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

**PENSION TRUST FUNDS OF THE STATE OF NEBRASKA**

**JANUARY 1, 2005 THROUGH DECEMBER 31, 2005**



**Issued on October 6, 2006**

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 eight members appointed by the Governor, with legislative approval, to five-year terms. Six of the appointed members shall be active or retired participants in the retirement system. The six members include:

- ♦ Two participants in the School Retirement System, consisting of one administrator and one teacher;
- ♦ One participant in the Nebraska Judges Retirement System;
- ♦ One participant in the Nebraska State Patrol Retirement System;
- ♦ One participant in the Retirement System for Nebraska Counties; and
- ♦ One participant in the State Employees Retirement System.

Two appointment members must meet the following requirements:

- ♦ One member shall not be an employee of the State of Nebraska or any of its political subdivisions; and
- ♦ One member shall have at least ten years of experience in the management of a public or private organization or have at least five years of experience in the field of actuarial analysis or the administration of an employee benefit plan.

Furthermore, the State Investment Officer serves as a nonvoting, ex-officio member.

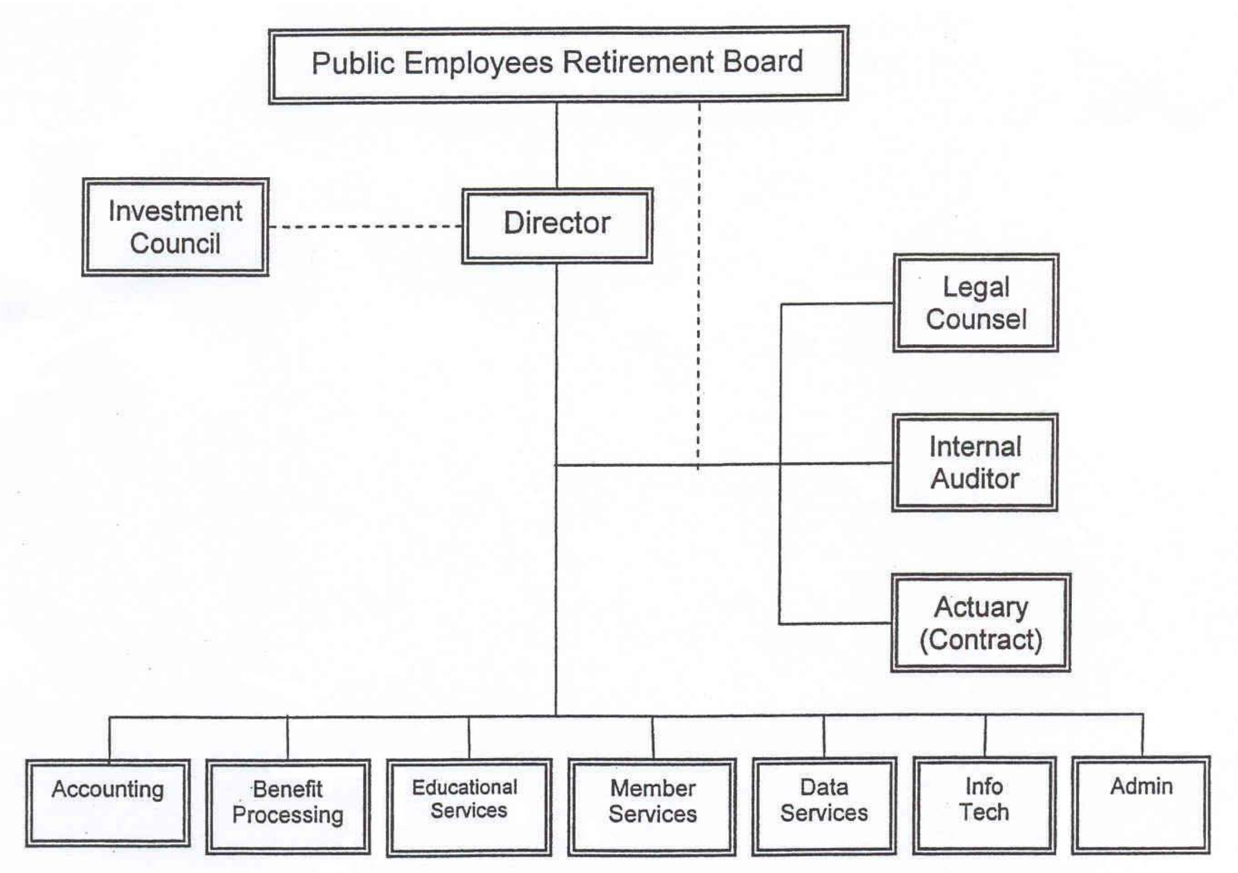
All appointed members must be Nebraska citizens. The Board meets monthly. As of July 1, 2005, members of the Board shall be paid fifty dollars per diem, and all members shall be reimbursed for actual and necessary expenses. The Board hires a director to manage the day-to-day operations. Expenses are 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 System 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
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

## ORGANIZATIONAL CHART



## EXIT CONFERENCE

An exit conference was held September 7, 2006, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our examination. Those in attendance for NPERS were:

| NAME | TITLE |
|---|---|
| Anna Sullivan | Director |
| Jane Bond | Member Services Manager |
| Joe Schaefer | Legal Counsel |
| Randy Gerke | Accounting & Finance Manager and Acting IT Manager |
| Cheryl Mueller | Auditor Associate |
| Teresa Zulauf | Internal Auditor |
| Denis Blank | Board Member |
| Glenn Camerer (via telephone) | Board Member |

## 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.*** ***Accounting Issues:*** Information provided by the NPERS accounting staff contained several errors which created extra work for the audit staff to verify and correct. There was limited knowledge of newly implemented accounting standards by NPERS accounting staff; no review was performed of information provided to the auditors by a second accountant or the Accounting Manager to ensure its accuracy; and errors were noted in percent allocations and calculations.

***2.*** ***Alternate Vesting Dates and Employer Forfeitures:*** There were 2 of 29 State Plan members and 1 of 30 County Plan members tested with an incorrect vesting date in OMNI. In addition, we noted NPERS did not verify members were properly vested when they terminated within 3 months of their vesting date. There was 1 State Plan member and 3 County Plan members tested whose employer accounts were either improperly forfeited or improperly paid out.

***3.*** ***Required Minimum Distributions:*** NPERS did not have adequate procedures to ensure required minimum distributions were properly calculated, paid timely, or were paid in accordance with Federal regulations, State statutes, and NPERS policy.

***4.*** ***Dividend Interest:*** Interest on the 2004 dividend for the Cash Balance Benefit members was not calculated and applied to members' accounts. The dividend earned approximately $175,457 in interest for the State Plan and $50,132 in interest for the County Plan between January 1, 2005, and June 24, 2005, when the dividend was distributed.

***5.*** ***County Plan Payroll Testing:*** We sampled payroll records in 23 counties and noted 8 counties did not adequately monitor non-participating, part-time employees' hours worked to ensure the mandatory contributions begin on time. There were also 8 employees that were not properly contributing to the Plans, two employees that began contributing to the Plan prior to becoming eligible, and one employee incorrectly contributed to the Plan for reimbursed expenses.

**SUMMARY OF COMMENTS**
(Continued)

6. ***Required Contribution Procedures:*** NPERS did not implement adequate procedures to ensure all required contributions were remitted. For 10 of 25 employees tested there was no documentation available to support NPERS had followed up on the individuals. One individual's vesting date was not properly adjusted after missed contributions were remitted and two rehired individuals did not begin contributing within 60 days per statute.

7. ***Inadequate Resolution of Prior Year Findings:*** NPERS inadequately resolved findings noted in prior audits from 2004 back to 2000 for the State and County Plans.

8. ***Plan Membership Eligibility:*** NPERS did not have adequate procedures to ensure only eligible employees entered the Plans. There was 1 of 30 State Plan members and 1 of 30 County Plan members who began contributing to the Plans before eligibility requirements were met.

9. ***PIONEER Concerns:*** We have identified areas of concerns or areas where improvement to PIONEER is needed to ensure the integrity of member data.

10. ***Member Address Changes:*** NPERS did not have adequate procedures to ensure address changes made to the OMNI system were properly authorized.

11. ***Initial Contributions:*** NPERS did not clearly state whether initial contributions should be pro-rated for the pay period that included the initial contribution. There were 16 of 29 new State Plan members tested whose initial retirement contribution was pro-rated by the system.

12. ***Required Rules and Regulations:*** We noted six State statutes that reference a corresponding rule and regulation, but NPERS did not have official rules and regulations for the statutes. In addition, one State statute required the Board to set a date for late fees. The Board had not set a date.

13. ***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 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.

**SUMMARY OF COMMENTS**
(Continued)

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. Accounting Issues

Good internal control requires the financial accounting and report disclosures to be complete and accurate.

Governmental Accounting Standards Board (GASB) Statement Number 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Deposit and investment policies related to the risks identified in the statement should be disclosed. The Statement was issued in March 2003, with an effective date for periods beginning after June 15, 2004. The State of Nebraska first implemented the Statement in conjunction with the issuance of the June 30, 2005, Comprehensive Annual Financial Report (CAFR) for the State of Nebraska. Significant work was performed by the Department of Administrative Services (DAS) Accounting Division with the help of the Nebraska Investment Council to prepare the appropriate disclosure information for the CAFR. For the June 30, 2005, School Employees, Judges, and State Patrol Retirement Plans audit, we were able to use the information prepared by DAS Accounting Division for the GASB 40 disclosures.

The NPERS accounting staff had very limited knowledge of GASB Statement Number 40. It appeared the accounting staff relied mostly on the information obtained during the June 30, 2005, CAFR audit, as opposed to obtaining an independent understanding and verification of the information. There was also no review of the information provided to the auditors by a second accountant or the Accounting Manager to ensure its accuracy, even after this was discussed with NPERS in June 2006. The following is a timeline of events and issues related to the GASB 40 information provided by NPERS:

- In January 2006, we notified NPERS of the new GASB 40 requirements and the need for NPERS to work with DAS Accounting Division to prepare this information on a calendar year end basis for the State and County Retirement Plans. NPERS immediately asked DAS Accounting Division for assistance.

- In February 2006, DAS Accounting Division indicated they had met with NPERS and provided the GASB 40 information.

- In March 2006, NPERS confirmed to the auditors they had received the information on the GASB 40 disclosures from DAS Accounting Division.

- The entrance conference for the State and County Employees Retirement Plans audit was held in April 2006. The GASB 40 information was again discussed.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**1. Accounting Issues** (Continued)

- On May 3, 2006, we received the first version of NPERS GASB 40 disclosures. It should be noted that the original investment holdings reports were received by NPERS from DAS Accounting Division who had access to the investment holdings information from the trustee bank. We quickly determined the first version did not include all of the funds. The new investor select fund was missing.

