Seward, and Fillmore.

- Nine employees did not begin contributing to the Plan as required by statute. The nine were employed by Dodge, Burt, Hamilton, Seward, Sarpy, Box Butte, and Antelope. Six employees are currently contributing to the Plan. However there was no documentation to determine whether missed contributions were remitted. All nine employees appeared to have missed contributions for approximately one year or more.

- One Sarpy County employee began contributing to the Plan prior to meeting the eligibility requirements for Plan participation. NPERS did not adjust the contributions in accordance with their Rules and Regulations.

d. One exception from the calendar year 2000 audit of the State Plan was not adequately resolved. The employee had excess contributions to the Plan of $66 and the employer had excess contributions to the Plan of $103. The excess contributions resulted from a miscalculation of missed required contributions.

e. Two exceptions from the calendar year 1999 audit of the State Plan were not adequately resolved. The two members were remitting missed contributions. However, when the new State accounting system went live in January 2003, the missed contributions ceased. The missed contributions were not reactivated for one member. Missed contributions were reactivated three months later for the other member.

NPERS did not have documentation to support whether they had followed up on any findings noted in the last four audits.

We continue to recommend NPERS implement procedures to ensure all audit exceptions are adequately resolved.

NPERS' Response: The prior audit findings have been reviewed. We will research the individuals identified by the auditors and advise the State Agencies and County Clerks of necessary changes. In some cases prior findings were not addressed due to immateriality. We will follow our materiality policy to determine which findings are material to correct.

Auditors' Response: We feel NPERS has a fiduciary responsibility to each member of the Plan to ensure contributions are accurate.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Inaccurate Financial Information Provided to Actuary

Good internal control and sound management practices require procedures to ensure amounts provided to the actuary for purposes of an actuarial valuation are accurate.

We noted several variances between the information NPERS provided the actuary and the information presented in the audited financial statements as follows:

- For the State Cash Balance Benefit, NPERS provided net assets held in trust for pension benefits as of December 31, 2003, in the amount of $280,389,952 to the actuary. The audited financial statements included $277,389,953 as the net assets held in trust for pension benefits. The difference of $2,999,999 was material to the State Cash Balance Benefit.

- For the County Cash Balance Benefit, NPERS provided net assets held in trust for pension benefits as of December 31, 2003, in the amount of $74,825,752 to the actuary. The audited financial statements included $76,249,464 as the net assets held in trust for pension benefits. The difference of $1,423,712 was material to the County Cash Balance Benefit.

- For the State Cash Balance Benefit, NPERS provided total benefit payments as of December 31, 2003, in the amount of $4,122,145 to the actuary. The total benefits presented in the audited financial statements are $5,476,107. The difference of $1,353,962 was a material variance to the State Cash Balance Benefit.

- Based on information provided from NPERS, the actuary calculated an actual return on market value of assets, net of expenses, of $12,062,673 for the County Cash Balance Benefit. The net investment income presented in the audited financial statements is $13,028,961. The difference of $966,288 was a material variance to the County Cash Balance Benefit.

Without providing accurate financial data to the actuary, there is an increased risk the actuarial valuation will not be accurate. Based on the variances noted above, the actuary decided to reissue the actuary reports as of December 31, 2003. The increase in time spent in reissuing the actuary reports may increase the cost for the actuary services.

We recommend NPERS implement procedures to ensure the financial information sent to the actuary is accurate and complete.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Inaccurate Financial Information Provided to Actuary (Concluded)

NPERS' Response: The actuary requests our financial statements as soon as possible at the close of the year. Due to the timing of the State and County audit, it was not possible for us to provide the actuary with audited financial statements. The financial statements prepared and given to the actuary contained the most accurate information that was available to us.

Plan Accounting with State Street Bank (the Custodial Bank) had not been established at the time the financial statements were prepared. We now have received historical plan accounting and will be receiving the information on a monthly basis going forward. This information will allow us to properly allocate income and expenses based on the assets of the funds NPERS used an allocation method based on total account balances, per plan, as reported by our recordkeeper, Ameritas.

Benefits Payable was not included in the information to the actuary. We will be calculating this information for future financial statements after we clarify the definition of "payable" as used by the auditors.

The difference in the net asset held in trust for pension benefits for the State and County plans was the result of the handling of a transfer figure. The amount was reported to the actuary as a transfer by us and not as income. With the change in the classification of this amount to income, the actuary's treatment of those dollars in his report must be revised due to our five-year smoothing policy on investment returns.

The actuary has assured us there would not be a lot of time required to reissue the annual actuarial valuation for the State and County Cash Balance benefits. Therefore, any extra costs should be minimal.

5. Incorrect Annuity Payments

Good internal control and sound business practice requires procedures to ensure annuity benefits are calculated accurately.

Neb. Rev. Stat. Section 84-1319.01 R.R.S. 1999 created the State Equal Retirement Benefit fund. Each State agency participating in the retirement system makes a contribution at least once per year to the fund, in addition to any other retirement contributions. Such contributions shall be in an amount determined by the Board to provide all similarly situated male and female members of the retirement system with equal benefits. Neb. Rev. Stat. Section 84-1319(2) R.S.Supp., 2003 defines the monthly annuity income payable to a member retiring on or after January 1, 1984.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Incorrect Annuity Payments (Concluded)

NPERS did not calculate the annuity benefit for State and County members in the prior audits. There was a contract with an annuity provider who calculated the benefits. During 2003, NPERS began to calculate and pay the annuity benefits of State and County members. We noted the following:

- Two State members tested did not receive the benefit as defined in statute for members retiring on or after January 1, 1984. Both members did not receive the monthly income based on accumulated contributions prior to January 1, 1984. The accumulated contributions for each State member prior to January 1, 1984 were $83,791 and $2,586.

- Annuity benefits were also calculated incorrectly for one of three county members tested and one of five state members tested. NPERS used the incorrect annuity factor when calculating the members benefit. The county member tested received $9 more per month than they should have received and the State member tested received $2 less per month than they should have received.

Without adequate procedures to ensure annuity benefits are calculated correctly, the risk increases for incorrect calculations for member benefits.

> We recommend NPERS implement procedures to ensure members with pre-1984 accumulated contributions receive the Equal Retirement Benefit due to them when selecting an annuity. We also recommend NPERS ensure all annuity benefits calculated manually by NPERS staff are calculated correctly and that any variances are appropriately resolved.

