

**ATTESTATION REPORT  
OF THE  
NEBRASKA INVESTMENT COUNCIL  
JULY 1, 2005 THROUGH JUNE 30, 2006**

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**Issued on October 13, 2006**

# NEBRASKA INVESTMENT COUNCIL

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## NEBRASKA INVESTMENT COUNCIL

### **BACKGROUND**

The Nebraska Investment Council (Council) was established under 1967 and 1969 laws as a central State investment agency. The Council provides investment management services for the State.

The Council is governed by a seven-member Council. Five voting members are appointed by the Governor and confirmed by the Legislature. They serve five-year terms, with one expiring each year. The State Treasurer and the Executive Director of the Public Employees Retirement Systems serve as non-voting members.

The Council establishes necessary and proper policies for the investment of the funds for which it is responsible. Such policies include appropriate investment strategy decisions, selection of external managers, and allocation of funds among managers. The Council appoints a State Investment Officer, subject to the approval of the Governor and the Legislature. The State Investment Officer, with the assistance of Council staff, directs the investments of these funds in accordance with State statutes and the policies of the Council.

Funds managed include the State's general and cash funds; retirement plans for the State Patrol, judges, and school employees (with the exception of Omaha); and trust funds such as the Permanent School Fund, the Veterans' Aid Fund, and the Health Care Trust Fund. The Council is also responsible for investing the State employee's and county employees' retirement system funds, the deferred compensation plan assets, and the funds of the Nebraska Educational Savings Plan Trust.

### **MISSION STATEMENT**

It is the mission of the Nebraska Investment Council to prudently manage the funds entrusted to us by the people of the State of Nebraska. We deliver investment management services to provide direct financial benefit exclusively to the owners of these funds. We are committed to thorough, sound, and informed analysis in order to achieve superior returns while maintaining prudent levels of risk.

# NEBRASKA INVESTMENT COUNCIL

## ORGANIZATIONAL CHART

Gail Werner-Robertson (Chairwoman)

Earl H. Scudder

Richard A. DeFusco

John L. Maginn

(non-voting)

Ron Ross

Anna Sullivan

State Treasurer

Director-Public Employees Retirement Systems

### STATE INVESTMENT OFFICER

Carol L. Kontor

### INVESTMENT SECURITIES ANALYSTS

Gayle A. Wrasse

Joseph P. Jurich

JoLynn Winkler

### BUSINESS MANAGER

Kathy Dawes

### SECRETARY

Brandee Freauf

### AUDITOR

Ray Friesen

#### Note:

Effective July 1, 2006, David L. Bomberger became the State Investment Officer

Effective July 17, 2006, John M. Dinkel was appointed to the Council

## NEBRASKA INVESTMENT COUNCIL

### EXIT CONFERENCE

An exit conference was held September 13, 2006, with the Council to discuss the results of our examination. Those in attendance for the Nebraska Investment Council were:

<b>NAME</b>	<b>TITLE</b>
Dave Bomberger	State Investment Officer
Kathy Dawes	Business Manager
Ray Friesen	Internal Auditor
Richard DeFusco	Council Member
John Maginn	Council Member

## NEBRASKA INVESTMENT COUNCIL

### SUMMARY OF COMMENTS

During our examination of the Nebraska Investment Council, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here.

1. ***Permanent School Fund Investments and Income:*** During our review of the investment activity of the Permanent School Fund, we noted the following problems: deposits made to increase the permanent portfolio were not all invested in long-term investments, not all interest and income were transferred out, and income transfers out did not include capital gains.
2. ***Reconciliation of Bank Records to the Nebraska Information System:*** The Department of Administrative Services' reconciliation process is still not done in a timely manner and continues to reflect unknown variances.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature as it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Council 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 examination.

We appreciate the cooperation and courtesy extended to our staff during the course of the examination.

## NEBRASKA INVESTMENT COUNCIL

### COMMENTS AND RECOMMENDATIONS

#### 1. Permanent School Fund Investments and Income

State of Nebraska Constitution Article VII-7 enumerates perpetual funds for common school purposes "... of which the annual interest and income only can be appropriated ..." Neb. Rev. Stat. Section 79-1035.01 R.R.S. 2003 states, "The permanent school fund is the fund described in Article VII, sections 7 and 8, of the Constitution of Nebraska, the principal of which shall be held and invested in perpetuity by the state in trust for the support of its common schools. The annual interest and other income, but not the principal, is subject to use for the support and maintenance of the common schools in each public school district of the state as the Legislature provides in accordance with Article VII, section 9, of the Constitution of Nebraska."