- A new version of the required disclosures was received on May 26, 2006. We determined the classifications of several individual securities had changed from the original version. After discussions with DAS Accounting Division, the Nebraska Investment Council, and State Street Bank, we determined the reason behind these reclassifications.

- We received three other versions of the disclosure information from NPERS before we received the final version on July 7, 2006. This version also had what we considered to be material misclassification of certain investments. We used this version and reclassified all material misclassifications we noted. After further testing, we determined the classification of the investments was materially correct.

We also noted other errors in the GASB Statement Number 40 financial information provided by the accounting staff. There were errors in the allocation percentages used to allocate the defined contribution options and the cash equivalent information was not in accordance with the accounting standards.

The procedures noted above created extra work for the audit staff to verify and correct information submitted by NPERS, which prevented an efficient completion of the audit.

We also had the following concerns related to other financial information provided by NPERS:

- During the process described above, we determined the State and County Equal Retirement Benefit Fund assets had been transferred from one fund in 2004 to four separate funds in 2005. NPERS could not provide an explanation for this change, so the information was obtained from the Nebraska Investment Council.

- There were allocation and calculation errors noted with securities lending information, interest receivable and payable information, master lease information, capital asset depreciation, and compensated absences payables. We feel strongly that an independent review of the information would alleviate many of the errors noted.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**1. <u>Accounting Issues</u>** (Concluded)

Without procedures to ensure financial information provided to the auditors is complete and accurate, there is a significant risk for materially misstated financial statements.

> We recommend NPERS implement procedures to ensure financial information provided to the auditors is complete and accurate. This would include a documented review of all information provided by the Accounting Manager, or another accountant with adequate knowledge of the requested information.

*NPERS' Response: This was the first year our office was required to provide information pertaining to Governmental Accounting Standards Board (GASB) Statement Number 40. We relied on the information provided to us by the Department of Administrative Services (DAS) Accounting Division.*

*We realize the information given to the auditors should have been more complete and accurate. Staff will meet, discuss procedures and implement procedures to make sure this does not occur in future audits. We will also have documented reviews completed by the Accounting/Finance Manager or another accountant in our office.*

**2. <u>Alternate Vesting Dates and Employer Forfeitures</u>**

Neb. Rev. Stat. Sections 23-2319(3) and 84-1321(3) R.S.Supp., 2004 states, "Members of the retirement system shall be vested after a total of three years of participation in the system, including eligibility and vesting credit."

Neb. Rev. Stat. Section 23-2319.01(1) R.S.Supp., 2005 states, "For a member who has terminated employment and is not vested, the balance of the member's employer account or employer cash balance account shall be forfeited."

Good internal control requires procedures to ensure alternate vesting dates recorded in the system are accurate and to ensure individuals are properly paid their employer account at termination. Good internal control also requires procedures to ensure members who have terminated and been paid out are properly notified if additional monies are owed to them.

## 2. Alternate Vesting Dates and Employer Forfeitures (Continued)

There were 2 of 29 State Plan members tested with an incorrect vesting date in OMNI, the system used by the record keeper. Both individuals remitted missed contributions. However, their vesting dates were not changed to reflect the missed contributions that were remitted. There was also 1 of 30 County Plan members tested with an incorrect vesting date in OMNI. This was also noted in the prior audit.

Incorrect information regarding alternate vesting dates may lead to employees incorrectly receiving or not receiving employer contributions at termination.

We also noted NPERS did not verify members were properly vested when they terminated within three months of their vesting date to ensure the employer account was properly paid. This procedure was implemented to mitigate the risk of incorrect vesting dates. The OMNI system automatically entered the plan entry date and alternate vesting date as the first of the month in which the first contribution posted. This is generally one month after the employee is actually paid (for monthly employees). We also noted NPERS failed to contact members who terminated and were paid, but still maintained an account balance, to inform them of additional amounts owed.

- We noted at least two State Plan members employer accounts were improperly forfeited. One member had vested, but the employer account was not properly paid. The amount improperly forfeited was $4,620. The other member had a vesting credit application on file and had vested, but the employer account was not properly paid. The balance of the account at April 30, 2006, was $1,135. Neither member was notified of the error until after the auditors brought it to NPERS' attention.

- We also noted four County Plan members tested whose employer accounts were either improperly forfeited or improperly paid. Two members were improperly paid their employer accounts of $4,080 and $2,412. These two members were not vested; therefore, their employer accounts should have been forfeited. Two members also had their employer account improperly forfeited. One member's employer account of $2,864 was improperly forfeited. The member was vested and therefore owed the employer account. The other member's employer account of $1,026 was also improperly forfeited. This member had a vesting credit application on file, and was vested. This member was also owed the employer account. Neither member was notified of the amounts owed to them until after the auditor brought this to NPERS' attention.

**2. <u>Alternate Vesting Dates and Employer Forfeitures</u>** (Concluded)

Without adequate procedures to ensure vesting credit dates in OMNI are accurate or to verify vesting at termination, there is an increased risk that the employer accounts are not properly paid when members retire. Additionally, without proper procedures to review and notify terminated members of remaining account balances, there is a significant risk all monies owed to members will not be distributed.

> We recommend NPERS implement procedures to ensure vesting dates are accurate in OMNI. We also recommend NPERS implement procedures to ensure the employer account is properly paid when a member terminates. Finally, we recommend NPERS implement procedures to ensure terminated members with account balances are properly notified of additional amounts owed to them.

*NPERS' Response: Staff is to review the vesting dates prior to a distribution of a member's account. We will review the procedures with staff and make changes as necessary. We will begin sampling/testing of terminated members to ensure terminated members are properly paid their requested account balance. Staff will meet to discuss implementing procedures to properly notify terminated members of any additional amounts owed to them.*

**3. <u>Required Minimum Distributions</u>**

26 C.F.R. Section 1.401(a)(9) states a required minimum distribution (RMD) must be paid by April 1 of the calendar year following the later of the calendar year in which the employee attains age 70 ½, or the calendar year in which the employee retires.

Neb. Rev. Stat. Sections 84-1317(3) and 23-2315(3) R.S.Supp., 2004 states, "Payment of any benefit provided under the retirement system may not be deferred later than April 1 of the year following the year in which the employee has both attained at least age seventy and one-half years and terminated his or her employment with the state (county)."

Neb. Rev. Stat. Section 84-1319(1) R.S.Supp., 2004 states, "A retiring employee may receive a benefit not to exceed the amount in his or her employer and employee accounts as of the date of final account value payable in a lump sum and, if the employee chooses not to receive the entire amount in such accounts, an annuity equal to the actuarial equivalent of the remainder of the retirement value, and the employee may choose any form of such annuity as provided for by the board."

## COMMENTS AND RECOMMENDATIONS
(Continued)

### 3. Required Minimum Distributions (Continued)

NPERS has developed an internal policy related to the calculation and handling of required minimum distributions. NPERS policy states, in part, all minimum distributions must be taken through the current calendar year before amounts can be rolled to another institution. The policy also provides for the calculation of the minimum distribution as follows: divide the account balance at the end of the calendar year prior to the minimum distribution year by the distribution period. The factor used is determined by the member's and/or spouse's age at their birthday during that calendar year (which should be the same as their age at the end of the calendar year). Finally, the policy states, if two distributions are taken in one calendar year, you must use the balances at the end of each of the two prior calendar years. When making the calculation for the second year, reduce the balance of the prior year by the amount of the prior year calculation.

NPERS did not have adequate procedures to ensure required minimum distributions were calculated correctly and paid timely, in accordance with Federal regulations, State statutes, and NPERS policy. We noted the following:

State Plan

- One of five State Plan member's required minimum distribution was calculated incorrectly. The 2004 distribution was calculated using the wrong year's ending balance. The individual's distribution was $539 higher than required.

- Two cash balance benefit members' accounts were rolled over after having received an RMD payment. The individuals were required, per statute, to take an annuity.

County Plan

- Two of eleven members tested did not receive the required minimum distribution timely. One member did not receive the required minimum distribution for 2005. The other member was paid the 2004 minimum distribution 10 days late.

- Two of six members' minimum distributions were not calculated correctly. One member's 2004 distribution was calculated using the wrong year's ending balance. The individual's distribution was $609 higher than required. One member's distribution was calculated using the wrong age factor. The individual's distribution was $110 higher than required.

- Two of six members tested did not receive all required minimum distributions prior to rolling over their account to another institution, as required by NPERS policy.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**3. Required Minimum Distributions** (Concluded)

County Plan (Concluded)

- One of six members received the 2004 and 2005 minimum distribution in one payment. The 2004 distribution was not paid timely. It should have been disbursed by April 1, 2005; however, the payment was not made until September 27, 2005, with the 2005 distribution. In addition, the 2005 distribution was not calculated using the correct account balance. The 2004 distribution should have been reduced from the balance used to calculate the 2005 distribution, per NPERS policy. This resulted in a minimal variance. Furthermore, the individual was a cash balance member and was required to receive an annuity after the minimum distribution; however, the individual was allowed to rollover the account balance to another institution.

Without adequate procedures to ensure compliance with Federal regulations and State statutes there is an increased risk the Plans could lose their status as qualified retirement plans.

> We recommend NPERS ensure required minimum distributions are properly paid in accordance with Federal regulations, State statutes, and NPERS policies.

*NPERS' Response: We are taking action to update our procedures and will provide additional training to staff to ensure the calculation of required minimum distributions are accurate and correct.*

**4. Dividend Interest**

Board Policy Number 10, on the granting of a dividend to members of the cash balance benefit, states, "Since the dividend will not be granted until sometime after January 1st, the value of the dividend will be credited with interest between the January 1st and the dividend distribution date, using the interest credit rate earned on regular contributions for the same period." Good internal control requires procedures to ensure dividend distributions are made in accordance with Board policy.

NPERS did not have adequate procedures to ensure the interest on dividends was calculated and distributed in accordance with Board policy. Interest on the 2004 dividend for the Cash Balance Benefit members was not calculated and applied to members' accounts until after the issue was brought to NPERS attention by the auditors. The dividend earned approximately $175,457 in interest for the State Plan and $50,132 in interest for the County Plan between January 1, 2005,

**4. <u>Dividend Interest</u>** (Concluded)

and June 24, 2005, when the dividend was distributed. These amounts should have been distributed to the members' accounts with the initial dividend payments. The interest was subsequently distributed to members or members' accounts in June 2006.

Without adequate procedures to ensure the dividend interest is calculated and distributed, members may not receive all monies owed.

> We recommend NPERS implement procedures to ensure dividend interest is properly calculated and credited to members' accounts in compliance with Board policy.