NPERS' Response: We are reviewing a list of individuals who have had a benefit calculated by our office to determine if any need to be recalculated due to the use of the wrong factor. If corrections are necessary we will make them promptly. These calculations are now being completed on, our information system, PIONEER, rather then manually, so future problems should not occur.

6. Required Contribution Procedures

Good internal control requires adequate procedures to ensure required contributions begin in accordance with statutes. Good internal control also requires procedures to adequately monitor all missed contributions to ensure the missed contributions are properly remitted in accordance with NPERS Rules and Regulations. Adequate procedures would include verification of the employee's salary and the number of pay periods missed.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Required Contribution Procedures (Continued)

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 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 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."

We noted NPERS did not have adequate policies and procedures to identify employees with missed contributions prior to being contacted by the State or County. Furthermore, NPERS did not have adequate policies and procedures to ensure make-up contributions were correctly calculated and remitted. We noted the following:

State Plan

a. The State of Nebraska implemented a new accounting system in January 2003 that was used for payroll processing. Initially, the new system had flaws related to retirement contributions. Some members who were contributing or remitting missed contributions ceased contributions after conversion. Additionally, the new system was initially not set up to allow the 4.8% contribution after $864 of contributions had been made each year. Therefore, some members also ceased contributions once they had contributed $864. We also noted members who contributed over and under $864 at the 4.33% rate. NPERS indicated they had relied on the Department of Administrative Services (DAS) Accounting Division to identify and correct the errors. After the problems were discovered, NPERS did not provide adequate documentation to indicate they had obtained or reviewed a comprehensive list of individuals affected by these errors. However, NPERS did provide correspondence with DAS related to some issues. Therefore, it is likely there are still individuals who missed contributions due to system errors that were not properly corrected. As the agency responsible for administering the retirement systems, it is NPERS responsibility to ensure required contributions are properly remitted.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Required Contribution Procedures (Continued)

b. During the first seven months of the audit period, NPERS did not verify whether all employees who met the requirements of participation in the Plan were properly contributing to the Plan. Before the conversion to the new accounting system, NPERS had developed a listing to determine which employees met the requirements of mandatory participation, but were not contributing. Seven months after conversion to the new system, NPERS developed a new listing to determine which employees met the requirements of mandatory participation, but were not contributing. However, NPERS did not review the first seven months of the year to ensure all members who met the requirements of participation were remitting contributions. Again, it is likely there are members who missed required contributions to the Plan that NPERS is not aware of.

c. We tested 21 employees from the listing NPERS developed after implementation of the new accounting system and noted 13 of the 21 employees tested missed contributions and the missed required contributions were not properly resolved by NPERS. Therefore, although NPERS had a procedure to identify employees who missed required contributions, they did not ensure the required contributions were properly remitted.

d. We also tested 30 members of the Plan and noted 2 of 30 members tested missed required contributions to the Plan and had missed required contributions that were not remitted. One employee missed contributions for 5 biweekly pay periods and the missed required contributions were not remitted. This employee also had an incorrect plan entry date in the record keeping system. The other employee missed one biweekly pay period and the employer share of the missed contribution was not remitted.

e. NPERS relied on the information from the agencies to determine the amount of the missed contribution. NPERS did not verify the total salary during the time of the missed contributions or the number of pay periods missed.

County Plan

We noted 5 of 30 members tested missed required contributions and the missed contributions were not properly remitted.

- Two members tested missed two months of required contributions and one member tested missed one month of required contributions. There was no documentation to indicate that the missed contributions were remitted.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Required Contribution Procedures (Continued)

- One member tested missed 12 months of required contributions and remitted missed contributions for 11 months. The employee and employer need to remit required contributions for one month, totaling $66. Additionally, the member's plan entry date in OMNI, the recordkeeping system at Ameritas, had not been updated to reflect an accurate plan entry date based on the missed contributions that were remitted.

- One elected official tested missed two months of required contributions. Elected officials are required to begin Plan participation immediately on taking office. There was no documentation on file to indicate the missed contributions were remitted.

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, since they would not receive the required employer match if contributions are missed. The risk also increases for the Plans, as they will not receive all possible forfeiture amounts for members who are not vested at termination. In addition, when employer contributions are paid before the corresponding employee contribution is paid, there is an increased risk an employee will terminate and receive more in employer match than statutorily required. A similar comment was noted in the prior audit report.

> We recommend NPERS implement adequate procedures to ensure all required contributions are remitted for the correct amounts and are remitted timely. We recommend NPERS review errors identified during the conversion of the State accounting system and obtain a listing of all members affected by the errors, to ensure any missed contributions are properly remitted. 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: We will address each item from the comments.
State Plan:

1. *Numerous emails have been exchanged with members of the NIS team concerning the issue of the conversion of the State Accounting system and missed contributions. The NIS team has assured us that cell errors were corrected and any missed contributions were properly remitted. The deductions and reports were balanced and all individuals who were initially impacted were corrected.*

COMMENTS AND RECOMMENDATIONS
(Continued)

6. <u>Required Contribution Procedures</u> (Concluded)

Auditors' Response: We noted at least two individuals in our sample who ceased contributions at $864 and were not adequately resolved at the time of field work. Therefore, it is still likely there are members who missed contributions due to system errors. As the administrator of the retirement systems, NPERS is responsible for ensuring all members of the system properly contributed to the system.

NPERS' Response, Continued:

2. *NIS had informed our agency early in the year that all members were contributing. We will continue to work with the State Agency Human Resource Personnel and the County Clerks to ensure contributions are remitted in the correct amounts and any missed contributions (employer and employee) are remitted in conjunction with each other.*

Auditors' Response: Again, NPERS is responsible for ensuring members are properly enrolled and contributing as required in the Plan. The NIS team would not know all members who were required to begin participation in the Plan, nor would it be their responsibility.

NPERS' Response, Continued:

3. *Agencies are notified on a monthly basis of individuals who should be members of the plan and that contributions were missed. We do have a process for monitoring missed contributions and the make-up of those contributions. However, we will work on strengthening the procedures.*

4. *We will examine the two individuals from the testing of thirty employees.*

5. *Since the Agency Human Resource personnel completes the Make-up Contribution Agreement, the information should be correct. We will continue to strengthen our procedures and working with the State Agencies in providing good information on the agreements.*

Auditors' Response: We recommend NPERS independently verify the calculation of the amount of missed contributions to the system.

