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

PENSION TRUST FUNDS OF THE STATE OF NEBRASKA

JULY 1, 2005 THROUGH JUNE 30, 2006

Issued on February 1, 2007

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

TABLE OF CONTENTS

BACKGROUND

The Nebraska Public Employees Retirement Board (Board) was created in 1971 to administer Nebraska retirement plans for school employees, State employees, judges, and the State patrol. Administration of the retirement system for Nebraska county employees was assumed by the Board in 1973.

The Board has 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 appointed 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.

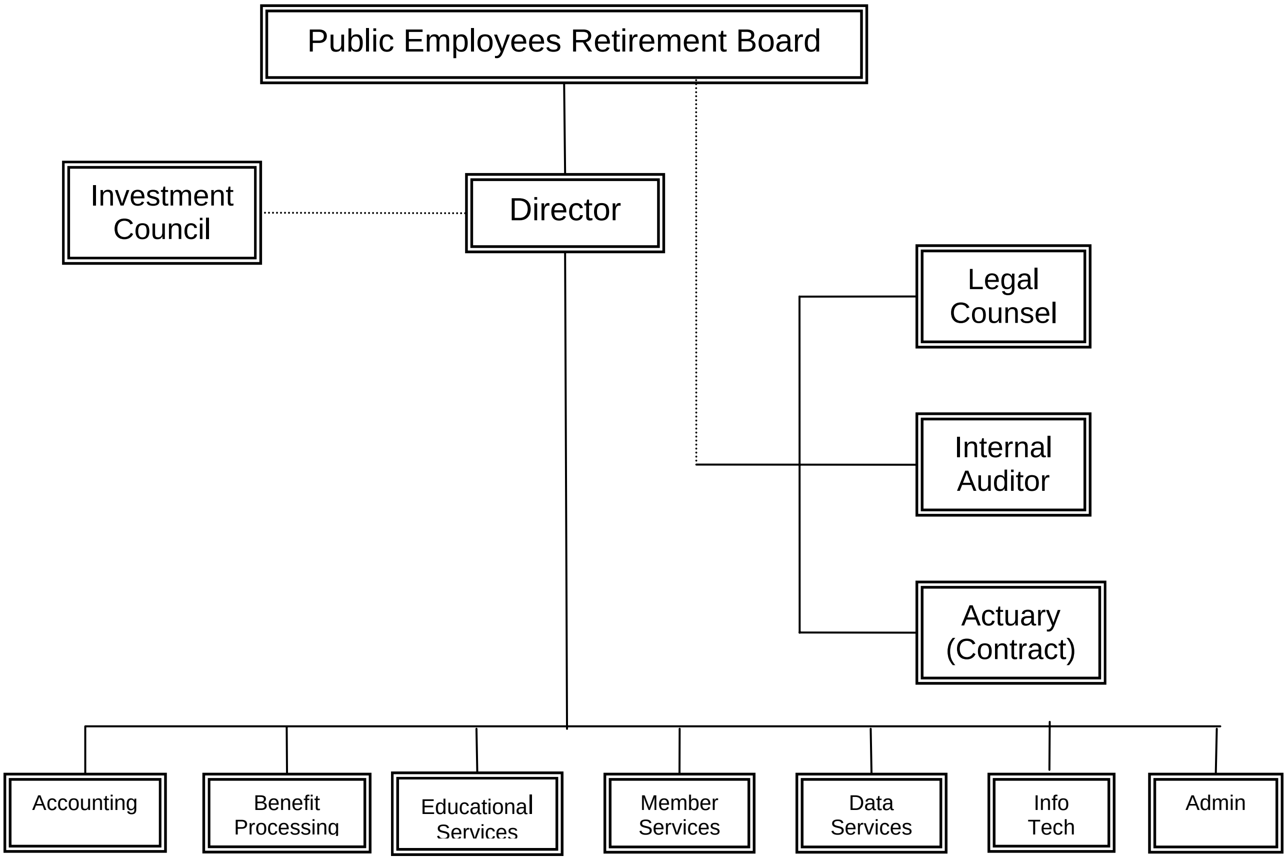
All appointed members must be Nebraska citizens. The Board meets monthly. As of July 1, 2005, members of the Board shall be paid fifty dollars per diem, and all members shall be reimbursed for actual and necessary expenses. The Board hires a director to manage the day-to-day operations. Expenses are 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 Systems recognizes the importance of a successful retirement and is dedicated to providing the highest quality service necessary to assist members in achieving this goal.

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

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held January 8, 2007, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our audit. Those in attendance for NPERS were:

NAME	TITLE
Phyllis Chambers	Director
Joe Schaefer	Legal Counsel
Teresa Zulauf	Internal Auditor
Randy Gerke	Accounting and Finance Manager
Jerry Brown	IT Manager
Jane Bond	Member Services Manager
Dennis Cooper	Data Services Manager
Jan Fox	Educational Services Manager
Tammy Petersen	Business Systems Analyst
Steve Penas	Accountant III
Cheryl Mueller	Auditor Associate
Iona Plautz	Retirement Specialist II
Mitch Snyder	Retirement Specialist II
Maria Davis	Retirement Specialist II

SUMMARY OF COMMENTS

During our audit of the Nebraska Public Employees Retirement Systems (NPERS) - School Employees, Judges, and State Patrol Retirement Plans, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Purchase of Service***: NPERS relied on PIONEER to calculate purchase of service payments after we had expressed concerns with the accuracy of the calculations in prior audits. Four of five payments tested were not calculated in accordance with the statutes. There were three overpayments from members ranging from $362 to $2,854, and one underpayment from a member of $674.