*NPERS' Response: The dividend interest has been distributed to the member's accounts. We will review the events that lead to this error and implement procedures to prevent this from happening in the granting of future dividends.*

**5. <u>County Plan Payroll Testing</u>**

Neb. Rev. Stat. Section 84-1503(2)(b) R.S.Supp., 2004 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 R.S.Supp., 2004 states, "(1) 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. (2) 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., 2004 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."

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

Neb. Rev. Stat. Section 23-2301(24) R.S.Supp., 2004 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."

Neb. Rev. Stat. Section 23-2305.01(1) R.S.Supp., 2004 states, "If the board determines that the retirement system has previously received contributions or distributed benefits which for any reason are not in accordance with the statutory provisions of the County Employees Retirement Act, the board shall refund contributions, require additional contributions, adjust benefits, or require repayment of benefits paid."

Neb. Rev. Stat. Section 23-2301(5)(a) R.S.Supp., 2004 defines compensation as the gross wages or salaries payable to the member for personal services performed during the plan year. Compensation does not include reimbursement for expenses incurred.

Good internal control requires NPERS to review county payroll information to ensure all eligible employees are enrolled in the Plan and to ensure the contributions are correctly withheld and census information is accurate.

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

- Eight of 23 counties tested did not adequately monitor non-participating, part-time employees' hours worked. Therefore, the counties could not identify whether employees switched to full-time status in order to correctly enroll employees in the Plan. The eight counties were Dodge, Hall, Hamilton, Howard, Jefferson, Seward, Stanton, and York.

  There were several of these counties, as noted below, that had employees who should have been participating in the Plan and were not. A similar finding was also noted in the prior audit.

- Eight employees tested were not properly contributing to the Plan as required by statute. There were two employees each from Burt, Dodge, and Stanton counties; and one each from Fillmore and Knox counties. The employees missed from seven months to in excess of two years. All eight employees are required to remit the missed contributions. A similar finding was noted in the prior audit.

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

- Two employees began contributing to the Plan prior to becoming eligible. A York County employee began contributions five months prior to meeting eligibility requirements. The individual should be refunded five months of ineligible contributions. An employee from Pawnee County also began contributions immediately upon hire for three pay periods. However, the county stopped the withholding after the error was discovered, but the ineligible contributions have not been refunded.

- One employee from Stanton County incorrectly contributed to the Plan for reimbursed expenses. The individual was reimbursed for uniform and cell phone expenses. This should not have been included in the retirement calculation.

- NPERS did not verify whether counties correctly input the retirement percentage in the field that is used to extract retirement information or whether the counties correctly input census information for each employee. A similar finding was noted in the prior audit.

NPERS began procedures in 2005 to sample county payroll data, but the sampling at the time of the audit was limited and was not relied on. NPERS did not test non-contributing members separately. Therefore, our reliance for that test would be limited.

Without adequate procedures to ensure all eligible and only eligible employees participate in the County Employees Retirement Plan as required by statute, there is an increased risk all eligible employees are not participating in the Plan. In addition, there is an increased risk incorrect contribution rates and census data are used without procedures to sample payroll data at the counties.

> We continue to recommend NPERS implement procedures to ensure employees are properly contributing to the Retirement Plan as require by statute. In addition, we recommend NPERS implement procedures to review information entered by counties to ensure the accuracy of that information and that contributions are being withheld correctly. Finally, we recommend NPERS resolve the issues noted in this finding with the counties.

*NPERS' Response: We have updated our procedures and are working with the county employers to make sure all eligible employees are contributing to the plan at the correct rate. We will work with the county employers to resolve the issues brought to our attention by the auditors.*

**COMMENTS AND RECOMMENDATIONS**
(Continued)

## 6. Required Contribution Procedures

Good internal control requires procedures to ensure all eligible employees are enrolled in the Plan. In addition, good internal control requires procedures to monitor missed contributions to ensure missed contributions are properly remitted and remitted in accordance with NPERS Rules and Regulations.

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 18-002.08 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."

Neb. Rev. Stat. Section 84-1322(2)(a) R.S.Supp., 2004 states, "A member who ceases to be an employee … and again becomes a permanent full-time or permanent part-time state employee prior to having a five-year break in service shall be reenrolled in the retirement system and resume making contributions within sixty days."

NPERS obtained a report from the Nebraska Information System (NIS) of State employees who were not contributing to the Plan. As part of their procedures to ensure all members properly contributed to the Plan, NPERS process was to follow up with the agency to ensure members began contributions on time or were properly remitted missed contributions.

As noted in prior audits, NPERS did not have adequate procedures to ensure State employees enrolled in the Plan timely, missed contributions were correctly calculated and remitted, and alternate vesting dates were properly adjusted for members who remitted missed contributions.

We tested 25 of 110 employees from the January 2006 report and noted the following:

- For 10 of 25 employees, NPERS indicated they had followed up on the individuals; however, there was no documentation available to support this claim.

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

- One individual remitted missed contributions; however, the vesting date was not adjusted in OMNI to reflect the missed contributions were remitted. The vesting date in OMNI was three months off.

- Two individuals were rehired with the State, but did not begin contributing within 60 days per statute. Both individuals missed contributions for one pay period.

Without adequate procedures to ensure required contributions are properly and timely remitted, the Plans are not in compliance with State statutes. Incorrect information regarding alternate vesting dates may lead to employees incorrectly receiving or not receiving employer contributions at termination.

> We recommend NPERS adequately document the procedures to follow up with agencies that have employees that are not properly enrolled in the Plan. We also recommend NPERS implement adequate procedures to ensure required contributions are remitted and remitted timely. We recommend NPERS implement procedures to ensure alternate vesting dates are properly adjusted when missed contributions are remitted. 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 work with staff to make sure procedures are properly documented and all follow up with employers is accurately documented.*

**7. <u>Inadequate Resolution of Prior Year Findings</u>**

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

a. Four findings from the 2004 audit of the State Plan were not adequately resolved. NPERS provided documentation that the employee and or employer had been contacted; however, the issues were still not adequately resolved.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**7. Inadequate Resolution of Prior Year Findings** (Continued)

- One member missed required contributions. A make-up agreement was submitted, indicating missed contributions would be remitted from November 2005 through January 2006. However, per review of the accounting system, no missed contributions were remitted.

- One member and employer over-contributed to the Plan. A refund has not been processed.

- Two members' contributions were not correct because the retirement contribution was not calculated on their total gross earnings. Make-up agreements had not been completed and missed contributions were not remitted.

b. Thirteen findings from the 2004 audit of the County Plan were not adequately resolved.

- 2 of 23 counties tested did not adequately monitor part-time employees to ensure enrollment requirements were met. The 2 counties were Hayes and Thurston. NPERS did not provide documentation to support whether the counties were contacted.

- 2 of 23 counties tested did not adequately monitor employees who will or will soon be required to join the plan to ensure mandatory contributions began on time. The 2 counties were Hayes and Hooker. NPERS did not provide documentation to support whether the counties were contacted.

- Three members missed required contributions. The individuals remitted missed contributions; however, no agreements were on file and no documentation was provided to ensure the amounts made up were correct.

- Three employees missed required contributions. It did not appear the individuals remitted missed contributions and no make-up agreements were on file. NPERS did not provide documentation to support whether the counties were contacted.

- Five employees began contributing to the Plan prior to meeting the eligibility requirements for Plan participation. All five employees need to be refunded contributions for one pay period.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**7. <u>Inadequate Resolution of Prior Year Findings</u>** (Concluded)

c. Two findings from the calendar year 2003 audit of the State Plan and five findings from the calendar year 2003 audit of the County Plan were not adequately resolved.

d. Two findings from the calendar year 2002 audit of the County Plan were not adequately resolved.

e. Three findings from the calendar year 2001 audit of the County Plan were not adequately resolved.

f. One finding from the calendar year 2000 audit of the State Plan was not adequately resolved.

Without adequate procedures for the timely follow up of previously identified problems, errors detected in testing remain unresolved. Additionally, State agencies and counties are not made aware of errors timely in order to resolve the issues.

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

*NPERS' Response: We have implemented procedures and will review those procedures to determine where improvements can be made. We have notified state agencies and county employers of audit exceptions and have worked with them to resolve the issues. We will continue to work with the employers to resolve prior audit findings.*

**8. <u>Plan Membership Eligibility</u>**

Neb. Rev. Stat. Section 84-1307(2) R.S.Supp., 2004 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. An employee who exercises the option to begin participation in the retirement system pursuant to this section shall remain in the retirement system until his or her termination of employment or retirement, regardless of any change of status as a permanent or temporary employee."

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**8. Plan Membership Eligibility** (Continued)

Neb. Rev. Stat. Section 23-2306 R.S.Supp., 2004 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. (2) 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 retirement system until termination or retirement, regardless of any change of status as a permanent or temporary employee."

Neb. Rev. Stat. Section 23-2305.01(1) R.S.Supp., 2004 states, "If the board determines that the retirement system has previously received contributions or distributed benefits which for any reason are not in accordance with the statutory provisions of the County Employees Retirement Act, the board shall refund contributions, require additional contributions, adjust benefits, or require repayment of benefits paid."

Good internal control requires procedures to ensure only eligible employees participate in the State and County Retirement Plans, as required by statute.

NPERS did not have adequate procedures to ensure only eligible employees entered the Plans.

- There was 1 of 30 new State Plan members tested who did not meet the requirements for membership in the Plan. The member began contributing to the Plan four months before eligibility requirements were met. The employee and employer need to be refunded ineligible contributions in the amount of $192. A similar finding was noted in the prior audit.

- There was also 1 of 30 new County Plan members tested who did not meet the requirements for membership in the Plan. The member began contributing to the Plan one month before eligibility requirements were met. The employee and employer need to be refunded ineligible contributions in the amount of $238. A similar finding was noted in the prior audit.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

## 8. Plan Membership Eligibility (Concluded)

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

> We continue to recommend NPERS implement procedures to ensure only eligible employees contribute to the Plan. We also recommend any ineligible contributions be refunded.

*NPERS' Response: We will review the procedures in place and work with staff to make sure only eligible employees are contributing to the Plan. We will contact the employers and have the ineligible contributions refunded to the member.*

## 9. PIONEER Concerns

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Good internal control would also require a second individual review all changes made to member accounts.

NPERS utilized an information system known as PIONEER that contains critical data on members in each of the Plans administered by NPERS. PIONEER calculates benefit payments to members and also contains critical data used by the actuary to determine actuarial assets and liabilities and to determine whether the Plans are adequately funded. The following areas of concern were noted:

- A comprehensive, written PIONEER policy and procedures manual has not been prepared to describe specific policies or procedures related to processing transactions in the system.
- There were no specific written security procedures. PIONEER did not automatically time-out for users who had been inactive for a period of time.
- There was no system control to require an audit of changes made to member addresses by employees who work on Benefits and Refunds.