NPERS' Response, Concluded:
County Plan:
We will examine the individuals from the testing completed by the office of Auditor of Public Accounts and make any corrections necessary.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Plan Membership Eligibility

Neb. Rev. Stat. Section 84-1503(2)(b) R.S.Supp., 2003 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 84-1307(2) R.S.Supp., 2002 states, "The following employees of the State of Nebraska are authorized to participate in the retirement system: (a) All permanent full-time employees who have twelve continuous months of service shall begin participation in the retirement system; and (b) all permanent full-time or permanent part-time employees, who have twelve months of service within a five-year period and who have attained the age of twenty, may exercise the option to begin participation in the retirement system."

The State and County Employees Retirement System Handbooks state an employee that does not meet mandatory participation but wishes to enroll may do so by first completing a Cash Balance voluntary enrollment form.

In addition, good internal control requires procedures to ensure only eligible employees participate in the State and County Employees Retirement Plans as required by statute. Good internal control also requires procedures to ensure employees who join under the voluntary requirements of membership have a completed enrollment form on file prior to the first contribution.

NPERS did not have adequate procedures to ensure only eligible employees joined the State and County Plans as required by statute. We noted the following:

- 2 of 30 County members tested began contributing to the Plan prior to meeting the eligibility requirements for Plan participation. One employee began contributing to the Plan two months prior to meeting the eligibility requirements and the second employee began contributing to the Plan one month prior to meeting the eligibility requirements.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Plan Membership Eligibility (Concluded)

- One State member tested also began contributing to the Plan prior to meeting the eligibility requirements for Plan participation. The employee used temporary service as part of the twelve month service requirement in statutes.
- One voluntary member tested in the County Plan did not have an enrollment form on file.
- Three of four voluntary members tested in the State Plan did not have enrollment forms on file at NPERS before the pay date of their first contribution. Two of the three members did not have an enrollment form on file at all.

Without adequate procedures to ensure only eligible employees participate in the State and County Employees Retirement Plans as required by statute, the risk that ineligible employees are participating in the Plans increases significantly, as noted in the finding.

> We continue to recommend NPERS implement procedures to ensure only eligible employees participate in the State and County Employees Retirement Plans as required by statute. We also recommend NPERS implement procedures to ensure enrollment forms are received for members who voluntarily become members of the Plans prior to the first contribution.

NPERS' Response: Neb. Rev. Stat. Section 84-1307(6) R.S.Supp., 2002 states, "State agencies shall ensure that employees authorized to participate in the retirement system pursuant to this section shall enroll and make required contributions to the retirement system within sixty days under rules and regulations adopted and promulgated by the board. Information necessary to determine membership in the retirement system shall be provided by the employer."

Neb. Rev. Stat. Section 23-2306(7) R.S.Supp., 2002 states, "Counties shall ensure that employees authorized to participate in the retirement system pursuant to this section shall enroll and make required contributions to the retirement system within sixty days under rules and regulations adopted and promulgated by the board. Information necessary to determine membership in the retirement system shall be provided by the employer."

It is the State Agencies and the Counties that hire employees and determines whether those employees are full- or part-time.

We will continue to remind State Agencies and County Clerks 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. We will work with the State Agencies and County Clerks on the importance of submitting all paperwork to the Retirement Office prior to any voluntary members making contributions.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Nebraska Information System and Accounting Procedures

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). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004 the Procurement and Employee Self-Service components were partially implemented. 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 obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), 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 DAS Accounting Division performed some reconciliation procedures. As of July 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.

   During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates

COMMENTS AND RECOMMENDATIONS
(Continued)

8. <u>Nebraska Information System and Accounting Procedures</u> (Continued)

an unknown variance between the bank records and the accounting records of $5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.

c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem, however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.

d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Nebraska Information System and Accounting Procedures (Continued)

e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State (Secretary of State). The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the administrator, (administrator means the State Records Administrator) schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.

g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.

h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation has not been provided to us.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Nebraska Information System and Accounting Procedures (Continued)

i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.

j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:

1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.
2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.
3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Nebraska Information System and Accounting Procedures (Concluded)

The issues identified above are the responsibility of the DAS 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 DAS, 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.

9. 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 agencies and counties allowed employees to begin their initial deduction in the pay period that began before the effective date of enrollment. We noted 6 of 30 new members tested in the State Plan and 6 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 two audit reports.

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 employer 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 employer matching contributions as those who begin participation early.

> We continue to 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.

COMMENTS AND RECOMMENDATIONS
(Continued)

9. Initial Contributions (Concluded)

NPERS' Response: We believe the following language found in our manual is clear, "It is your responsibility as the employer to ensure that the contributions to the retirement plan commence within the first pay period following the effective date of enrollment." We will send a reminder to the employers of this policy. If a State Agency or County Clerk has a question, they can call or email our office for an answer.

Auditors' Response: Agencies and counties are not clear on the policy, as evidenced by the number of inconsistencies noted in this and the prior audit.

10. Policy Manual Updates Not Timely

Good business practice requires that State agencies and counties have current policy manuals to use in administering the Plans, especially after significant changes to the Plans.

The Nebraska State Retirement System Manual for State agencies has not been updated since January 1997 although there have been many significant changes. The Nebraska County Retirement System Manual for County Clerks has not been updated since September 1999. Although NPERS has sent several memos to the State agencies and county clerks, it is important to keep the manuals updated more timely.

Without updated manuals for State agencies and county clerks, it is more difficult for State agencies and county clerks to be aware of current Statutes, NPERS Rules and Regulations, or revisions to NPERS policies and procedures.

> We recommend NPERS implement procedures to ensure policy manuals are updated more timely.

NPERS' Response: Memos are sent to the employers annually to update the manual when needed rather than redoing the full manual every year. When significant changes have been made to the plans, in a timely manner, detailed correspondence has been sent to the State Agencies and County Clerks. We have made regular presentations at the NACO convention for many years, our Educational Service unit is available for employer training on the State and County level. The current manual is in the final review stages before being sent to the printer.

Overall NPERS' 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.

STATE OF NEBRASKA
AUDITOR OF PUBLIC ACCOUNTS

P.O. Box 98917
State Capitol, Suite 2303
Lincoln, NE 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

Kate Witek
State Auditor
kwitek@mail.state.ne.us

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

Don Dunlap, CPA
Asst. Deputy Auditor
ddunlap@mail.state.ne.us

Pat Reding, CPA
Asst. Deputy Auditor
reding@mail.state.ne.us

Tim Channer, CPA
Asst. Deputy Auditor
channer@mail.state.ne.us

Mary Avery
SAE/Finance Manager
marya@mail.state.ne.us

Dennis Meyer, CGFM
Subdivision Budget
Coordinator
dmeyer@mail.state.ne.us

Mark Avery, CPA
Subdivision Audit
Review Coordinator
mavery@mail.state.ne.us

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES 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) - State and County Employees Retirement Plans as of December 31, 2003, 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.

