

**ATTESTATION REPORT  
OF THE  
NEBRASKA INVESTMENT COUNCIL  
JULY 1, 2006 THROUGH JUNE 30, 2007**

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**Issued on September 7, 2007**

# NEBRASKA INVESTMENT COUNCIL

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## NEBRASKA INVESTMENT COUNCIL

### **BACKGROUND**

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

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

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

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

### **MISSION STATEMENT**

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

NEBRASKA INVESTMENT COUNCIL

**ORGANIZATIONAL CHART**

**INVESTMENT COUNCIL**

Gail Werner-Robertson (Chairwoman)

Earl H. Scudder

Richard A. DeFusco

John L. Maginn

John M. Dinkel

(non-voting)

Shane Osborn

State Treasurer

Phyllis Chambers

Director-Public Employees Retirement Systems

**STATE INVESTMENT OFFICER**

David L. Bomberger

**INVESTMENT SECURITIES ANALYSTS**

Gayle A. Wrasse

Joseph P. Jurich

JoLynn Winkler

**BUSINESS MANAGER**

Kathy Dawes

**SECRETARY**

Brandee Freauf

**AUDITOR**

Ray Friesen

NEBRASKA INVESTMENT COUNCIL

**EXIT CONFERENCE**

An exit conference was held August 15, 2007, with the Council to discuss the results of our examination. Those in attendance for the Nebraska Investment Council were:

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

Draft copies of this report were furnished to the Council to provide them an opportunity to review the report.

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



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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### NEBRASKA INVESTMENT COUNCIL

### INDEPENDENT ACCOUNTANT'S REPORT

Nebraska Investment Council  
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council (Council) for the fiscal year ended June 30, 2007. The Council's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

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

In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Investment Council for the fiscal year ended June 30, 2007, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 4, 2007, on our consideration of the Nebraska Investment Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial

reporting or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

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

September 4, 2007

  
Assistant Deputy Auditor

NEBRASKA INVESTMENT COUNCIL  
**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**  
For the Fiscal Year Ended June 30, 2007

	Nebraska Investment Council Cash Fund 27510	Operating Pool Distributive Fund 77500	<b>Totals (Memorandum Only)</b>
<b>REVENUES:</b>			
Sales & Charges	\$ 873,127	\$ -	\$ 873,127
Miscellaneous	369,255	-	369,255
<b>TOTAL REVENUES</b>	<u>1,242,382</u>	<u>-</u>	<u>1,242,382</u>
<b>EXPENDITURES:</b>			
Personal Services	577,020	-	577,020
Operating	587,161	-	587,161
Travel	20,336	-	20,336
Capital Outlay	2,563	-	2,563
<b>TOTAL EXPENDITURES</b>	<u>1,187,080</u>	<u>-</u>	<u>1,187,080</u>
Net Change in Fund Balances	55,302	-	55,302
FUND BALANCES, JULY 1, 2006	<u>191,960</u>	<u>-</u>	<u>191,960</u>
FUND BALANCES, JUNE 30, 2007	<u>\$ 247,262</u>	<u>\$ -</u>	<u>\$ 247,262</u>
<b>FUND BALANCES CONSIST OF:</b>			
General Cash	\$ 247,992	\$ (21,565,928)	\$ (21,317,936)
Deposits with Vendors	504	-	504
Due to Vendors	(1,234)	-	(1,234)
OIP Interest Receivable	-	21,565,928	21,565,928
<b>TOTAL FUND BALANCES</b>	<u>\$ 247,262</u>	<u>\$ -</u>	<u>\$ 247,262</u>

The accompanying notes are an integral part of the schedule.

# NEBRASKA INVESTMENT COUNCIL

## NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2007

### 1. Criteria

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

Per Neb. Rev. Stat. Section 81-1107(2) R.S.Supp., 2006, the State of Nebraska Director of Administrative Services duties include “The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes.”