Without written procedures and adequate controls over PIONEER, there is a risk employees may unintentionally or intentionally corrupt critical data and errors could occur and go undetected. A similar finding was noted in the prior audit.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**9. PIONEER Concerns** (Concluded)

> We recommend NPERS ensure policies and procedures are established in regards to the PIONEER system. We further recommend that security issues are addressed appropriately and timely.

*NPERS' Response:*

- *NPERS understands the need for a PIONEER policy and procedures manual. The PIONEER policy and procedures manual has been started. This is being done in conjunction with staff developing process instructions and procedures for Disaster Recovery Plan. NPERS will continue to develop this manual.*

- *NPERS is in the process of writing security procedures for PIONEER. Additionally, NPERS has asked for an estimate of time and cost to implement a time-out for users. We will evaluate for cost effectiveness and perhaps implement when we receive the proposal.*

- *NPERS has requested an estimate to add the feature to audit changes made to member addresses by employees who work on Benefits and Refunds from the software vender. We will evaluate for cost effectiveness and perhaps implement when we receive the proposal.*

**10. Member Address Changes**

Good internal control requires procedures to ensure changes made to member's addresses are properly authorized.

NPERS did not have adequate procedures to ensure any address changes made to the OMNI system were properly authorized. Screen shots of the old address in the system were printed with the new address manually written on the screen shot. There was no comparison of the change made to the actual signed address change request form by the individuals performing the review of the change.

Without adequate controls to ensure member address changes are authorized there is an increased risk fraudulent benefit payments could be processed, if a staff member fraudulently changed the address of a member.

> We recommend NPERS implement procedures to ensure address changes are properly authorized by comparing the address in OMNI to the address authorized by the member in writing.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

**10. Member Address Changes** (Concluded)

*NPERS' Response: We will review and update our procedures concerning address changes. Staff will be made aware of the importance of the comparison of the address to signed original supporting documentation.*

**11. Initial Contributions**

The Nebraska State Retirement System Manual states, "You [the employer] are required to start retirement deductions for a new plan member within the first full pay period after his/her eligibility date and in all cases before 60 days has elapsed."

Sound business practices require clear policies to ensure consistency in the reporting of initial contributions.

NPERS' policy did not clearly state whether initial contributions should be pro-rated for the pay period that included the initial contribution. NPERS has verbally indicated they did not intend for initial contributions to be prorated. This was a comment in the prior audit report.

The State accounting system calculates the retirement contribution based on the work dates entered in the system. The retirement contribution will only be calculated for any work date on or after the retirement begin date entered on the system. Therefore, the system was built to prorate the contributions based on these dates. NPERS did not provide documentation to indicate this issue had been communicated with the State agencies. There were 16 of 29 new State Plan members tested whose initial retirement contribution was pro-rated by the system.

Without a clear, communicated policy defining when the initial retirement contributions should begin, the initial contributions are not consistently determined for each employee by State agencies.

> We recommend NPERS develop clear policies regarding initial contributions to ensure the pay period of the initial contribution include wages eligible for the deduction. In addition, we recommend NPERS work with the NIS team to address the use of prorating in the system or notify all employers of the correct procedures for the initial retirement contribution.

*NPERS' Response: We will contact the Nebraska Information System team and discuss the issue of prorating in the system. We will notify all state agency employers of the proper procedures for the initial retirement contribution.*

**COMMENTS AND RECOMMENDATIONS**
(Continued)

## 12. Required Rules and Regulations

Good internal control requires procedures to ensure rules and regulations required by statute are created.

The Board had not developed a rule and regulation for several statutes as noted:

- Neb. Rev. Stat. Sections 23-2306(7) and 84-1307(6) R.S.Supp., 2004 state, "… that employees authorized to participate in the retirement system … shall enroll and make required contributions to the retirement system within sixty days under rules and regulations adopted and promulgated by the board."

- Neb. Rev. Stat. Section 23-2306.02 R.R.S. 1997 states, "Under such rules and regulations as the retirement board adopts and promulgates, a full-time or part-time employee of a city, village, or township who becomes a county employee pursuant to a merger of services may pay to the retirement system an amount equal to the sum of all deductions which were made from the employee's compensation."

- Neb. Rev. Stat. Section 23-2306.03 R.S.Supp., 2004 states, "Under such rules and regulations as the retirement board adopts and promulgates, a full-time or part-time employee of a city, village, fire protection district, or township who becomes a municipal county employee shall transfer all of his or her funds in the retirement system of the city, village, fire protection district, or township by paying to the Retirement System."

- Neb. Rev. Stat. Sections 23-2320(2)(a) and 84-1322(2)(a) R.S.Supp., 2004 state, "A member who ceases to be an employee before becoming eligible for retirement … and again becomes a permanent full-time or permanent part-time county (state) employee prior to having a five-year break in service shall be reenrolled in the retirement system and resume making contributions within sixty days under rules and regulations adopted (established) by the board."

We also noted the Board has not set a date for late fees as required in the following statute, Neb. Rev. Stat. Section 23-2308 R.S.Supp., 2005 states, "The board may charge the county an administrative processing fee of twenty-five dollars if the reports of necessary information or payments made pursuant to this section are received later than the date on which the board requires that such information or money should be received."

Lack of rules and regulations where required by statutes can cause inconsistency in handling of issues.

**COMMENTS AND RECOMMENDATIONS**
(Continued)

## 12. Required Rules and Regulations (Concluded)

We recommend the Board develop official rules and regulations as required by the statutes mentioned above.

*NPERS' Response: All changes or updates to Rules and Regulations have been prioritized by importance. Due to the passage of LB 366 (2006), additional changes and/or updates are being made. NPERS currently has changes pending which address enrollment of members, remittance of required contributions, and assessment of late charges. These will be reviewed by the Public Employees Retirement Board after which hearing dates will be set and the process completed.*

## 13. 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 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.

## COMMENTS AND RECOMMENDATIONS
(Continued)

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

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 timelier 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.

*NPERS' Response: The responsibility for resolving this issue lies with the State of Nebraska Department of Administrative Services (DAS) and the Nebraska Information System implementation team.*

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## INDEPENDENT AUDITORS' REPORT

Nebraska Public Employees Retirement Board
Lincoln, Nebraska

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 and for the calendar year ended December 31, 2005, 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, 2005, 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 described in Note 13 to the financial statements, NPERS adopted in 2005 the provisions of Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment to GASB Statement No. 3.*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2006, 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 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 or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing 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 the 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," "Calendar Year 2005 Expenses and Fees," "Average Administrative Expense per Member for Calendar Year 2005," and "Total Benefits Paid" are presented for purposes of additional analysis and are not a required part of the financial statements of the Nebraska Public Employees Retirement Systems - State and County Employees Retirement Plans. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects in relation to the financial statements taken as a whole.

Pat Reding, CPA

September 7, 2006 — Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE EMPLOYEES RETIREMENT PLAN
**STATEMENT OF PLAN NET ASSETS**
AS OF DECEMBER 31, 2005

| ASSETS | STATE CASH BALANCE BENEFIT | STATE DEFINED CONTRIBUTION |
|---|---|---|
| Cash in State Treasury | $ 46,256 | $ 1,272,914 |
| Receivables: | | |
| Contributions | 2,396 | 604 |
| Interest | 1,441,579 | 197,230 |
| Other Receivables (Note 11) | 5,980,686 | - |
| Total Receivables | 7,424,661 | 197,834 |
| Investments, at fair value (Note 3): | | |
| U.S. Treasury Securities | 11,287,413 | - |
| U.S. Agency Securities | 25,670,923 | - |
| Corporate Bonds | 12,295,491 | - |
| Equity Securities | 45,121,652 | - |
| Options | (29,698) | - |
| Taxable Municipal Bonds | 187,562 | - |
| Real Estate Investment Trust | 9,567,191 | - |
| Asset Backed Securities | 4,530,255 | - |
| Collateralized Mortgage Obligations (CMOs) | 4,943,331 | - |
| Mutual Funds | 28,669,146 | 60,891,916 |
| Pooled Funds | 205,136,127 | 484,125,072 |
| Investment Contracts | 3,156,546 | 96,458,321 |
| Repurchase Agreements | 2,519,053 | - |
| Commercial Paper, Money Market Funds and Foreign Currency | 11,595,467 | 56,462,705 |
| Total Investments | 364,650,459 | 697,938,014 |
| Invested Securities Lending Collateral (Note 3) | 16,061,959 | 2,808,640 |
| Capital Assets (Note 9): | | |
| Equipment | 2,104,130 | 1,099,992 |
| Less: Accumulated Depreciation | (680,500) | (625,610) |
| Total Capital Assets | 1,423,630 | 474,382 |
| Total Assets | 389,606,965 | 702,691,784 |
| **LIABILITIES** | | |
| Compensated Absences (Note 6) | 10,162 | 19,817 |
| Other Payables (Note 11) | 15,274,652 | 130,720 |
| Benefits Payable | 444,393 | - |
| Obligations Under Securities Lending (Note 3) | 16,061,959 | 2,808,640 |
| Capital Lease Obligations (Note 5) | 1,355,239 | 621,576 |
| Total Liabilities | 33,146,405 | 3,580,753 |
| Net assets held in trust for pension benefits (A schedule of funding progress for each cash balance benefit plan is presented on page 53.) | $ 356,460,560 | $ 699,111,031 |

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, 2005

| ASSETS | COUNTY CASH BALANCE BENEFIT | COUNTY DEFINED CONTRIBUTION |
|---|---|---|
| Cash in State Treasury | $ 25,217 | $ 30,462 |
| Receivables: | | |
| Contributions | 273,749 | 282,408 |
| Interest | 416,380 | 50,449 |
| Other Receivables (Note 11) | 1,727,437 | - |
| Total Receivables | 2,417,566 | 332,857 |
| Pooled Investments, at fair value (Note 3): | | |
| U.S. Treasury Securities | 3,260,209 | - |
| U.S. Agency Securities | 7,414,683 | - |
| Corporate Bonds | 3,552,541 | - |
| Equity Securities | 13,032,735 | - |
| Options | (8,578) | - |
| Taxable Municipal Bonds | 54,175 | - |
| Real Estate Investment Trust | 2,763,348 | - |
| Asset Backed Securities | 1,308,500 | - |
| Collateralized Mortgage Obligations (CMOs) | 1,427,811 | - |
| Mutual Funds | 8,280,678 | 12,928,637 |
| Pooled Funds | 59,249,524 | 115,000,563 |
| Investment Contracts | 958,172 | 22,128,177 |
| Repurchase Agreements | 727,594 | - |
| Commercial Paper, Money Market Funds and Foreign Currency | 3,349,194 | 14,530,280 |
| Total Investments | 105,370,586 | 164,587,657 |
| Invested Securities Lending Collateral (Note 3) | 4,639,250 | 640,636 |
| Capital Assets (Note 9): | | |
| Equipment | 1,107,437 | 502,373 |
| Less: Accumulated Depreciation | (358,158) | (376,177) |
| Total Capital Assets | 749,279 | 126,196 |
| Total Assets | 113,201,898 | 165,717,808 |
| **LIABILITIES** | | |
| Compensated Absences (Note 6) | 6,269 | 9,903 |
| Other Payables (Note 11) | 4,411,867 | 30,376 |
| Benefits Payable | 163,670 | - |
| Obligations Under Securities Lending (Note 3) | 4,639,250 | 640,636 |
| Capital Lease Obligations (Note 5) | 713,284 | 254,744 |
| Total Liabilities | 9,934,340 | 935,659 |
| Net assets held in trust for pension benefits (A schedule of funding progress for each cash balance benefit plan is presented on page 53.) | $ 103,267,558 | $ 164,782,149 |