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.

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.

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, 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.

As discussed in Note 2 to the financial statements, the State and County Retirement Plans were modified by law effective January 1, 2003.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2004, 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.

The "Schedules of Funding Progress" and "Schedules of Contributions From Employers" 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 methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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 schedules of "Average Administrative Expense Per Member" and related graph are 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.

September 23, 2004 Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS

STATE EMPLOYEES RETIREMENT PLAN

STATEMENT OF PLAN NET ASSETS

AS OF DECEMBER 31, 2003

ASSETS	STATE CASH BALANCE BENEFIT	STATE DEFINED CONTRIBUTION
Cash in State Treasury	$ 32,796	$ 422,833
Receivables:		
Contributions	2,498	608
Interest	1,048,206	43,948
Receivable for Investment Sales (Note 12)	2,737,667	-
Total Receivables	3,788,371	44,556
Pooled Investments, at fair value (Note 3):		
U.S. Government Securities	46,541,145	-
Corporate Bonds	28,299,729	-
Asset Backed Securities	11,165,656	-
Collateralized Mortgage Obligations	1,686,773	-
Taxable Municipal Bonds	991,233	-
Mutual Funds and Cash Equivalents	178,542,055	515,504,637
Total Pooled Investments	267,226,591	515,504,637
Guaranteed Investment Contracts, at contract value (Note 3)	14,286,939	81,986,402
Invested Securities Lending Collateral (Note 3)	21,570,801	2,803,543
Capital Assets:		
Equipment	1,607,305	872,125
Less: Accumulated Depreciation	(114,807)	(327,602)
Net Capital Assets	1,492,498	544,523
Total Assets	308,397,996	601,306,494
LIABILITIES		
Compensated Absences (Note 6)	8,162	18,917
Accrued Liabilities	-	74,920
Payable for Investment Purchases (Note 12)	6,698,602	-
Benefits Payable	1,302,723	-
Obligations Under Securities Lending (Note 3)	21,570,801	2,803,543
Capital Lease Obligations (Note 5)	1,427,755	654,835
Total Liabilities	31,008,043	3,552,215
Net assets held in trust for pension benefits (A schedule of funding progress for each cash balance benefit plan is presented on page 50.)	$ 277,389,953	$ 597,754,279

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
COUNTY EMPLOYEES RETIREMENT PLAN
STATEMENT OF PLAN NET ASSETS
AS OF DECEMBER 31, 2003

	COUNTY CASH BALANCE BENEFIT	COUNTY DEFINED CONTRIBUTION
ASSETS		
Cash in State Treasury	$ 9,564	$ 64,525
Due From Other Funds	11,000	-
Receivables:		
Contributions	241,518	353,647
Interest	285,800	-
Receivable for Investment Sales (Note 12)	746,443	10,649
Total Receivables	1,273,761	364,296
Pooled Investments, at fair value (Note 3):		
U.S. Government Securities	12,689,747	-
Corporate Bonds	7,716,106	-
Asset Backed Securities	3,044,389	-
Collateralized Mortgage Obligations	459,910	-
Taxable Municipal Bonds	270,266	-
Mutual Funds and Cash Equivalents	48,680,657	117,820,984
Total Pooled Investments	72,861,075	117,820,984
Guaranteed Investment Contracts, at contract value (Note 3)	3,936,511	19,818,022
Invested Securities Lending Collateral (Note 3)	5,879,951	674,566
Capital Assets:		
Equipment	845,950	408,985
Less: Accumulated Depreciation	(60,425)	(239,312)
Net Capital Assets	785,525	169,673
Total Assets	84,757,387	138,912,066
LIABILITIES		
Due to Other Funds	-	36,000
Compensated Absences (Note 6)	4,590	9,238
Accrued Liabilities	-	17,589
Payable for Investments Purchases (Note 12)	1,826,417	-
Benefits Payable	45,515	-
Obligations Under Securities Lending (Note 3)	5,879,951	674,566
Capital Lease Obligations (Note 5)	751,450	268,375
Total Liabilities	8,507,923	1,005,768
Net assets held in trust for pension benefits (A schedule of funding progress for each cash balance benefit plan is presented on page 50.)	$ 76,249,464	$ 137,906,298

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE EMPLOYEES RETIREMENT PLAN
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2003

	STATE CASH BALANCE BENEFIT	STATE DEFINED CONTRIBUTION
ADDITIONS:		
Contributions:		
Employee	$ 7,177,860	$ 15,923,349
Employer (Note 4)	11,225,906	24,886,756
Total Contributions	18,403,766	40,810,105
Investment Income:		
Net income (loss) from investing activities	46,537,414	88,915,704
Securities lending income	232,895	40,635
Securities lending expense	(190,791)	(31,377)
Net Investment Income (loss)	46,579,518	88,924,962
Total Additions	64,983,284	129,735,067
DEDUCTIONS:		
Benefits	5,476,107	20,679,738
Administrative expenses	483,812	943,619
Total Deductions	5,959,919	21,623,357
TRANSFERS (Note 10)	218,366,588	(218,366,588)
Net increase (decrease)	277,389,953	(110,254,878)
Net assets held in trust for pension benefits:		
Beginning of year	-	708,009,157
End of year	$ 277,389,953	$ 597,754,279

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
COUNTY EMPLOYEES RETIREMENT PLAN
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2003

	COUNTY CASH BALANCE BENEFIT	COUNTY DEFINED CONTRIBUTION
ADDITIONS:		
Contributions:		
Employee	$ 2,764,201	$ 4,706,834
Employer (Note 4)	4,093,395	6,938,905
Total Contributions	6,857,596	11,645,739
Investment Income:		
Net income (loss) from investing activities	13,017,484	20,275,342
Securities lending income	63,484	9,777
Securities lending expense	(52,007)	(7,550)
Net Investment Income (loss)	13,028,961	20,277,569
Total Additions	19,886,557	31,923,308
DEDUCTIONS:		
Benefits	1,731,868	7,295,622
Administrative expenses	290,139	663,502
Total Deductions	2,022,007	7,959,124
TRANSFERS (Note 10)	58,384,914	(58,384,914)
Net increase (decrease)	76,249,464	(34,420,730)
Net assets held in trust for pension benefits:		
Beginning of year	-	172,327,028
End of year	$ 76,249,464	$ 137,906,298

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

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2003

1. Summary of Significant Accounting Policies

Reporting Entity. 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: 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, 2003 and the Deferred Compensation Plan for the fiscal year ended December 31, 2001.