The Nebraska Information System (NIS) is the official accounting system prescribed by DAS for the State of Nebraska. Policies and procedures are detailed in the Nebraska State Accounting Manual published by DAS – Accounting Division and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Council was obtained directly from NIS. NIS records accounts receivable and accounts payable as transactions occur. As such, certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounts payable liability recorded on NIS, and thus recorded as expenditures, as of June 30, 2007, includes only those payables posted to NIS before June 30, 2007, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2007, **does not** include amounts for goods and services received before June 30, 2007, which had not been posted to NIS as of June 30, 2007.

The Council had no accounts receivable at June 30, 2007. NIS does not include liabilities for accrued payroll and compensated absences.

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

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

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

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**

(Continued)

**1. Criteria** (Continued)

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

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

**Miscellaneous** – Revenue from sources not covered by other major categories, such as investment income and recaptured commissions. For further information on recaptured commissions, see Note 9.

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

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

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

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

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

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

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

**Liabilities** – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions increase expenditures and decrease fund balance. DAS Accounting Division uses a liability account on NIS (Object Account 215190) to record other income, realized gains

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**

(Continued)

**1. Criteria** (Concluded)

and losses, and management fees and to distribute the income to funds participating in the Operating Investment Pool. This liability account did not increase expenditures. The activity recorded in the liability account generally decreases cash. The net activity of this account each month is zero.

**2. State Agency**

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

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

**3. Totals**

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

**4. General Cash**

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

**5. Capital Assets**

Under NIS, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as expenditures. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) would be reported for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). The Council values all capital assets at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**  
(Continued)

**5. Capital Assets** (Concluded)

that has a cost of \$1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized, as well as all computers. Depreciation expenses would be reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend the asset's life is not capitalized.

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

Capital asset activity of the Council for the fiscal year ended June 30, 2007, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital Assets				
Equipment	\$ 39,819	\$ 2,563	\$ -	\$ 42,382
Less accumulated depreciation for:				
Equipment				<u>36,866</u>
Total capital assets, net of depreciation				<u>\$ 5,516</u>

**6. Reconciliation of Bank Records to the Nebraska Information System**

Through their bank reconciliation procedures, DAS State Accounting Division (State Accounting) has identified a large unknown statewide variance between the State Treasurer's bank statements and the State's balances in the general ledger. This unknown variance indicates the bank records are short as compared to the accounting records. Some adjustments to the accounting records may be needed and may affect the fund balances of the Council. At this time, it has not been determined how or when adjustments to the accounting records might be made. State Accounting is unable to determine the affect of such adjustment, if any, on the Council's balances; however, State Accounting believes it will not have a material impact on the Council's operations.

**7. Operating Investment Pool Activity (Fund 77500)**

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

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**

(Continued)

**7. Operating Investment Pool Activity (Fund 77500) (Concluded)**

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

<u>Balance</u> <u>July 1, 2006</u>	<u>Net Earned</u> <u>Income Received</u>	<u>Net Earned</u> <u>Income Allocated</u>	<u>Balance</u> <u>June 30, 2007</u>
<u>\$ (17,182,015)</u>	<u>\$ 106,282,773</u>	<u>\$ (110,666,686)</u>	<u>\$ (21,565,928)</u>

**8. Fees on Investments**

There are several fees that are charged against all investments. They are external manager fees, State Street Banks (SSB) fees, treasury management fees, and Nebraska Investment Council fees.