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, 2005

| | STATE CASH BALANCE BENEFIT | STATE DEFINED CONTRIBUTION |
|---|---|---|
| **ADDITIONS:** | | |
| Contributions: | | |
| Employee | $ 9,515,541 | $ 14,747,424 |
| Employer (Note 4) | 14,884,856 | 23,041,547 |
| Total Contributions | 24,400,397 | 37,788,971 |
| Investment income: | | |
| Net income (loss) from investing activities | 22,240,923 | 33,568,827 |
| Securities lending income | 603,703 | 85,301 |
| Securities lending expense | (574,241) | (82,067) |
| Net investment income (loss) | 22,270,385 | 33,572,061 |
| Total Additions | 46,670,782 | 71,361,032 |
| **DEDUCTIONS:** | | |
| Benefits | 15,463,446 | 27,148,547 |
| Administrative expenses | 781,130 | 795,641 |
| Total Deductions | 16,244,576 | 27,944,188 |
| **TRANSFERS** (Note 10) | 4,429,834 | (4,429,834) |
| Net Increase (Decrease) | 34,856,040 | 38,987,010 |
| Net assets held in trust for pension benefits: | | |
| Beginning of year | 321,604,520 | 660,124,021 |
| End of year | $ 356,460,560 | $ 699,111,031 |

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, 2005

| | COUNTY CASH BALANCE BENEFIT | COUNTY DEFINED CONTRIBUTION |
|---|---|---|
| **ADDITIONS:** | | |
| Contributions: | | |
| Employee | $ 3,719,560 | $ 4,500,047 |
| Employer (Note 4) | 5,521,165 | 6,552,744 |
| Total Contributions | 9,240,725 | 11,052,791 |
| Investment income: | | |
| Net income (loss) from investing activities | 6,552,812 | 7,817,390 |
| Securities lending income | 174,370 | 19,457 |
| Securities lending expense | (165,860) | (18,719) |
| Net investment income (loss) | 6,561,322 | 7,818,128 |
| Total Additions | 15,802,047 | 18,870,919 |
| **DEDUCTIONS:** | | |
| Benefits | 3,866,692 | 7,597,458 |
| Administrative expenses | 411,642 | 353,953 |
| Total Deductions | 4,278,334 | 7,951,411 |
| **TRANSFERS** (Note 10) | 1,108,927 | (1,108,927) |
| Net Increase (Decrease) | 12,632,640 | 9,810,581 |
| Net assets held in trust for pension benefits: | | |
| Beginning of year | 90,634,918 | 154,971,568 |
| End of year | $ 103,267,558 | $ 164,782,149 |

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

# NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2005

## 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, 2005, and the Deferred Compensation Plan for the fiscal year ended December 31, 2005.

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 of accounting. 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 2005.

**Investments.** Investments as reported in the financial statements include long-term investments. Law or legal instruments may restrict these investments. All investments are stated at fair value based on quoted market prices. The State Treasurer is the custodian of all funds; however, investments are under the responsibility of the Nebraska Investment Council.

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 seven 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 NPERS is provided for general information purposes. Participants should refer to Neb. Rev. Stat. Sections 84-1301 through 84-1333, for the State Employees Retirement Plan, and Neb. Rev. Stat. Sections 23-2301 through 23-2335, for the County Employees Retirement Plan for more complete information.

**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 option or begin participation in the cash balance benefit. The defined contribution option 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.** Per statute, 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 Option.** 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, 2005:

| | Defined Contribution | Cash Balance |
|---|---|---|
| Retirees and Beneficiaries Receiving Benefits | - | 194 |
| Terminated Plan Members Entitled to but not yet Receiving Benefits | 1,819 | 314 |
| Active Plan Members | 8,433 | 6,918 |
| Total | 10,252 | 7,426 |

The 194 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 \$66,314. NPERS, as part of the State of Nebraska, contributed \$103,451.

**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., 2004.

**2. Plan Descriptions** (Continued)

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 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 option or begin participation in the cash balance benefit. The defined contribution option is closed to new entrants. All new members of the Plan on or 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.** Per statutes, 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. Since forfeitures are not sufficient to pay administrative expenses, NPERS has implemented an asset charge on the defined contribution option assets. NPERS also uses plan assets when forfeitures are not sufficient in the cash balance benefit.

## 2. Plan Descriptions (Concluded)

**Defined Contribution Option.** 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.

**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, 2005:

| | Defined Contribution | Cash Balance |
|---|---|---|
| Retirees and Beneficiaries Receiving Benefits | - | 99 |
| Terminated Plan Members Entitled to but not yet Receiving Benefits | 899 | 107 |
| Active Plan Members | 3,363 | 3,364 |
| Total | 4,262 | 3,570 |

The 99 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

**Investments.** Listed below is a summary of the investment portfolio that comprises the Investments on the Statement of Net Assets. All securities purchased or held must be in the custody of the State or deposited with an agent in the State's name. Neb. Rev. Stat. Section 72-1239.01 authorizes the appointed members of the council to act with the care,

**3. Investments** (Continued)

skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims by diversifying the investments of the assets of the retirement systems.

NPERS' investments for the State and County Employees Retirement Plans at December 31, 2005, are presented below. All investments are presented by investment type and debt securities are presented with effective duration presented in years.

**State and County Employees Retirement Plan Investments at December 31, 2005**

| | **State and County Cash Balance Benefit** | | **State and County Defined Contribution** | |
|---|---|---|---|---|
| | Fair Value | Effective Duration | Fair Value | Effective Duration |
| Debt Securities | | | | |
| U.S. Treasury Securities | $ 14,547,622 | 4.59 | $ - | - |
| U.S. Agency Securities | 33,085,606 | 3.83 | - | - |
| Corporate Bonds | 15,848,032 | 4.88 | - | - |
| Collateral Mortgage Obligations | 6,371,142 | 3.74 | - | - |
| Asset Backed Securities | 5,838,755 | 4.88 | - | - |
| Repurchase Agreements | 3,246,647 | 2.67 | - | - |
| Commercial Paper | 5,734,036 | 2.67 | - | - |
| Money Market Funds | 8,848,203 | 2.67 | 70,992,985 | 0.07 |
| Municipal Bonds | 241,737 | 12.31 | - | - |
| | 93,761,780 | | 70,992,985 | |
| Other Investments | | | | |
| Equity Securities | 58,154,387 | | - | |
| Pooled Funds | 264,385,651 | | 599,125,635 | |
| Mutual Funds | 36,949,824 | | 73,820,553 | |
| Investment Contracts | 4,114,718 | | 118,586,498 | |
| Options | (38,276) | | - | |
| Foreign Currency | 362,422 | | - | |
| Real Estate Investment Trust | 12,330,539 | | - | |
| Total Investments | 470,021,045 | | 862,525,671 | |
| Securities Lending Short-term Collateral Investment Pool | 20,701,209 | | 3,449,276 | |
| Total | $ 490,722,254 | | $865,974,947 | |

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

## 3. <u>Investments</u> (Continued)

**Interest Rate Risk.** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investments full price. The State has contracts with investment managers that limit the effective duration to within one year of the effective duration of the benchmark.

**Credit Risk of Debt Securities.** Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The State has contracts with investment managers that set minimum quality ratings for securities. NPERS' rated debt investments as of December 31, 2005, were rated by Standards and Poor's and/or an equivalent national rating organization and the ratings are presented below using the Standard and Poor's rating scale.

**Cash Balance Benefit/Defined Contribution Investments at December 31, 2005**
**Quality Ratings**

| | **Cash Balance Benefit** | | | | | | | | | | | **Defined Contribution** | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Fair Value** | **AAA** | **AA** | **A** | **BBB** | **BB** | **B** | **CCC** | **D** | **A-1** | **Unrated** | **Fair Value** | **Unrated** |
| U.S. Agency Securities | $33,085,606 | $23,861,467 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $9,224,139 | $ - | $ - |
| Corporate Bonds | $15,848,032 | $2,217,890 | $2,413,932 | $3,377,022 | $ 3,390,782 | $2,433,377 | $1,029,851 | $ 22,711 | $ 227 | $ - | $ 962,240 | $ - | $ - |
| Collateral Mortgage Obligations | $6,371,142 | $5,868,043 | $ 135,598 | $ - | $ - | $ - | $ 62,509 | $ - | $ - | $ - | $ 304,992 | $ - | $ - |
| Asset Backed Securities | $5,838,755 | $4,568,092 | $ - | $ 6,697 | $ 5,725 | $ 18,445 | $ 139,295 | $ - | $ - | $ - | $1,100,501 | $ - | $ - |
| Repurchase Agreements | $3,246,647 | $ - | $3,246,647 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Commercial Paper | $5,734,036 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ 657,502 | $5,076,534 | $ - | $ - |
| Money Market Funds | $8,848,203 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $8,848,203 | $70,992,985 | $70,992,985 |
| Municipal Bonds | $ 241,737 | $ 139,044 | $ 70,078 | $ - | $ 19,713 | $ - | $ - | $ - | $ - | $ - | $ 12,902 | $ - | $ - |

**NOTES TO FINANCIAL STATEMENTS**

3. **Investments** (Continued)

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The State has contracts with investment managers that limit the maximum amount for an issuer, excluding U.S. Treasury, U.S. Agency, mortgages, and non-U.S. sovereign issuers, to 5 percent of the total account.

At December 31, 2005, NPERS had debt securities investments with more than 5 percent or more of total investments in Federal National Mortgage Corporation (7 percent).