The Nebraska Investment Council and the State Treasurer work closely together to invest the State's funds and distribute income to the appropriate funds. These investment procedures include: the Council investing funds in either the Operating Investment Pool (OIP) or long-term investments as directed by the fund's owner; the Council setting the procedures used to determine the amount of interest and income earned by the investments; the State's investment record keeper, using Council procedures; determining the amount of interest and income earned each month; and the State Treasurer transferring the interest and income to the appropriate funds.

During our review of the investment activity of the Permanent School Fund, we noted the following:

- All deposits made to the Permanent School Fund that were intended to increase the permanent portfolio were invested in the OIP and not long-term investments. Since July 1, 2002, there was \$47,634,522 in deposits intended to increase the permanent portfolio.
- All interest and income from the Permanent School Fund's long-term investments was transferred to the common schools. However, at least \$4,955,147 in interest and income from the Permanent School Fund's OIP investments was not transferred to the common schools.
- The investment income that was transferred out of the Permanent School Fund included interest and dividends, but did not include realized or unrealized capital gains.
- Our review of statutes and the State constitution determined there does not appear to be a clear definition for investment income, including, whether realized and unrealized capital gains are income.

# NEBRASKA INVESTMENT COUNCIL

## COMMENTS AND RECOMMENDATIONS

(Continued)

### 1. **Permanent School Fund Investments and Income** (Continued)

- While our review included only the Permanent School Fund, it appears these concerns may apply to other permanent endowment funds.

As a result, the Permanent School Fund may not have been invested to the fullest benefit of the State, common schools had not received all income due them, additional income may be due to the common schools, and other funds may be due additional income.

We recommend the Nebraska Investment Council and the State Treasurer continue to work together to ensure all investment income is correctly recorded and transferred to the appropriate funds.

We further recommend:

1. The State Treasurer ensure all investment income from the Permanent School Fund, including both the OIP and long-term investments income, is transferred to the common schools.
2. The State Treasurer and Nebraska Investment Council determine and document the definition of investment income for permanent endowment funds, specifically whether income includes realized or unrealized capital gains. This may require working with the Nebraska Attorney General and the Legislature to determine the Framer's intent.
3. The State Treasurer and Nebraska Investment Council ensure income from all permanent endowment funds is distributed based on the documented definition of investment income.
4. The State Treasurer review all permanent endowment funds to determine whether any investment income from the OIP remains in the funds that should have been transferred. If it is determined income has not been transferred, the amounts, method, and timing of the transfer should be determined.
5. The State Treasurer ensure all deposits intended to increase the permanent portfolio of all endowment funds are fully invested.



## NEBRASKA INVESTMENT COUNCIL

### COMMENTS AND RECOMMENDATIONS

(Continued)

#### 1. Permanent School Fund Investments and Income (Concluded)

*Council's Response: The Nebraska Investment Council (Council) has followed its documented procedures in distributing income from the endowment funds to the agencies. A 2005 opinion from the Nebraska Attorney General (#05001) defined income more broadly than it had been defined in the past. This opinion only applied to one of the eight endowments that the Council manages, and it may have resulted in some of the apparent lack of a clear definition of investment income to which the Auditors refer in their finding. In a letter dated August 3, 2006, the State Treasurer and the State Investment Officer jointly requested a formal legal opinion from the Nebraska Attorney General regarding allowable distributions from each of these eight State endowment funds, including the Permanent School Fund. On August 28, 2006, representatives from the Treasurer's office and the Nebraska Investment Council met with a lawyer from the Attorney General's office to discuss the matter. No opinion has been issued to date. In addition, the Council does not believe that it has the responsibility or the authority to determine how funds that are distributed from the endowments to the agencies should be reinvested. The Council believes that is the responsibility of the agency. Pending that agency decision, it is prudent for funds to remain invested in the Operating Investment Pool.*

**Auditor's Response:** We agree the distribution of funds is not the responsibility of the Council. We have also communicated this finding to other State agencies involved in this process.