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

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 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 liabilities associated with the operation of these funds are included on the Statements of Plan Net Assets.

The State and County Employees Retirement Plans' financial statements were prepared on the accrual basis. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Employee and employer contributions are recognized 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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

Cash in State Treasury. Cash in State Treasury represents the cash balance of a fund as reflected on the Nebraska Information System (NIS). 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 2003.

Investments. 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, 2003. 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.

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 where 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

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, R.S.Supp., 2002, and R.S.Supp., 2003 for the State Employees Retirement Plan, and Neb. Rev. Stat. Sections 23-2301 through 23-2335, R.R.S. 1997, R.S.Supp., 2002, and R.S.Supp., 2003, for the County Employees Retirement Plan for more complete information.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions (Continued)

A. Nebraska State Employees Retirement Plan

The single employer plan became effective by statute on January 1, 1964. Prior to January 1, 2003, the plan consisted of a defined contribution plan that covered State employees. Effective January 1, 2003, a cash balance benefit was added to the State Employees Retirement Act. The cash balance benefit is a type of defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution benefit or begin participation in the cash balance benefit. The defined contribution benefit is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit.

All permanent full-time employees who have 12 continuous months of service are required 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.

Contributions. 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. The employer's account is fully vested after 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.

Defined Contribution Benefit. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions (Continued)

Cash Balance Benefit. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is a single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of a lump-sum or partial lump-sum.

Membership of the Plan consisted of the following at December 31, 2003:

	Defined Contribution	Cash Balance
Retirees and Beneficiaries Receiving Benefits	-	46
Terminated Plan Members Entitled to but not yet Receiving Benefits	1,887	56
Active Plan Members	9,713	5,206
Total	11,600	5,308

The 46 retirees and beneficiaries receiving benefits includes defined contribution members who elected an annuity. Defined contribution members may also choose from other forms of payment such as withdrawal or lump-sum payment. Generally, these are one-time payouts. Therefore, these retired members are not shown above.

The NPERS employees are employees of the State of Nebraska and contributed $66,342. NPERS, as part of the State of Nebraska, contributed $103,494.

B. Nebraska County Employees Retirement Plan

In 1973 the State Legislature brought the County Employees Retirement Plan under the administration of the Board. This multiple-employer plan covers employees of 91 of the State's 93 counties and several county health districts. Douglas and Lancaster counties have separate retirement plans for their employees as listed in Neb. Rev. Stat. Section 23-2301(11) R.S.Supp., 2003. Prior to January 1, 2003, the Plan consisted of a defined contribution plan. Effective January 1, 2003, a cash balance benefit was added to the County Employees Retirement Act. The cash balance benefit is a type of

2. Plan Descriptions (Continued)

defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution benefit or begin participation in the cash balance benefit. The defined contribution benefit is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit.

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 20 and completing a total of 12 months service within a five-year period. Part-time elected officials may exercise the option to join.

Contributions. County employees and elected officials contribute 4½ percent of their total compensation. Present and future commissioned law enforcement personnel employed by such counties shall contribute additional contributions to a supplemental retirement plan. Commissioned law enforcement personnel in participating counties with less than eighty-five thousand inhabitants shall contribute an extra one percent, or a total of 5½ percent of their total compensation. Commissioned law enforcement personnel in participating counties with a population in excess of eighty-five thousand inhabitants shall contribute an extra two percent, or a total of 6½ percent of their total compensation. 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. The employer's account is vested after 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.

Defined Contribution Benefit. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions (Concluded)

Cash Balance Benefit. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is a single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of a lump-sum or partial lump-sum.

Membership of the Plan consisted of the following at December 31, 2003:

	Defined Contribution	Cash Balance
Retirees and Beneficiaries Receiving Benefits	-	35
Terminated Plan Members Entitled to but not yet Receiving Benefits	1,056	72
Active Plan Members	3,738	2,516
Total	4,794	2,623

The 35 retirees and beneficiaries receiving benefits includes defined contribution members who elected an annuity. Defined contribution members may also choose from other forms of payment such as withdrawal or lump-sum payment. Generally, these are one-time payouts. Therefore, these retired members are not shown above.

3. Investments and Securities Lending

Neb. Rev. Stat. Section 72-1239.01(1)(a) R.R.S. 2003 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 the 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.R.S. 2003 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 like capacity and familiar with such matters would use in the conduct of

3. Investments and Securities Lending (Continued)

an enterprise of a like character and with like aims by diversifying the investments of the retirement systems . . . so as to minimize risk of large losses, unless in light of such circumstances it is clearly prudent not to do so."

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.

State statutes detail investment options for the defined contribution benefit of the County Employees Retirement Plan and the State Employees Retirement Plan, respectively. Upon enrollment in the plans, a defined contribution participant may direct employee contributions in any of several investment options. Employer contributions are required by statute to be invested in the Employer Fund. There were three pre-mixed funds in which the members could allocate their employer account.

The Nebraska Investment Council has contracted with outside managers to manage the funds of the cash balance benefit, except for funds in the State Treasury and one of the funds that comprise the cash balance benefit that includes the guaranteed investment contract clones.

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

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 or agent but not in NPERS' name.

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. NPERS custodial bank administers the securities lending program and receives cash, United States Government or government agency obligations,

3. Investments and Securities Lending (Continued)

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 uncategorized 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. The collateral securities can not 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 (at the June 30, 2003 year end). 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 December 31, 2003, NPERS held futures contracts with a par value of $(4,500,000) and a market value of $0. This activity was part of the cash balance benefit.

Defined Contribution Benefit
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.

The defined contribution benefit of the State and County Employees Retirement Plans has 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, 2003 at contract value as reported to the Nebraska Investment Council by the investment fund manager. Contract value represents contributions made under the contract, plus earnings, less withdrawals, and expenses. The

3. Investments and Securities Lending (Continued)

December 31, 2003, balance was $81,986,402 for the State Employees Retirement Plan and $19,818,022 for the County Employees Retirement Plan. Activity is recorded in the Stable Fund. Guaranteed investment contracts are not required to be categorized per GASB Statement Number 3.