**Foreign Currency Risk.** Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The State does not have an overall policy regarding foreign currency risk; however, the State has contracts with investment managers that limit foreign currency risk. At December 31, 2005, the defined contribution plan did not have exposure to foreign currency risk. The cash balance benefit exposure to foreign currency risk is presented on the following table.

**Cash Balance Benefit Foreign Currency at December 31, 2005**

| | Cash | Equity Securities | Corporate Bonds |
|---|---|---|---|
| Argentine Peso | $ - | $ - | $ 15,671 |
| Australian Dollar | 4,445 | 780,411 | - |
| Canadian Dollar | 21,892 | 103,682 | - |
| Colombian Peso | - | - | 15,183 |
| Danish Krone | - | 12,876 | - |
| Euro Currency | 5,194 | 5,226,816 | 301,294 |
| Hong Kong Dollar | 67 | 763,043 | - |
| Indonesian Rupiah | - | 38,895 | - |
| Japanese Yen | 300,808 | 1,921,370 | - |
| Mexican Peso | 24,478 | - | 285,703 |
| New Zealand Dollar | - | - | - |
| Polish Zloty | 57 | 34,653 | - |
| Pound Sterling | 3,861 | 2,274,921 | - |
| Singapore Dollar | - | 94,322 | - |
| South Korean Won | - | 280,289 | - |
| Swedish Krona | 44 | 391,677 | - |
| Swiss Franc | 1,494 | 1,236,936 | - |
| Thailand Baht | 82 | 60,073 | - |
| Total | $ 362,422 | $ 13,219,964 | $ 617,851 |

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

**3. Investments** (Continued)

**Securities Lending Transactions.** The State participates in securities lending transactions, where securities are loaned to broker-dealers and banks with a simultaneous agreement to return the collateral for the same securities in the future. The State's primary custodial bank administers the securities lending program and receives cash, United States government or government agency obligations, or convertible bonds at least equal in value to the market value of the loaned securities as collateral for securities of the type of loan at year-end. At year-end, the State had no credit risk exposure to borrowers because the amounts the State owes the borrowers exceed the amounts the borrowers owe the State. The collateral securities can not be pledged or sold by the State unless the borrower defaults. There are no restrictions on the amount of securities that can be loaned, and there were no losses from borrower default during the year.

Either the State or the borrowers can terminate all securities loans on demand. Cash collateral is invested in one of the lending agent's short-term investment pools that had average durations of 25 and 32 days (as of June 30, 2005). 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 the State by the contract with the custodian.

**Derivative Financial Instruments.** Derivative instruments are financial contracts whose underlying values depend on the values of one or more underlying assets, reference rates or financial indices. These instruments are used primarily to enhance performance and/or reduce the volatility of the portfolio, in accordance with the Investment Council-approved Derivatives Policy. Derivative instruments used by the State include futures, options, and swaps. Futures represent commitments to purchase or sell securities or money market instruments at a future date and at a specific price. Options represent the right, but not the obligation, to purchase or sell securities or money market instruments at a future date and at a specific price. The State invests in these contracts related to securities of the U.S. government or government agency obligations based on reference notes, which are traded on organized exchanges, thereby minimizing the State's credit risk. The net change in the contract value is settled daily in cash with the exchanges. Swaps represent an exchange of streams of payments over time according to specified terms.

At December 31, 2005, the State held futures contracts with a notional value of \$(699,100,000) and a market value of \$0. In addition, the State held options with a notional value of \$(15,352,500) and a market value of \$(552,930) and swaps with a notional value of \$106,000,000 and a market value of \$457,825 at December 31, 2005.

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

**3. Investments** (Concluded)

The amounts presented for the derivative financial instruments do not agree with the statements of net assets and the investment disclosures. The amounts here include both the Cash Balance Benefit and the Defined Benefit Plans portion of the School Employees, Judges, and State Patrol Retirement Plans, as these funds are commingled for investment purposes.

**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., 2005, and 84-1321.01(1) R.S.Supp., 2005, forfeitures are first used to pay administrative expenses of the Board. The remaining balance, if any, shall then be used to reduce State and County employer contributions respectively. During 2005, there were no forfeitures used to offset the State and County employer contributions. The balance of the Defined Contribution forfeiture accounts at December 31, 2005, was $484,639 for the State Plan and $20,076 for the County Plan. The balance of the Cash Balance Benefit forfeiture accounts was $248,650 for the State Plan and $24,984 for the County Plan.

**5. Contingencies and Capital Lease Commitments**

**Risk Management.** NPERS is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. NPERS, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State with the exception of the health and life insurance programs which are maintained by the DAS Personnel Division. The State generally self-insures for general liability and workers' compensation. The State has chosen to purchase insurance for:

A. Motor vehicle liability, which is insured for the first $5 million of exposure per accident with a self-insured retention of $300,000 per accident, except of accidents involving vehicular pursuit which have a $1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.

B. Health care and life insurance for eligible employees.

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

**5. Contingencies and Capital Lease Commitments** (Continued)

C. Crime coverage, with a limit of $1 million for each loss, and a $25,000 self-insured retention per incident was in effect from July 1, 2005 through October 18, 2005. Starting October 19, 2005, the limit for each loss was increased to $21 million.

D. Real and personal property on a blanket basis for losses up to $250,000,000, with a self-insured retention of $200,000 per loss occurrence. Newly acquired properties are covered up to $5,000,000 for 90 days or until the value of the property is reported to the insurance company. The perils of flood, earthquake, and acts of terrorism have various coverages, sublimits, and self insurance. Details of these coverages are available from the Department of Administrative Services Risk Management Division. State Agencies have the option to purchase building contents and inland marine coverage.

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

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

The 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, dated July 11, 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 26, 2003, was for $5,915,227 including interest costs of $525,227, a rate of 2.757%. The fifth Master Lease Agreement, dated

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

## 5. Contingencies and Capital Lease Commitments (Concluded)

February 12, 2004, was for $4,062,231 including interest costs of $326,708, a rate of 2.530%. The lease agreements are made with NPERS, not any of the individual plans. The payments are allocated according to the expense allocation policy of NPERS. The minimum annual lease payments and the present value of future minimum payments for all capital leases as of December 31, 2005, are as follows:

| Calendar Year | State Cash Balance Benefit | State Defined Contribution | County Cash Balance Benefit | County Defined Contribution |
|---|---|---|---|---|
| 2006 | $ 358,534 | $ 164,440 | $ 188,702 | $ 67,394 |
| 2007 | 356,107 | 163,327 | 187,425 | 66,938 |
| 2008 | 322,518 | 147,922 | 169,746 | 60,624 |
| 2009 | 280,907 | 128,837 | 147,846 | 52,802 |
| 2010 | 99,200 | 45,498 | 52,211 | 18,647 |
| 2011 | 18,888 | 8,664 | 9,940 | 3,549 |
| Total Minimum Payments | 1,436,154 | 658,688 | 755,870 | 269,954 |
| Less: Interest and Executory Costs | 80,915 | 37,112 | 42,587 | 15,210 |
| Present Value of Net Minimum Payments | $ 1,355,239 | $ 621,576 | $ 713,283 | $ 254,744 |

**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 NPERS' opinion that final settlement of those matters should not have an adverse effect on NPERS' ability to administer current programs. Any judgment against NPERS would have to be processed through the State Claims Board and be approved by the Legislature.

## 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.

**6. Compensated Absences** (Concluded)

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 60 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, 2005, is as follows:

| | State Defined Contribution Employees | State Cash Balance Benefit Employees | County Defined Contribution Employees | County Cash Balance Benefit Employees |
|---|---|---|---|---|
| Annual Leave | $ 10,561 | $ 5,415 | $ 5,278 | $ 3,341 |
| Sick Leave | 9,233 | 4,735 | 4,614 | 2,921 |
| Compensatory Leave | 23 | 12 | 11 | 7 |
| | $ 19,817 | $ 10,162 | $ 9,903 | $ 6,269 |

**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.

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

## 8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2005, are summarized as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance | Amounts Due Within One Year |
|---|---|---|---|---|---|
| **State Defined Contribution** | | | | | |
| Compensated Absences | $ 45,184 | $ - | $ 25,367 | $ 19,817 | $ 2,860 |
| Capital Lease Obligations | 760,788 | - | 139,212 | 621,576 | 158,734 |
| Totals | $ 805,972 | $ - | $ 164,579 | $ 641,393 | $ 161,594 |
| **State Cash Balance Benefit** | | | | | |
| Compensated Absences | $ 30,267 | $ - | $ 20,105 | $ 10,162 | $ 1,466 |
| Capital Lease Obligations | 1,658,768 | - | 303,529 | 1,355,239 | 346,093 |
| Totals | $ 1,689,035 | $ - | $ 323,634 | $ 1,365,401 | $ 347,559 |
| **County Defined Contribution** | | | | | |
| Compensated Absences | $ 22,075 | $ - | $ 12,172 | $ 9,903 | $ 1,429 |
| Capital Lease Obligations | 311,798 | - | 57,054 | 254,744 | 65,055 |
| Totals | $ 333,873 | $ - | $ 69,226 | $ 264,647 | $ 66,484 |
| **County Cash Balance Benefit** | | | | | |
| Compensated Absences | $ 17,990 | $ - | $ 11,721 | $ 6,269 | $ 905 |
| Capital Lease Obligations | 873,036 | - | 159,752 | 713,284 | 182,154 |
| Totals | $ 891,026 | $ - | $ 171,473 | $ 719,553 | $ 183,059 |

## 9. Capital Assets

Capital asset activity for the year ended December 31, 2005, was as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| **State Defined Contribution** | | | | |
| Equipment | $ 1,099,992 | $ - | $ - | $ 1,099,992 |
| Less: Accumulated Depreciation | 468,468 | 157,142 | - | 625,610 |
| Capital Assets, Net | $ 631,524 | $ (157,142) | $ - | $ 474,382 |
| **State Cash Balance Benefit** | | | | |
| Equipment | $ 2,104,130 | $ - | $ - | $ 2,104,130 |
| Less: Accumulated Depreciation | 379,909 | 300,591 | - | 680,500 |
| Capital Assets, Net | $ 1,724,221 | $ (300,591) | $ - | $ 1,423,630 |

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

## 9. Capital Assets (Concluded)

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| **County Defined Contribution** | | | | |
| Equipment | $ 502,373 | $ - | $ - | $ 502,373 |
| Less: Accumulated Depreciation | 304,409 | 71,768 | - | 376,177 |
| Capital Assets, Net | $ 197,964 | $ (71,768) | $ - | $ 126,196 |
| **County Cash Balance Benefit** | | | | |
| Equipment | $ 1,107,437 | $ - | $ - | $ 1,107,437 |
| Less: Accumulated Depreciation | 199,953 | 158,205 | - | 358,158 |
| Capital Assets, Net | $ 907,484 | $ (158,205) | $ - | $ 749,279 |

## 10. Transfers

Transfer activity for the year ended December 31, 2005, was as follows:

| | State Cash Balance Benefit | State Defined Contribution |
|---|---|---|
| Annuity Balances from Defined Contribution to Cash Balance Benefit | $ 3,624,923 | $ (3,624,923) |
| Miscellaneous Transfers | 804,911 | (804,911) |
| Total Transfers | $ 4,429,834 | $ (4,429,834) |

| | County Cash Balance Benefit | County Defined Contribution |
|---|---|---|
| Annuity Balances from Defined Contribution to Cash Balance Benefit | $ 677,774 | $ (677,774) |
| Miscellaneous Transfers | 431,153 | (431,153) |
| Total Transfers | $ 1,108,927 | $ (1,108,927) |

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.