#### 2. Reconciliation of Bank Records to the Nebraska Information System

During the audit of the Comprehensive Annual Financial Report (CAFR) of the State of Nebraska, the Auditor of Public Accounts (APA) noted the absence of reconciliation between the Nebraska State Treasurer's actual bank statements and Nebraska accounting records (in both the Nebraska Information System (NIS) and the Nebraska Accounting System (NAS), system before NIS). This has been an issue for the Department of Administrative Services Accounting Division (State Accounting) for many years. The APA's previous comments noted monthly reconciliations have not been completed in a timely manner and reconciliations performed have shown significant unknown variances between the bank records and the accounting records, with the bank being short compared to the accounting records. Although State Accounting continues to work on correcting the reconciliation of bank records to NIS, the APA continues to note areas where improvement is still needed in the reconciliation process to ensure NIS integrity and operational efficiency. Specifically, the APA noted the status of the reconciliation process as of December 19, 2005, to be as follows:

State Accounting has worked on the reconciliation process, but continued progress is needed. State Accounting's reconciliation process has developed into a very detailed process of analyzing bank activity, compared to activity recorded on NIS, to identify

## NEBRASKA INVESTMENT COUNCIL

### COMMENTS AND RECOMMENDATIONS

(Continued)

#### 2. **Reconciliation of Bank Records to the Nebraska Information System** (Concluded)

reconciling items. State Accounting has completed their reconciliation process for the months of July of 2004 and May, June, and July of 2005. The APA has reviewed these reconciliations. The months of May, June, and July show variances of \$3,425,381, \$3,405,702, and \$3,405,862, respectively. Again, the reconciliations show the bank being short compared to the accounting records. Per inquiry of management, State Accounting has started the reconciliation process for various months of the fiscal year ended June 30, 2006; however, the reconciliation process has not been a continuous monthly process and no monthly reconciliation has been completed since July of 2005.

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial information. Without a timely and complete reconciliation of bank records to the NIS, there is a greater risk for fraud and errors to occur and to remain undetected.

Although State Accounting has worked on the reconciliation process, the process is still not done in a timely manner. The reconciliation continues to reflect unknown variances and shortages. Complete and timely reconciliation procedures between bank records and accounting records are required to provide control over cash and accurate financial information.

We recommend State Accounting continue their reconciliation process, in a more timely manner, and on at least a monthly basis, to ensure all financial information is correct on NIS. We also recommend, when a consistent cash variance between the bank records and the accounting records is obtained (based on at least six months of reconciliations), DAS submit their plan for adjusting NIS to the Governor and the Legislature so they may take appropriate action to correct NIS and resolve the variances noted.

This issue is the responsibility of State Accounting; however, as the variances have not been identified by fund or agency, this issue directly affects all Nebraska State agencies' financial information and must be disclosed in this report.

*Council's Response: The Council acknowledges that this finding is included in the audit reports of all State Agencies. The Council has no information that could provide an explanation for the shortfall. Because the shortfall could have originated from any number of other state agencies over which the Council has no authority or responsibility, the Council is unable to provide a meaningful response with respect to those agencies.*

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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## NEBRASKA INVESTMENT COUNCIL

### INDEPENDENT ACCOUNTANT'S REPORT

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Nebraska Investment Council  
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council (Council) for the fiscal year ended June 30, 2006. The Council's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting the schedule of revenues, expenditures, and changes in fund balances and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.


In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Investment Council for the fiscal year ended June 30, 2006, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 13, 2006, on our consideration of the Nebraska Investment Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe

the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

This report is intended solely for the information and use of the Council and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

September 13, 2006

  
Assistant Deputy Auditor

NEBRASKA INVESTMENT COUNCIL  
**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**  
For the Fiscal Year Ended June 30, 2006