The Nebraska Investment Council fees are the only fees shown on the Council's financial schedule as Sales and Charges. Investment income is recorded net of these fees on the State of Nebraska's financial statements. (Investment transactions and balances are not recorded on the Council's financial schedule.) The following schedule shows the fees charged against investments for the fiscal year ended June 30, 2007:

(Continued on Next Page)

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**

(Continued)

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

External Manager Fees	
Abbott Capital Management, LLC	\$ 330,000
Acadian Asset Management, Inc.	1,127,977
AllianceBernstein L.P.	1,213,669
Ariel Capital Management, LLC	767,561
Baillie Gifford Overseas Ltd.	940,283
Barclays Global Investors	1,021,416
BlackRock Financial Management	1,063,821
Dimensional Fund Advisors, Inc.	1,643,096
Goldman Sachs Asset Management	296,957
Grantham, Mayo, Van Otterloo & Co., LLC	3,065,465
Heitman Real Estate Securities, LLC	225,943
Loomis Sayles	342,374
MFS Institutional Advisors, Inc.	1,043,651
Pathway Capital Management, LLC	901,329
PIMCO	1,998,851
Prudential Investment Management, Inc.	1,019,907
State Street Global Advisors	177,289
T. Rowe Price Associates, Inc.	195,840
UBS Global Asset Management, Inc.	1,003,160
Total External Manager Fees	<u>18,378,589</u>
SSB Custodian Fee	1,159,396
SSB Cash Management Fees	115,425
SSB Securities Lending Fees	389,076
Nebraska Investment Council Fees	873,127
Total Investment Fees	<u>20,915,613</u>
State Treasurer - Treasury Management Fees	670,134
Total Fees Charged Against Investments at June 30, 2007	<u><u>\$ 21,585,747</u></u>

**9. Recaptured Commissions**

Some of the assets managed by the Council received recaptured commissions from investment managers. The amount rebated was based on a certain percentage of the brokerage costs of trading and was negotiated between the Council and individual investment managers. The recaptured commissions were transferred into and subsequently held in a separate account at State Street Bank. As the Council disbursed money from this account to pay for expenses related

NEBRASKA INVESTMENT COUNCIL

**NOTES TO THE SCHEDULE**

(Continued)

**9. Recaptured Commissions** (Concluded)

to the Plans generating the commissions, they recorded a revenue and disbursement on NIS and also increased their appropriations by submitting the expenses to DAS Budget Division. The following schedule reconciles the recaptured commission account for the fiscal year ended June 30, 2007:

Beginning Balance July 1, 2006	\$	278,772
Recaptured Commissions and Interest Earned		81,643
Recaptured Commissions Used for Expenses		<u>(359,964)</u>
Ending Balance June 30, 2007	\$	<u>451</u>



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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

Nebraska Investment Council  
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council as of and for the year ended June 30, 2007, and have issued our report thereon dated September 4, 2007. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our examination, we considered the Nebraska Investment Council's internal control over financial reporting as a basis for designing our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, but not for the purpose of expressing an opinion on the effectiveness of the Nebraska Investment Council's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Investment Council's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services such that there is more than a remote likelihood that a misstatement of the entity's financial schedule that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedule will not be prevented or detected by the Nebraska Investment Council's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Investment Council's financial schedule is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our 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*.