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

## 11. Other Receivables/Other Payables

Other receivables consisted of receivables for investments sold, receivables for foreign exchanges, tax reclaim receivables, unrealized appreciation/depreciation on income receivables, unrealized appreciation/depreciation on investment receivables, unrealized appreciation/depreciation on foreign exchange receivables, and other receivables as recorded by the custodial bank. Other payables consisted of payables for investments purchased, payable for foreign currency purchased, unrealized appreciation/depreciation on investments payable, unrealized appreciation/depreciation on foreign exchange payables, and other payables as recorded by the custodial bank.

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. Receivables and payables for investments sold and purchased represent securities in which the asset has been recorded as of December 31, 2005, but the security has not settled.

## 12. Fees on Investments

There are several fees that are charged against all investments. Investment income is recorded net of these fees on the financial statements. The following schedule shows the external fees charged against investments for the calendar year ended December 31, 2005:

| **External Manager Fees** | **State & County Cash Balance Benefit** | **State & County Defined Contribution** |
|---|---|---|
| Abbott Capital | $ 7,621 | $ - |
| Acadian Asset Management, Inc. | 8,337 | - |
| Alliance Bernstein Institutional Investment Management | 46,242 | - |
| Ariel Capital Management, LLC. | 44,206 | - |
| Baillie Gifford | 55,368 | - |
| Barclays Global Investors | 126,208 | 26,344 |
| BlackRock Financial Management | 82,330 | - |
| Dimensional Fund Advisors, Inc | 57,052 | 246,310 |
| Goldman Sachs Asset Management | 15,066 | - |
| Grantham, Mayo, Van Otterloo & Co., LLC | 59,883 | - |
| Heitman | 12,170 | - |
| PIMCO | 79,118 | - |
| State Street Global Advisors | - | 248,315 |
| Synthetic GIC Holdings/WRAP Fee | - | 86,498 |
| T. Rowe Price Associates, Inc. | 16,777 | 193,441 |
| UBS Global Asset Management (Americas), Inc. | 149 | - |
| Total External Manager Fees | $ 610,527 | $ 800,908 |

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

**12. Fees on Investments** (Concluded)

See the Nebraska Investment Council attestation report for further information regarding other fees.

**13. Accounting Changes**

GASB Statement No. 40, *Deposit and Investment Risk Disclosures, An Amendment of GASB Statement No. 3*, was implemented during calendar year 2005. As a result, the disclosures related to deposit and investment risk were changed. The changes are reflected in Note 3.

**14. Subsequent Events**

Membership Requirements
Effective January 1, 2007, State and County retirement plan membership is mandatory for all full-time employees immediately upon date of hire. Retirement plan membership is voluntary for part-time employees who have attained the age of twenty. In addition, contributions to State retirement will be at the rate of 4.8%. The State contributes one hundred fifty-six percent (156%) of the employee contribution.

Calendar Year 2005 Dividends
The Board had not granted the dividend for the calendar year 2005 State and County Cash Balance Plans. All eligible State and County Cash Balance Plan members will receive the dividend. The Board anticipates the granting of the dividend before the end of the calendar year 2006. The dividend for calendar year 2004 was approximately $8.8 million.

Dividend Make-ups
AG opinion #06003 determined all members that had an account balance in the Plan at calendar year end would be eligible to receive the dividend issued for the State and County Cash Balance Benefit Plans. Therefore, make-up dividends were issued in May 2006 to those members that had not received the dividend due to the prior Board Policy. The State share was $1,276,446 and the County share was $311,080, for a total of $1,587,526.

Union Bank
Effective July 1, 2006, Union Bank and Trust replaced Ameritas as the record keeper for the State, County, and Deferred Compensation Plan assets.

**NOTES TO FINANCIAL STATEMENTS**
(Continued)

**14. Subsequent Events** (Concluded)

Effective September 7, 2006, Union Bank and Trust withdrew as the record keeper for the State, County, and Deferred Compensation Plan assets. Effective no later than September 30, 2006, Ameritas will resume as the record keeper.

Resignation of Director
Effective September 30, 2006, the Director of NPERS has submitted her resignation.

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, 2005
**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** | | | | | | |
| 12/31/2005 | $ 342,729,602 | $ 300,852,371 | $ (41,877,231) | 113.9% | $ 238,874,344 | (17.5%) |
| 12/31/2004 | $ 297,573,422 | $ 272,300,201 | $ (25,273,221) | 109.3% | $ 192,618,880 | (13.1%) |
| 12/31/2003 | $ 254,175,882 | $ 241,192,355 | $ (12,983,527) | 105.4% | $ 171,324,288 | (7.6%) |
| **COUNTY EMPLOYEES** | | | | | | |
| 12/31/2005 | $ 99,464,149 | $ 84,817,488 | $ (14,646,661) | 117.3% | $ 88,144,293 | (16.6%) |
| 12/31/2004 | $ 83,869,272 | $ 73,913,434 | $ (9,955,838) | 113.5% | $ 67,810,140 | (14.7%) |
| 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, 2005
**UNAUDITED**

SCHEDULE 2

**STATE EMPLOYEES**

| Year Ended December 31 | Annual Required Contribution State | Percentage Contributed |
|---|---|---|
| 2005 | $ 14,884,856 | 100% |
| 2004 | $ 13,170,792 | 100% |
| 2003 | $ 11,225,906 | 100% |

**COUNTY EMPLOYEES**

| Year Ended December 31 | Annual Required Contribution Counties | Percentage Contributed |
|---|---|---|
| 2005 | $ 5,521,165 | 100% |
| 2004 | $ 4,869,010 | 100% |
| 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, 2005 | December 31, 2005 |
| 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.

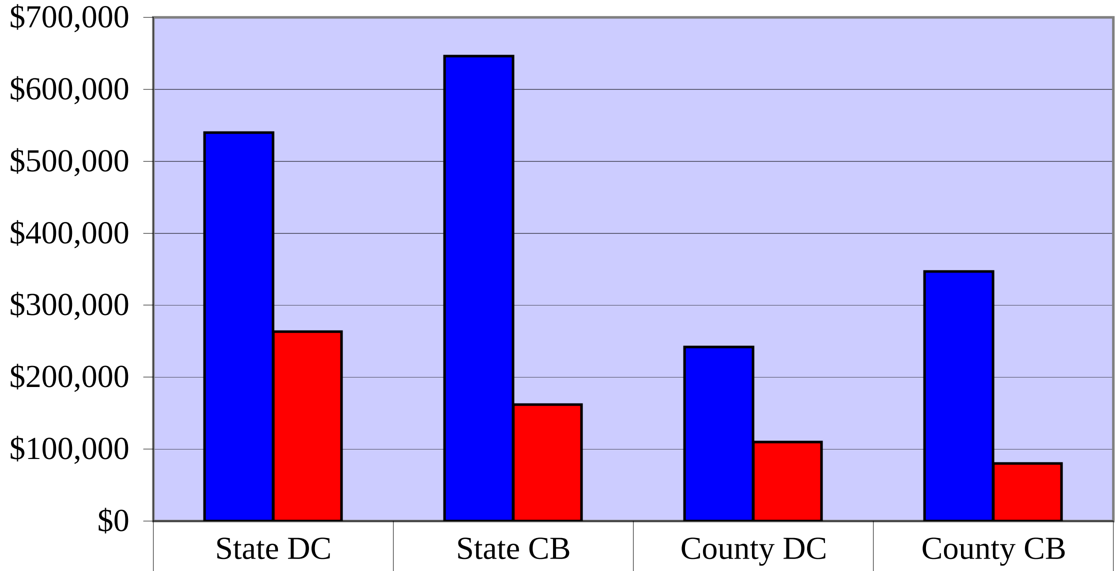
NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS
**AVERAGE ADMINISTRATIVE EXPENSE PER MEMBER**

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **STATE DEFINED CONTRIBUTION** | | | | | |
| Members: | | | | | |
| Active | 12,750 | 14,349 | 9,713 | 8,974 | 8,433 |
| Inactive | 2,070 | 2,002 | 1,887 | 1,969 | 1,819 |
| Total Members | 14,820 | 16,351 | 11,600 | 10,943 | 10,252 |
| Cash Basis Administrative Expenses: | | | | | |
| NPERS Expenses Paid on NIS (2) | $ 342,389 | $ 688,714 | $ 597,478 | $ 478,583 | $ 539,692 |
| Ameritas Record Keeper Fees (3) | $ 384,613 | $ 404,662 | $ 302,851 | $ 279,458 | $ 263,371 |
| Total Cash Basis Fees and Expenses | $ 727,002 | $ 1,093,376 | $ 900,329 | $ 758,041 | $ 803,063 |
| Administrative Expenses per GAAP Financial Statements | $ 826,910 | $ 1,112,260 | $ 943,619 | $ 815,170 | $ 795,641 |
| Average Administrative Expense Per Member (1) | $ 56 | $ 68 | $ 81 | $ 74 | $ 78 |
| **STATE CASH BALANCE (4)** | | | | | |
| Members: | | | | | |
| Active | | | 5,206 | 6,051 | 6,918 |
| Inactive | | | 56 | 197 | 314 |
| Total Members | | | 5,262 | 6,248 | 7,232 |
| Cash Basis Administrative Expenses: | | | | | |
| NPERS Expenses Paid on NIS (2) | | | $ 421,509 | $ 625,623 | $ 646,210 |
| Ameritas Record Keeper Fees (3) | | | $ 112,189 | $ 138,685 | $ 161,704 |
| Total Cash Basis Fees and Expenses | | | $ 533,698 | $ 764,308 | $ 807,914 |
| Administrative Expenses per GAAP Financial Statements | | | $ 483,812 | $ 781,256 | $ 781,130 |
| Average Administrative Expense Per Member (1) | | | $ 92 | $ 125 | $ 108 |
| **COUNTY DEFINED CONTRIBUTION** | | | | | |
| Members: | | | | | |
| Active | 5,983 | 6,162 | 3,738 | 3,588 | 3,363 |
| Inactive | 1,083 | 1,032 | 1,056 | 956 | 899 |
| Total Members | 7,066 | 7,194 | 4,794 | 4,544 | 4,262 |
| Cash Basis Administrative Expenses: | | | | | |
| NPERS Expenses Paid on NIS (2) | $ 167,475 | $ 482,349 | $ 320,531 | $ 231,034 | $ 241,928 |
| Ameritas Record Keeper Fees (3) | $ 184,505 | $ 194,220 | $ 127,993 | $ 116,941 | $ 109,869 |
| Total Cash Basis Fees and Expenses | $ 351,980 | $ 676,569 | $ 448,524 | $ 347,975 | $ 351,797 |
| Administrative Expenses per GAAP Financial Statements | $ 403,034 | $ 636,041 | $ 663,502 | $ 583,002 | $ 353,953 |
| Average Administrative Expense Per Member (1) | $ 57 | $ 88 | $ 138 | $ 128 | $ 83 |
| **COUNTY CASH BALANCE (4)** | | | | | |
| Members: | | | | | |
| Active | | | 2,516 | 2,995 | 3,364 |
| Inactive | | | 72 | 58 | 107 |
| Total Members | | | 2,588 | 3,053 | 3,471 |
| Cash Basis Administrative Expenses: | | | | | |
| NPERS Expenses Paid on NIS (2) | | | $ 247,856 | $ 333,433 | $ 346,867 |
| Ameritas Record Keeper Fees (3) | | | $ 56,988 | $ 98,863 | $ 79,946 |
| Total Cash Basis Fees and Expenses | | | $ 304,844 | $ 432,296 | $ 426,813 |
| Administrative Expenses per GAAP Financial Statements | | | $ 290,139 | $ 443,326 | $ 411,642 |
| Average Administrative Expense Per Member (1) | | | $ 112 | $ 145 | $ 119 |