	Nebraska Investment Council Cash Fund 27510	Operating Pool Distributive Fund 77500	Totals (Memorandum Only)
REVENUES:			
Sales & Charges	\$ 760,032	\$ -	\$ 760,032
Miscellaneous	391,397	-	391,397
TOTAL REVENUES	<u>1,151,429</u>	<u>-</u>	<u>1,151,429</u>
EXPENDITURES:			
Personal Services	530,804	-	530,804
Operating	592,421	-	592,421
Travel	9,526	-	9,526
Capital Outlay	948	-	948
TOTAL EXPENDITURES	<u>1,133,699</u>	<u>-</u>	<u>1,133,699</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>17,730</u>	<u>-</u>	<u>17,730</u>
OTHER FINANCING SOURCES (USES):			
Sales of Assets	<u>7</u>	<u>-</u>	<u>7</u>
TOTAL OTHER FINANCING SOURCES (USES)	<u>7</u>	<u>-</u>	<u>7</u>
Net Change in Fund Balances	17,737	-	17,737
FUND BALANCES, JULY 1, 2005	<u>174,223</u>	<u>-</u>	<u>174,223</u>
FUND BALANCES, JUNE 30, 2006	<u>\$ 191,960</u>	<u>\$ -</u>	<u>\$ 191,960</u>
FUND BALANCES CONSIST OF:			
General Cash (Note 6)	\$ 192,593	\$ (17,182,015)	\$ (16,989,422)
Deposits with Vendors	504	-	504
Due to Vendors	(1,137)	-	(1,137)
OIP Interest Receivable (Note 6)	-	17,182,015	17,182,015
TOTAL FUND BALANCES	<u>\$ 191,960</u>	<u>\$ -</u>	<u>\$ 191,960</u>

The accompanying notes are an integral part of the schedule.

# NEBRASKA INVESTMENT COUNCIL

## NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2006

### 1. Criteria

The accounting policies of the Nebraska Investment Council (Council) are on the basis of accounting as prescribed by the State of Nebraska Department of Administrative Services (DAS).

Per Neb. Rev. Stat. Section 81-1107(2) R.S.Supp., 2004, the State of Nebraska Director of Administrative Services duties include “The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes.”

The Nebraska Information System (NIS) is the official accounting system prescribed by DAS for the State of Nebraska. Policies and procedures are detailed in the Nebraska State Accounting Manual published by DAS – Accounting Division and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Council was obtained directly from the NIS. NIS records accounts receivable and accounts payable as transactions occur. As such certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounts payable liability recorded on NIS, and thus recorded as expenditures, as of June 30, 2006, includes only those payables posted to NIS before June 30, 2006, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2006, **does not** include amounts for goods and services received before June 30, 2006, which had not been posted to NIS as of June 30, 2006.

The Council had no accounts receivable at June 30, 2006. The NIS system does not include liabilities for accrued payroll and compensated absences.

The fund types established by NIS that are used by the Council are:

**20000 – Cash Funds** – account for revenues generated by specific activities from sources outside of State government and the expenditures directly related to the generation of the revenues. Cash funds are established by State statutes and must be used in accordance with those statutes.

**70000 – Distributive Funds** – account for assets held by the State as an agent for individuals, private organizations, other governments, and/or other funds.

The major revenue object account codes established by NIS used by the Council are:

**Sales & Charges** – Income derived from sales of merchandise and commodities, compensation for services rendered, and charges for various licenses, permits, and fees.

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

(Continued)

1. **Criteria** (Concluded)

**Miscellaneous** – Revenue from sources not covered by other major categories, such as investment income and recaptured commissions. For further information on recaptured commissions, see Note 8.

The major expenditure object account titles established by NIS used by the Council are:

**Personal Services** – Salaries, wages, and related employee benefits provided for all persons employed by the Council.

**Operating** – Expenditures directly related to a program's primary service activities.

**Travel** – All travel expenses for any state officer, employee, or member of any commission, council, committee, or board of the State.

**Capital Outlay** – Expenditures which result in the acquisition of or an addition to capital assets. Capital assets are resources of a long-term character, owned or held by the government.

Other significant object account codes established by NIS and used by the Council include:

**Assets** – Resources owned or held by a government that have monetary value. Assets include cash accounts, deposits with vendors, and receivable accounts. Cash accounts and deposits with vendors are also included in fund balance and are reported as recorded on NIS. DAS Accounting Division records all interest and dividend income (received and earned) as accounts receivable on NIS (Object Account 134590) as part of the reconciliation of Fund 77500. Earned income that is not received increases the receivable and increases the liability account used to distribute the income. Received income decreases the receivable and increases cash. These receivables did not increase revenues.

**Liabilities** – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions increase expenditures and decrease fund balance. DAS Accounting Division uses a liability account on NIS (Object Account 215190) to record other income, realized gains and losses, and management fees and to distribute the income to funds participating in the Operating Investment Pool. This liability account did not increase expenditures. The activity recorded in the liability account generally decreases cash. The net activity of this account each month is zero.