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

September 4, 2007

  
Assistant Deputy Auditor

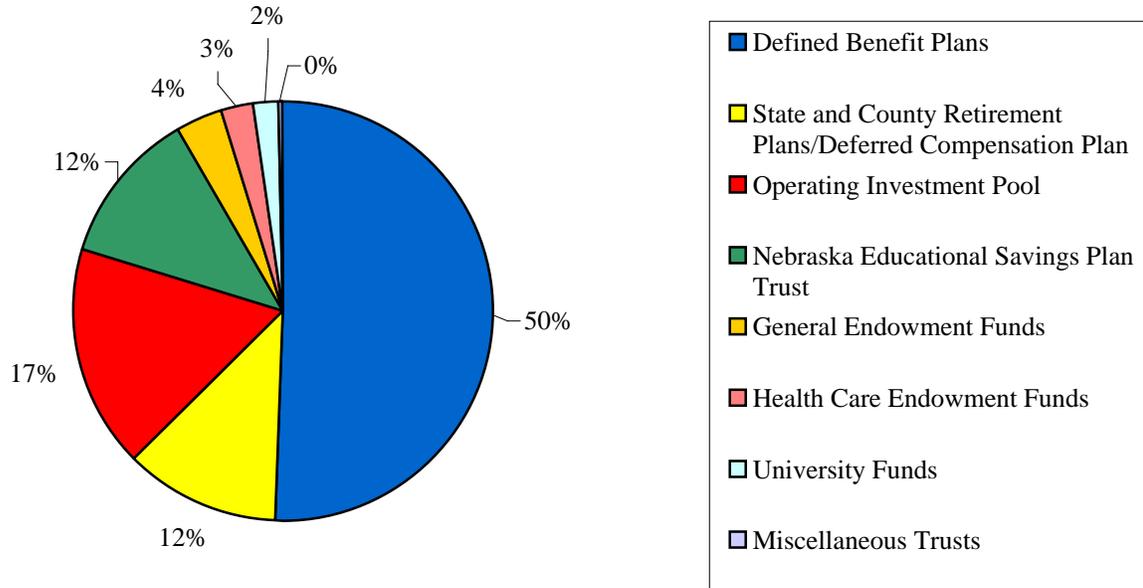
NEBRASKA INVESTMENT COUNCIL

**STATISTICAL SECTION**

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

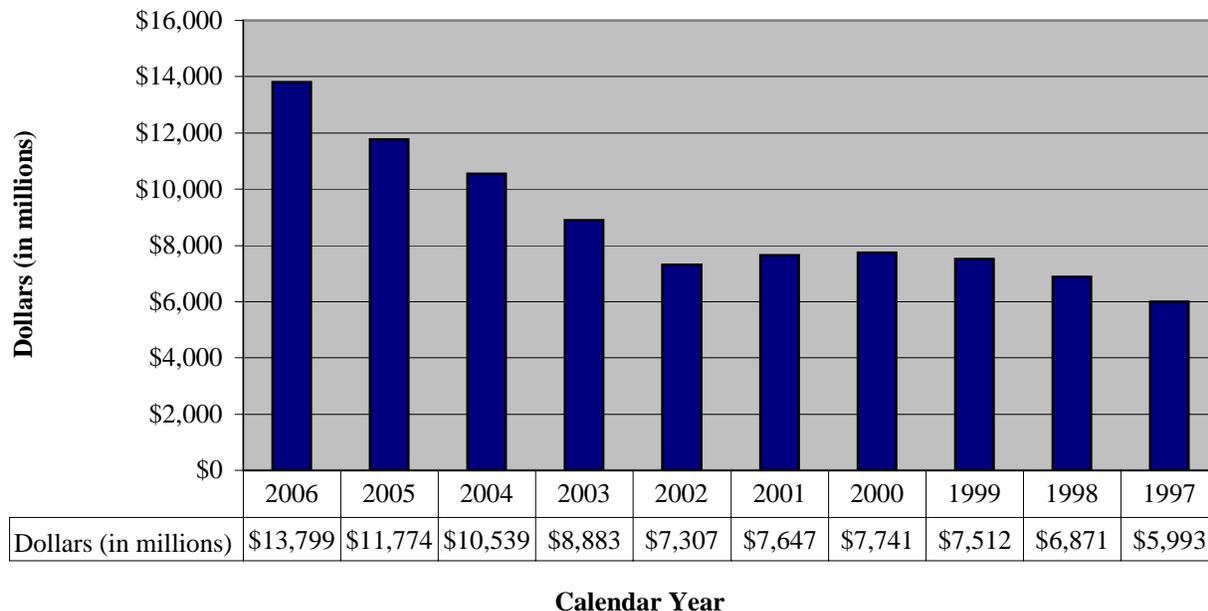
## NEBRASKA INVESTMENT COUNCIL

### Investments Managed as of December 31, 2006



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

### Closing Investment Balances at December 31st



Source: Nebraska Investment Council Calendar Year 2006 Annual Report.