(1) Calculated: Total Administrative Expenses per Audited Financial Statements/Total Members=Avg. Administrative Expense
(2) NPERS expenses paid on NIS are expenses incurred by NPERS and allocated to these plans.
(3) Ameritas record keeper fees are amounts charged by Ameritas to members for record keeping services. This is the amount members see as fees on their quarterly statements.
(4) Cash balance benefit became effective January 1, 2003.

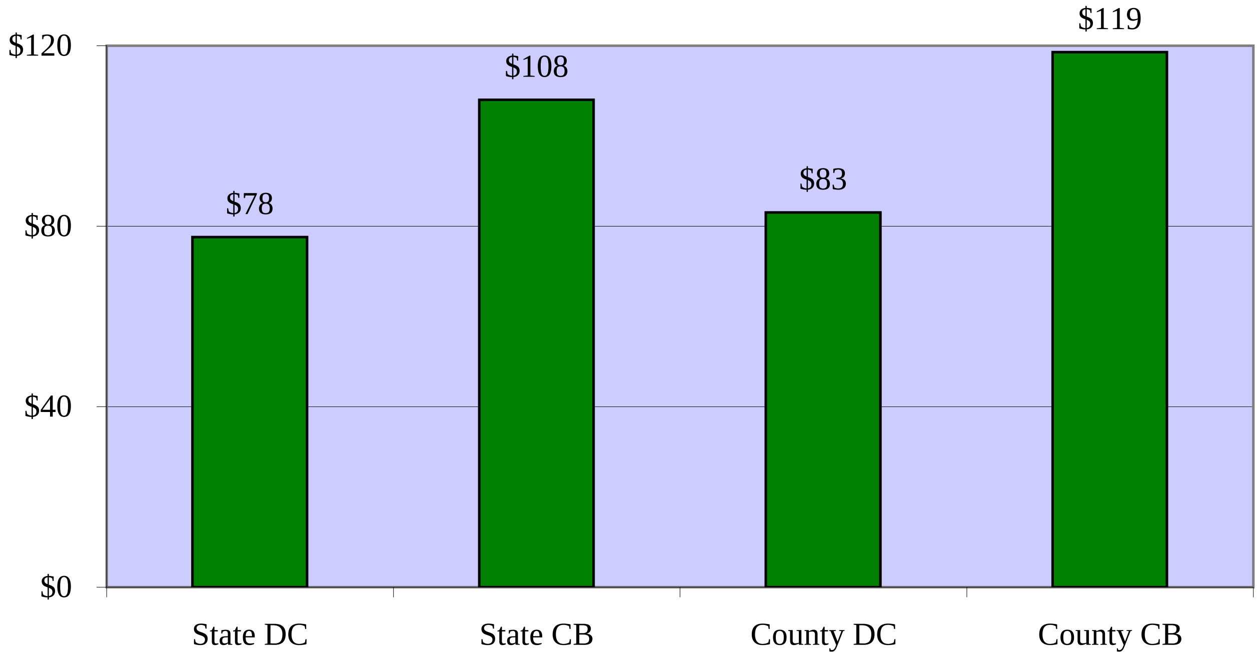
NOTE: During CY 2005 there were redemption fees of $6,703. These are fees charged to members for excessive trading of shares in the International Stock Fund. These fees were not reflected in the schedule.

**Calendar Year 2005 Expenses and Fees**



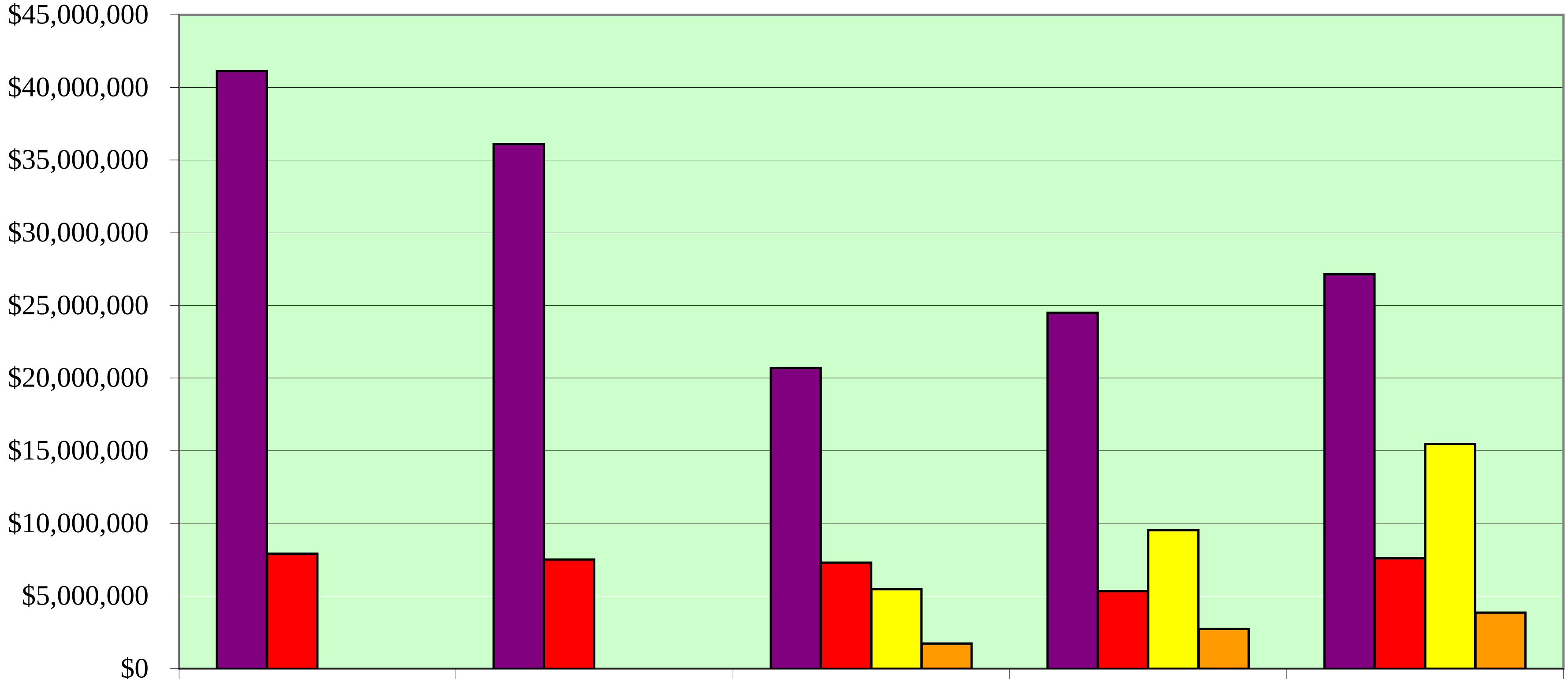

| | State DC | State CB | County DC | County CB |
|---|---|---|---|---|
| NPERS Expenses | $539,692 | $646,210 | $241,928 | $346,867 |
| Ameritas Fees | $263,371 | $161,704 | $109,869 | $79,946 |

**Average Administrative Expense per Member for Calendar Year 2005**



NEBRASKA EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

**Total Benefits Paid**




| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| State DC | $41,118,137 | $36,121,096 | $20,679,738 | $24,493,621 | $27,148,547 |
| County DC | $7,924,949 | $7,510,164 | $7,295,622 | $5,338,455 | $7,597,458 |
| State CB | - | - | $5,476,107 | $9,523,423 | $15,463,446 |
| County CB | - | - | $1,731,868 | $2,741,771 | $3,866,692 |

Note: Cash balance benefit became effective January 1, 2003.

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AUDITOR OF PUBLIC ACCOUNTS

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
STATE AND COUNTY EMPLOYEES RETIREMENT PLANS

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Nebraska Public Employees Retirement Systems
Lincoln, Nebraska

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, 2005, and have issued our report thereon dated September 7, 2006. The Independent Auditors' Report was modified to disclose that the Required Supplementary Information was unaudited and to emphasize the financial statements present only the State and County Employees Retirement Plans. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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 procedures for the purpose of expressing our opinion on the financial statements, and not to provide an opinion 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 (Accounting Issues), Comment Number 2 (Alternate Vesting Dates and Employer Forfeitures), Comment Number 3 (Required Minimum Distributions), Comment Number 4 (Dividend Interest), Comment Number 5 (County Plan Payroll Testing), Comment Number 6 (Required Contribution Procedures), Comment Number 7 (Inadequate Resolution of Prior Year Findings), Comment Number 8 (Plan Membership Eligibility), and Comment Number 13 (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 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.

Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain additional items that we 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 9 (PIONEER Concerns), Comment Number 10 (Member Address Changes), Comment Number 11 (Initial Contributions), and Comment Number 12 (Required Rules and Regulations).

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

Pat Reding, CPA

September 7, 2006 Assistant Deputy Auditor