**Other Financing Sources** – Proceeds of fixed asset dispositions.

## NEBRASKA INVESTMENT COUNCIL

### NOTES TO THE SCHEDULE

(Continued)

#### 2. State Agency

The Nebraska Investment Council is a State agency established under and governed by the laws of the State of Nebraska. As such, the Council is exempt from State and Federal income taxes. The schedule includes the Nebraska Investment Council Cash Fund and the Operating Pool Distributive Fund.

The Nebraska Investment Council is part of the primary government for the State of Nebraska.

#### 3. Totals

The Totals "Memorandum Only" column represents an aggregation of individual account balances. The column is presented for overview informational purposes and does not present consolidated financial information because interfund balances and transactions have not been eliminated.

#### 4. General Cash

General cash accounts are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on those investments is allocated to funds based on their percentage of the investment pool.

#### 5. Capital Assets

Under NIS, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as expenditures. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) would be reported for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). The Council values all capital assets at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment that has a cost of \$1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized, as well as computers. Depreciation expenses would be reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend the asset's life is not capitalized.

Equipment is depreciated using the straight-line method with estimated useful lives of three years.



# NEBRASKA INVESTMENT COUNCIL

## NOTES TO THE SCHEDULE

(Continued)

### 5. Capital Assets (Concluded)

Capital asset activity of the Council for the fiscal year ended June 30, 2006, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets				
Equipment	\$ 38,871	\$ 948	\$ -	\$ 39,819
Less accumulated depreciation for:				
Equipment				35,305
Total capital assets, net of depreciation				\$ 4,514

### 6. Operating Investment Pool Activity (Fund 77500)

The activity recorded in Fund 77500 is the recording and distribution of income on the investments in the Operating Investment Pool and Time Deposit Open Account funds. DAS Accounting Division records the income earned on NIS and distributes the earned income to all funds designated for investment.

The Operating Investment Pool income transactions are recorded directly to the fund's accounts receivable and liability accounts, rather than through a revenue or expenditure account. These accounts offset the cash account. These transactions represent income earned on the funds, which are owed and distributed to funds making up the Operating Investment Pool. The cash account is negative since income is distributed when earned, before it is received. The following table shows the activity of the cash account. The balance represents dividends, interest, and net amortization receivable from the custodial bank.

Balance July 1, 2005	Net Earned Income Received	Net Earned Income Allocated	Balance June 30, 2006
\$ (14,472,969)	\$ 81,591,780	\$ (84,300,826)	\$ (17,182,015)

### 7. Fees on Investments

There are several fees that are charged against all investments. They are external manager fees, State Street Bank (SSB) fees, investment consultant fees, Treasury Management Fees, and the Nebraska Investment Council fees. The Nebraska Investment Council fees and the consultant

# NEBRASKA INVESTMENT COUNCIL

## NOTES TO THE SCHEDULE

(Continued)

### 7. Fees on Investments (Concluded)

fees paid from the recaptured commissions (see Note 8) are the only fees shown on the Council's financial schedule. Investment income is recorded net of these fees on the State of Nebraska's financial statements. (Investment transactions and balances are not recorded on the Council's financial schedule.) The Council's fees are recorded on the financial schedule of the Council and were reported as Sales and Charges. The consultant fees are recorded on the financial schedule of the Council and were reported as Miscellaneous Revenues. The following schedule shows the fees charged against investments for the fiscal year ended June 30, 2006:

External Manager Fees	
Abbott Capital	\$ 220,000
Acadian Asset Management, Inc.	633,089
Alliance Bernstein Institutional Investment Management	1,132,337
Ariel Capital Management, LLC	725,093
Baillie Gifford	843,540
Barclays Global Investors	981,374
Blackrock Financial Management	901,639
Dimensional Fund Advisors, Inc.	1,419,515
Goldman Sachs Asset Management	499,563
Grantham, Mayo, Van Otterloo & Co., LLC	2,609,862
Heitman	382,570
JP Morgan Investment Management, Inc.	620,566
MFS Global Equity	488,113
PIMCO	1,607,816
State Street Global Advisors	472,910
T. Rowe Price Associates, Inc.	580,320
UBS Global Asset Management (Americas), Inc.	570,432
Total External Managers' Fees	<hr/> 14,688,739
SSB Custodian Fee	1,056,089
SSB Cash Management Fees	203,636
SSB Securities Lending Fees	477,650
Ennis Knupp Consultant Fees	283,737
Nebraska Investment Council Fees	<hr/> 760,032
Total Investment Fees	17,469,883
State Treasurer – Treasury Management Fees	573,647
Total Fees Charged Against Investments at June 30, 2006	<hr/> <hr/> \$ 18,043,530