The S & P 500 Stock Index Fund, International Stock Fund, Money Market Fund, Bond Market Index Fund, Large Growth Stock Index Fund, Large 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 carrying amount of these pooled investments at December 31, 2003, is at market value as set forth below:

Not Categorized	
Mutual Funds	$ 633,325,621
Guaranteed Investment Contracts	53,978,681
Synthetic Investment Contracts	44,417,918
Investments held by broker-dealers Under Securities Loan with Cash Collateral:	
Synthetic Investment Contracts	3,407,825
Securities Lending Short-Term Collateral Investment Pool	3,478,109
TOTAL	$ 738,608,154

	State	County	Total
Investments, at fair value	$515,504,637	$117,820,984	$633,325,621
Guaranteed Investment Contracts	81,986,402	19,818,022	101,804,424
Invested Securities Lending Collateral	2,803,543	674,566	3,478,109
Total Investments Defined Contribution	$600,294,582	$138,313,572	$738,608,154

Cash Balance Benefit

The Nebraska Public Employees Retirement Systems – State and County Retirement Plans cash balance benefit 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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Investments and Securities Lending (Concluded)

The carrying amount of these pooled investments at December 31, 2003, is at market value as set forth below:

Investments – Category 1	
U.S. Government Securities	$ 34,487,701
Corporate Bonds	33,854,559
Asset Backed Securities	14,210,046
Collateralized Mortgage Obligations (CMOs)	2,146,683
Municipal Bonds	1,261,499
Subtotal	85,960,488
Not Categorized	
Investments held by broker-dealers	
Under Securities Loan with Cash Collateral	
U. S. Government Securities	24,743,191
Corporate Bonds	2,161,275
Securities Lending Short-Term Collateral	
Investment Pool	27,450,752
Mutual Funds	212,874,211
Guaranteed Investment Contracts	18,223,450
Cash Equivalents	14,348,501
Total	$ 385,761,868

	State	County	Total
Investments, at fair value	$ 267,226,591	$ 72,861,075	$340,087,666
Guaranteed Investment Contracts	14,286,939	3,936,511	18,223,450
Invested Securities Lending Collateral	21,570,801	5,879,951	27,450,752
Total Investments Cash Balance Benefit	$ 303,084,331	$ 82,677,537	$385,761,868

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., 2003, and 84-1321.01(1) R.S.Supp., 2003, forfeitures are first used to pay administrative expenses of the

4. Employer Contributions (Concluded)

Board. The remaining balance, if any, shall then be used to reduce State and County employer contributions respectively. During 2003, there were no forfeitures used to offset the State and County employer contributions. The balance of the forfeiture accounts at December 31, 2003 was $929,157 for the State Plan and $59,494 for the County Plan.

5. Contingencies and 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 fourth Master Lease Agreement, dated February 28, 2003, was for $5,915,227 including interest costs of $525,227, a rate of 2.757%. The minimum annual lease payments and the present value of future minimum payments for all capital leases as of December 31, 2003 are as follows:

Year		State and County Plans
2004	$	738,025
2005		752,036
2006		752,036
2007		746,763
2008		673,776
2009-2011		785,891
Total Minimum Payments		4,448,527
Less: Interest and Executory costs		368,418
Present value of net minimum payments	$	4,080,109

5. Contingencies and 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, 2003, is as follows:

	State Defined Contribution Employees	State Cash Balance Benefit Employees	County Defined Contribution Employees	County Cash Balance Benefit Employees
Annual Leave	$ 12,637	$ 5,452	$ 6,171	$ 3,066
Sick Leave	6,135	2,647	2,996	1,489
Compensatory Leave	145	63	71	35
	$ 18,917	$ 8,162	$ 9,238	$ 4,590

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Historical Trend Information

Historical trend information designed to provide information about NPERS' progress made in accumulating sufficient assets to pay benefits when due for the cash balance benefit is presented as required supplementary information following these Notes to Financial Statements.

8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2003 are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
State Defined Contribution					
Compensated Absences	$ 26,099	$ -	$ 7,182	$ 18,917	$ 2,730
Capital Lease Obligations	1,158,235	328,790	832,190	654,835	155,777
Totals	$ 1,184,334	$ 328,790	$ 839,372	$ 673,752	$ 158,507
State Cash Balance Benefit					
Compensated Absences	$ -	$ 8,162	$ -	$ 8,162	$ 1,178
Capital Lease Obligations	-	1,607,305	179,550	1,427,755	339,645
Totals	$ -	$ 1,615,467	$ 179,550	1,435,917	$ 340,823
County Defined Contribution					
Compensated Absences	$ 13,704	$ -	$ 4,466	$ 9,238	$ 1,333
Capital Lease Obligations	917,215	134,750	783,590	268,375	63,843
Totals	$ 930,919	$ 134,750	$ 788,056	$ 277,613	$ 65,176
County Cash Balance Benefit					
Compensated Absences	$ -	$ 4,590	$ -	$ 4,590	$ 662
Capital Lease Obligations	-	845,950	94,500	751,450	178,760
Totals	$ -	$ 850,540	$ 94,500	$ 756,040	$ 179,422

9. Capital Assets

Capital asset activity for the year ended December 31, 2003, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
State Defined Contribution				
Equipment	$ 1,293,175	$ -	$ 421,050	$ 872,125
Less: Accumulated Depreciation	172,938	154,664	-	327,602
Capital Assets, Net	$ 1,120,237	$ (154,664)	$ 421,050	$ 544,523

NOTES TO FINANCIAL STATEMENTS
(Continued)

9. Capital Assets (Concluded)

	Beginning Balance	Increases	Decreases	Ending Balance
State Cash Balance Benefit				
Equipment	$ -	$ 1,607,305	$ -	$ 1,607,305
Less: Accumulated Depreciation	-	114,807	-	114,807
Capital Assets, Net	$ -	$ 1,492,498	$ -	$ 1,492,498
County Defined Contribution				
Equipment	$ 1,024,075	$ -	$ 615,090	$ 408,985
Less: Accumulated Depreciation	136,951	102,361	-	239,312
Capital Assets, Net	$ 887,124	$ (102,361)	$ 615,090	$ 169,673
County Cash Balance Benefit				
Equipment	$ -	$ 845,950	$ -	$ 845,950
Less: Accumulated Depreciation	-	60,425	-	60,425
Capital Assets, Net	$ -	$ 785,525	$ -	$ 785,525

10. Transfers

Transfer activity for the year ended December 31, 2003, was as follows:

	State Cash Balance Benefit	State Defined Contribution
January 1, 2003 from Defined Contribution to Cash Balance Benefit	$ 216,677,627	$ (216,677,627)
Annuity Balances from Defined Contribution to Cash Balance Benefit	1,249,739	(1,249,739)
Miscellaneous Transfers	350,018	(350,018)
ERBF Transfer from Defined Contribution to Cash Balance Benefit	89,204	(89,204)
Total Transfers	$ 218,366,588	($218,366,588)

	County Cash Balance Benefit	County Defined Contribution
January 1, 2003 from Defined Contribution to Cash Balance Benefit	$ 57,399,823	$ (57,399,823)
Annuity Balances from Defined Contribution to Cash Balance Benefit	665,868	(665,868)
Miscellaneous Transfers	254,861	(254,861)
ERBF Transfer from Defined Contribution to Cash Balance Benefit	64,362	(64,362)
Total Transfers	$ 58,384,914	$ (58,384,914)

NOTES TO FINANCIAL STATEMENTS
(Continued)

10. Transfers (Concluded)

The January 1, 2003 represents the transfer of member balances who elected to convert their defined contribution accounts to the cash balance benefit. The annuity balances represent the transfer of member balances who elected an annuity in the defined contribution plan. Since NPERS pays the annuities, the balances are transferred to the cash balance fund in order for the annuity to be processed. Miscellaneous transfers consist mainly of members who had previous balances in the defined contribution fund, but were rehired after January 1, 2003. They are required to be in the cash balance benefit; therefore, their defined contribution balance was transferred to the cash balance fund. The ERBF transfer is the allocation of the Equal Retirement Benefit Fund (ERBF) between defined contribution and cash balance. This allocation is based on the balances of members with accumulated contributions prior to January 1, 1984.

11. Due To/From Other Funds

Due To/From Other Funds represent transfers between cash funds of other Plans. In 2003, the County defined contribution cash fund did not have enough cash to pay expenses and received $47,000 in transfers from other funds. At December 31, 2003, $36,000 was due to the NPERS Administrative Cash Fund, which is part of the School Plan. The County cash balance fund transferred $11,000 to the County defined contribution cash fund during the year, and that amount was also still due at December 31, 2003.

12. Receivable/Payable for Investment Sales/Purchases

Securities are recorded on a trade date basis. On the trade date, the Plans own the asset. However, if the security has not settled, payment has not been received or made.

The receivable and payable for investment sales and purchases represent securities in which the asset has been recorded as of December 31, 2003, but the security has not settled.

13. 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. The interest rate is 2.53%.

Investment Options
Neb. Rev. Stat. Sections 23-2310.05 and 84-1311.03 changed the investment options for the employer account of the defined contribution plans to include all of the same investment options as the employee account, effective July 16, 2004.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
CASH BALANCE BENEFIT
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 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
STATE EMPLOYEES						
12/31/2003	$254,175,882	$241,192,355	($12,983,527)	105.4%	$171,324,288	(7.6%)
COUNTY EMPLOYEES						
12/31/2003	$ 69,761,178	$ 63,270,991	$ 6,490,187	110.3%	$ 60,626,584	(10.7%)

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
CASH BALANCE BENEFIT

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYERS

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003

UNAUDITED

SCHEDULE 2

STATE EMPLOYEES

Year Ended December 31	Annual Required Contribution State	Percentage Contributed
2003	$11,225,906	100%

COUNTY EMPLOYEES

Year Ended December 31	Annual Required Contribution Counties	Percentage Contributed
2003	$4,093,395	100%

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

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.

	State Cash Balance Benefit	County Cash Balance Benefit
Valuation Date	December 31, 2003	December 31, 2003
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Dollar Closed	Level Dollar Closed
Remaining Amortization Period	25 Years	25 Years
Mortality	1994 Group Annuity Table One year set back, sex distinct	1994 Group Annuity Table One year set back, sex distinct
Asset Valuation Method	5 year smoothing	5 year smoothing
Actuarial Assumptions:		
Investment Rate of Return (1)	7.6%	7.6%
Projected Salary Increases (1)	4.5% - 9.1%	4.5% - 9.1%
Cost-Of-Living Adjustments (COLA)	None	None

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

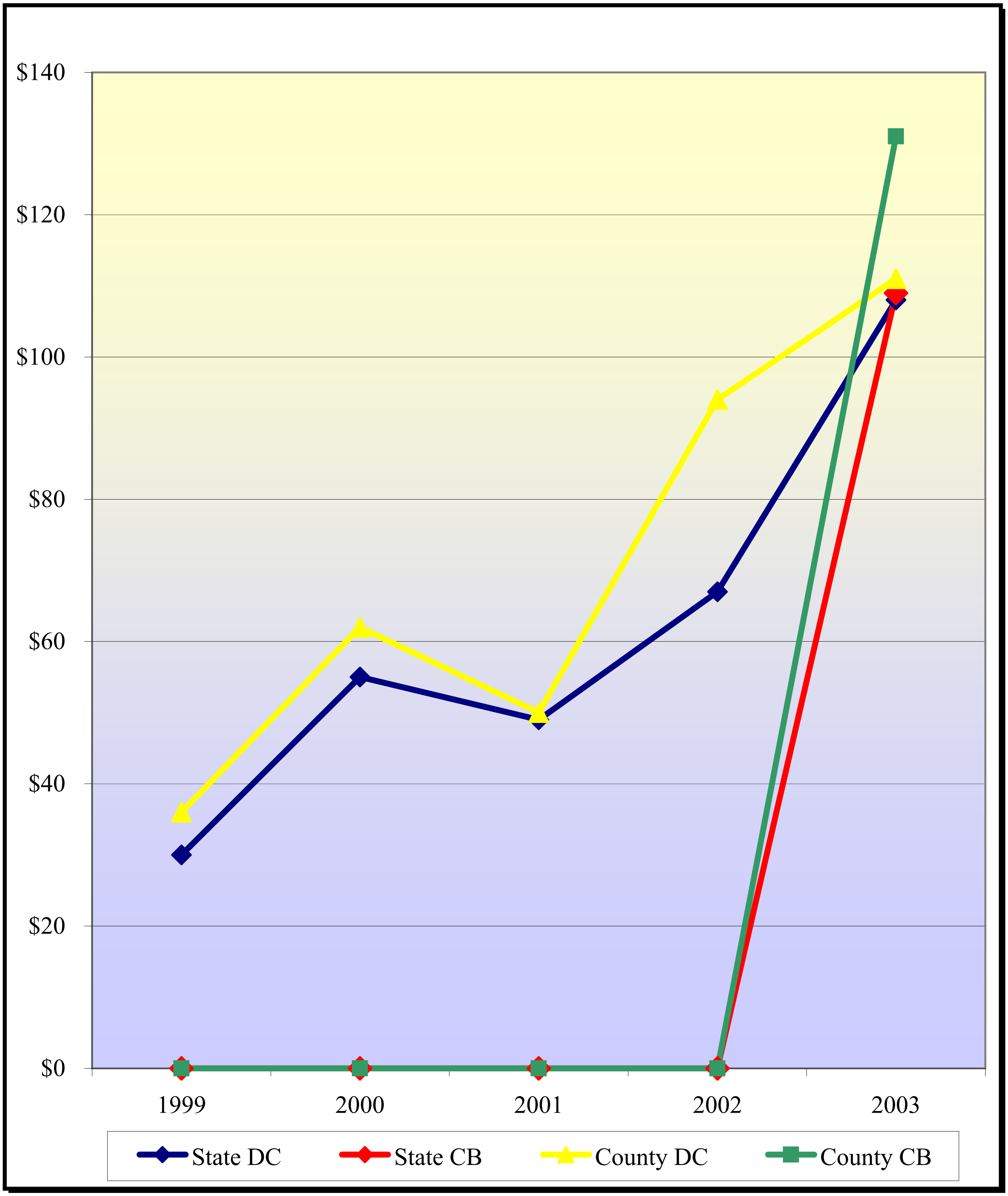
NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
AVERAGE ADMINISTRATIVE EXPENSE PER MEMBER