# NEBRASKA INVESTMENT COUNCIL

## NOTES TO THE SCHEDULE

(Continued)

### 8. Recaptured Commissions

Some of the assets managed by the Council received recaptured commissions from investment managers. The amount rebated was based on a certain percentage of the brokerage costs of trading and was negotiated between the Council and individual investment managers. The recaptured commissions were transferred into and subsequently held in a separate account at State Street Bank. As the Council disbursed money from this account to pay for expenses related to the Plans generating the commissions, they recorded a revenue and disbursement on NIS and also increased their appropriations by submitting the expenses to DAS Budget Division. The following schedule reconciles the recaptured commission account for the fiscal year ended June 30, 2006:

Beginning Balance July 1, 2005	\$	615,298
Recaptured Commissions and Interest Earned		120,781
Recaptured Commissions Used for Expenses		(382,231)
Recaptured Commissions Returned to Plans		(75,076)
Ending Balance June 30, 2006	\$	<u>278,772</u>

### 9. Lawsuit Against Council Dismissed by District Court; Appeal Pending

In 2001, a taxpayer filed a lawsuit against the Nebraska Investment Council, its members, the State Investment Officer, and other defendants in the District Court of Lancaster County, Nebraska. The plaintiff alleged a certain investment made by the Council in 2001 violated State law.

The matter involved an investment in an enhanced S & P 500 Index fund. Because of a downturn in the U.S. stock market in 2001, there were periods when the investment resulted in an unrealized loss. Subsequently, the market rebounded and the investment was sold at a gain.

The District Court dismissed most of the claims in July 2004 and dismissed the remaining claims in March 2005. The taxpayer appealed the case. The Nebraska Supreme Court ordered that the case bypass the Court of Appeals. Oral arguments before the Nebraska Supreme Court were held on September 7, 2006. The Nebraska Supreme Court has not yet rendered a decision.

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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NEBRASKA INVESTMENT COUNCIL  
**REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN EXAMINATION OF THE SCHEDULE OF  
REVENUES, EXPENDITURES, AND CHANGES IN FUND  
BALANCES PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council for the fiscal year ended June 30, 2006, and have issued our report thereon dated September 13, 2006. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

## Internal Control Over Financial Reporting

In planning and performing our examination, we considered the Nebraska Investment Council's internal control over financial reporting in order to determine our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Investment Council's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedule. A reportable condition is described in the Comments Section of the report as Comment Number 2 (Reconciliation of Bank Records to the Nebraska Information System).


A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the financial schedule being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Investment Council's schedule of revenues, expenditures, and changes in fund balances, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our examination, and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, and is described in the Comments Section of our report as Comment Number 1 (Permanent School Fund Investments and Income).

This report is intended solely for the information and use of the Council and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