	1999	2000	2001	2002	2003
STATE DEFINED CONTRIBUTION					
Members:					
Active	12,840	12,861	12,750	14,349	9,713
Inactive	1,656	1,828	2,070	2,002	1,887
Total Members	14,496	14,689	14,820	16,351	11,600
Administrative Expenses: (1)					
PERS Expenses paid in NIS (3)	$ 263,287	$ 523,675	$ 342,389	$ 688,714	$ 597,478
Ameritas Recordkeeper fees (4)	176,991	280,796	384,613	404,662	302,851
Asset Charge (5)					354,141
Total Expenses	$ 440,278	$ 804,471	$ 727,002	$ 1,093,376	$ 1,254,470
Average Administrative Expense Per Member (2)	$ 30	$ 55	$ 49	$ 67	$ 108
STATE CASH BALANCE BENEFIT					
Members:					
Active					5,206
Inactive					56
Total Members					5,262
Administrative Expenses: (1)					
Reimbursements from Assets (6)					$ 461,000
Ameritas Recordkeeper fees (4)					112,189
Total Expenses					$ 573,189
Average Administrative Expense Per Member (2)					$ 109
COUNTY DEFINED CONTRIBUTION					
Members:					
Active	5,840	5,921	5,983	6,162	3,738
Inactive	877	951	1,083	1,032	1,056
Total Members	6,717	6,872	7,066	7,194	4,794
Administrative Expenses: (1)					
PERS Expenses paid in NIS (3)	$ 158,164	$ 292,074	$ 167,475	$ 482,349	$ 320,531
Ameritas Recordkeeper fees (4)	83,449	132,948	184,505	194,220	127,993
Asset Charge (5)					82,392
Total Expenses	$ 241,613	$ 425,022	$ 351,980	$ 676,569	$ 530,916
Average Administrative Expense Per Member (2)	$ 36	$ 62	$ 50	$ 94	$ 111
COUNTY CASH BALANCE BENEFIT					
Members:					
Active					2,516
Inactive					72
Total Members					2,588
Administrative Expenses: (1)					
Reimbursements from Assets (6)					$ 283,200
Ameritas Recordkeeper fees (4)					56,988
Total Expenses					$ 340,188
Average Administrative Expense Per Member (2)					$ 131

(1) Administrative Expenses are on a Cash Basis.
(2) Calculated: Total Administrative Expenses/Total Members=Average Administrative Expense
(3) NPERS expenses paid in NIS are expenses incurred by NPERS and allocated to these plans.
(4) Ameritas record keeper fees are amounts charged by Ameritas to members for record keeping services. This is the amount members se as fees on their quarterly statements.
(5) Asset charge is a 10 basis point charge against the assets of the defined contribution funds used to pay expenses.
(6) Reimbursements from Assets are reimbursements received from the assets held at the bank based on requests from NPERS.

NOTE: Prior to 2003 the NPERS expenses included reimbursements from Ameritas for expenses. The total expenses consisted on these reimbursements and the Ameritas record keeping fee, which is not shown separately.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
AVERAGE ADMINISTRATIVE EXPENSE PER MEMBER



STATE OF NEBRASKA
AUDITOR OF PUBLIC ACCOUNTS

P.O. Box 98917
State Capitol, Suite 2303
Lincoln, NE 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

Kate Witek
State Auditor
kwitek@mail.state.ne.us

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

Don Dunlap, CPA
Asst. Deputy Auditor
ddunlap@mail.state.ne.us

Pat Reding, CPA
Asst. Deputy Auditor
reding@mail.state.ne.us

Tim Channer, CPA
Asst. Deputy Auditor
channer@mail.state.ne.us

Mary Avery
SAE/Finance Manager
marya@mail.state.ne.us

Dennis Meyer, CGFM
Subdivision Budget
Coordinator
dmeyer@mail.state.ne.us

Mark Avery, CPA
Subdivision Audit
Review Coordinator
mavery@mail.state.ne.us

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*

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, 2003, and have issued our report thereon dated September 23, 2004. 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.

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 2 (County Plan Payroll Testing), Comment Number 5 (Incorrect Annuity Payments), Comment Number 6 (Required Contribution Procedures), and Comment Number 7 (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 (Plan Accounting), Comment Number 2 (County Plan Payroll Testing), Comment Number 3 (Inadequate Resolution of Prior Audit Findings), Comment Number 4 (Inaccurate Financial Information Provided to Actuary), Comment Number 6 (Required Contribution Procedures), and Comment Number 7 (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. We also noted other matters involving internal control over financial reporting that we have reported to management of the Nebraska Public Employees Retirement Systems - State and County Retirement Plans in the Comments Section of the report as Comment Number 5 (Incorrect Annuity Payments) and Comment Number 8 (Nebraska Information System and Accounting Procedures).

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.

September 23, 2004 Assistant Deputy Auditor