September 13, 2006

  
Assistant Deputy Auditor

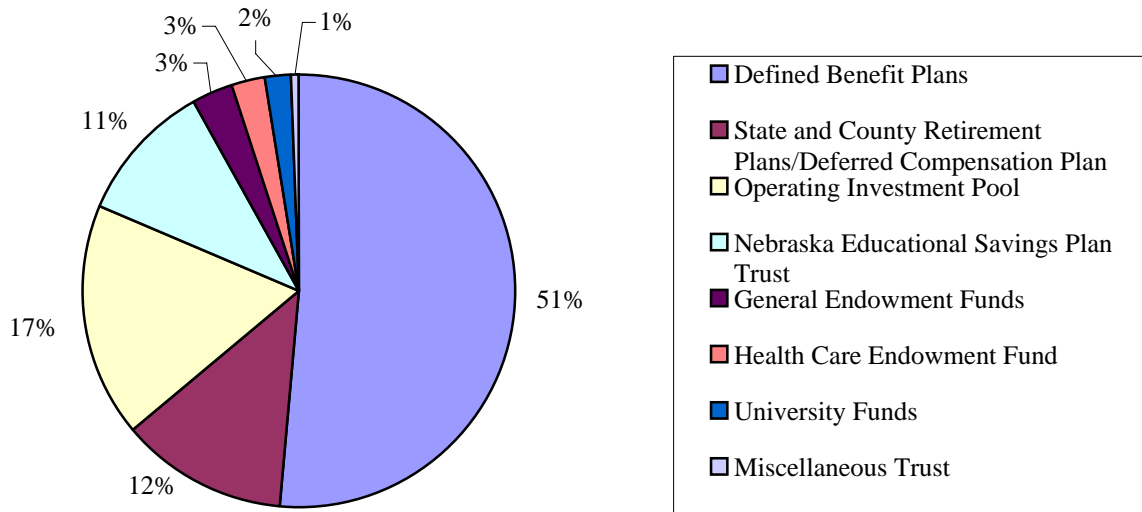
## NEBRASKA INVESTMENT COUNCIL

### **STATISTICAL SECTION**

Our examination was conducted for the purpose of forming an opinion on the schedule of revenues, expenditures, and changes in fund balances. Statistical Section information is presented for purposes of additional analysis. Such information has not been subjected to the procedures applied in the examination of the schedule of revenues, expenditures, and changes in fund balances, and, accordingly, we express no opinion on it.

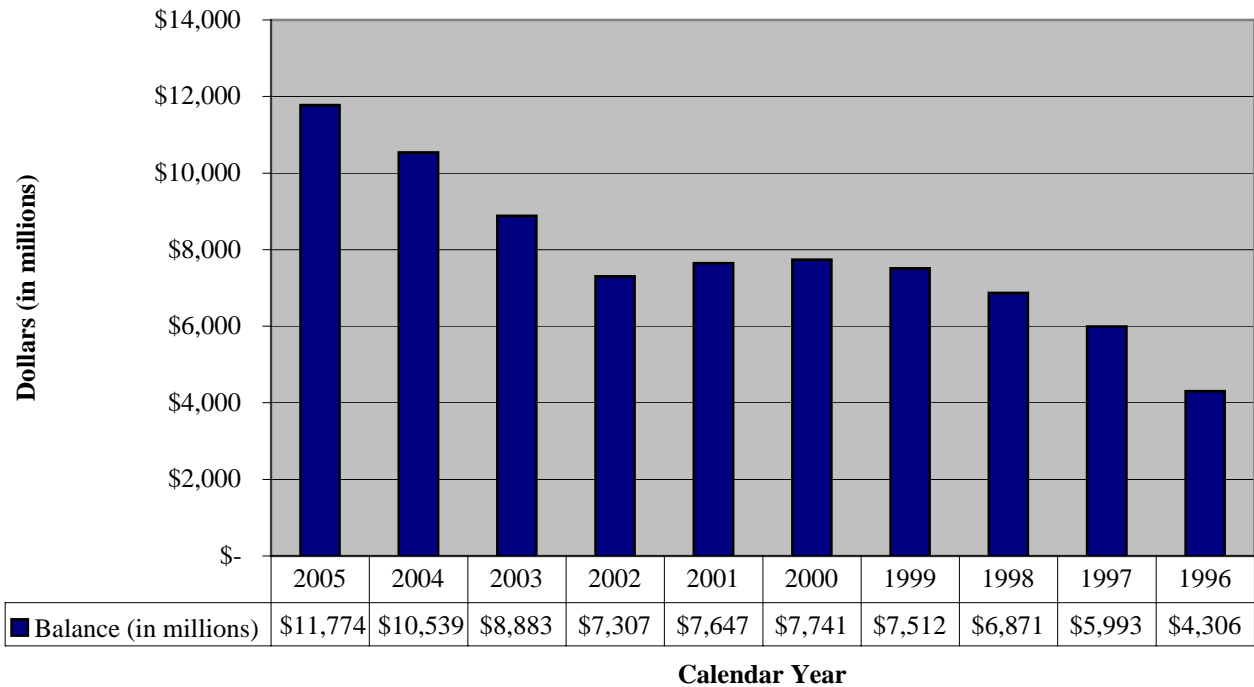
## NEBRASKA INVESTMENT COUNCIL

### Investments Managed as of December 31, 2005



The Nebraska Investment Council (Council) manages the investments of 30 different entities, not counting the many separate departments of State government included in the Operating Investment Pool. These entities fall into the eight major categories displayed above. For all these entities, the Council's responsibilities are primarily regarding asset management. It does not determine the amount of funds contributed to nor disbursed from the funds it manages.

### Closing Investment Balances at December 31st



Source: Nebraska Investment Council Calendar Year 2005 Annual Report.