2. ***Benefit Adjustments:*** NPERS' calculations for one method of benefit adjustments did not appear to be in agreement with statutes. The errors in the calculation ranged from $1 per month to $28 per month. NPERS also did not appear to be in compliance with statutes that limit the benefit adjustment so as not to exceed the change in the CPI. Four of five patrol members tested received adjustments in excess of the change in the CPI dating back to July 2000. NPERS applied the calculation of the change in the CPI inconsistently in one of the three methods to calculate the benefit adjustment.

3. ***PIONEER Concerns:*** Areas of concern were noted where improvement of the NPERS information system is needed to ensure both system integrity and operational efficiency were identified.

4. ***School District Testing:*** There is an inconsistency among districts regarding the definition of compensation and components of compensation for retirement purposes. Seven of thirty school districts tested did not have all eligible employees contributing to the Plan. Five of thirty school districts tested reported compensation that was not in compliance with the definition of compensation in the Act. Two of thirty school districts tested did not include all of the required salary components in compensation.

5. ***Resolution of Prior Audit Findings - School District Testing:*** Prior audit findings were not appropriately resolved for six school districts from fiscal year 2005, four school districts from fiscal year 2004, and three school districts from fiscal year 2003.

6. ***Segregation of Duties Over School Contributions:*** One individual in accounting was able to process school contributions, had access to the checks, and also performed the follow up of school districts that had not remitted contributions between March 2006 and October 2006.

SUMMARY OF COMMENTS
(Continued)

7. ***Notarized Applications:*** We noted 7 of 14 Judges' retirement applications tested and 10 of 15 School employee retirement applications tested were not notarized to ensure the individual requesting the payment was entitled to the benefit payment.

8. ***Member Interest:*** Interest was posted to member accounts at the end of the month based on beginning of the month balances. In January 2004, two estimates were brought to the Board, one to make the change to calculate interest on the average daily balance and the second to change back to applying the interest to the balance at the end of the month. The policy has not been revisited by the Board.

9. ***Travel Expenses:*** We noted unreasonable meal expenses for four of six documents tested. We also noted the Plans paid for lodging of 7 of 14 Board members or staff who attended the Board's annual retreat in Nebraska City, which was less than 60 miles from their headquarter city. State vehicles were rented and not used for a total of 13 days in September and October 2005. We also noted unreasonable mileage on the use of the State vehicle.

10. ***Minimum Accrual Rate:*** NPERS did not calculate the minimum accrual rate in accordance with statutes.

11. ***Reconciliation of Bank Records to the Nebraska Information System:*** The Department of Administrative Services' bank reconciliation process is still not done in a timely manner and continues to reflect unknown variances between the bank records and accounting records.

More detailed information on the above items is provided hereafter. It should be noted that this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement and does not include our observations on any strong features of NPERS.

Draft copies of this report were furnished to NPERS to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

COMMENTS AND RECOMMENDATIONS

1. Purchase of Service

Good internal control requires procedures to ensure the calculation of the cost for a member to purchase service is accurate and in accordance with statute.

Neb. Rev. Stat. Section 79-921(2) R.S.Supp., 2006 states, "The retirement board shall reinstate to membership, with the same status as when such membership ceased, a school employee who has withdrawn his or her accumulated contributions under the following conditions: (a) If he or she again becomes an employee and if such employee chooses within three years after rejoining the system to repay, within five years after the date on which he or she rejoins the retirement system or prior to termination of employment, whichever is first, to the retirement board part or all of the amount he or she has withdrawn plus interest which would have accrued on that amount under the retirement system; or (b) If, more than three years after again becoming an employee and rejoining the system but prior to termination of employment, he or she chooses to repay part or all of the amount he or she has withdrawn, plus an amount equal to the actuarial assumed rate of return for the period repaid. Payment must be completed within five years after electing to repay or prior to termination, whichever is earlier."

We tested five purchases of service calculations and noted the following:

- NPERS continued to rely on PIONEER to calculate purchase of service payments after we had expressed concerns with the accuracy of the calculations in prior audits. Four of five purchases of service calculations under the School retirement plan were not in accordance with statute. All four payments included a full or partial repayment of a refunded retirement account. There were three overpayments from members ranging from $362 to $2,854, and one underpayment from a member of $674. The reasons for the difference between our calculation and the PIONEER calculation were the same as identified in the prior year. First, the PIONEER calculation did not match the amount the member previously withdrew, as required by statute. PIONEER did not use the period the initial contribution posted in its calculation. PIONEER used the period the contribution was related to, regardless of when the funds were posted. Second, PIONEER also included bonus interest in all repayment of refund calculations. Bonus interest of 2% was granted to the School Plan by the Nebraska Public Employees Board in September 1988 and June 1990. Bonus interest should only be included when the original refund was received after the dates of the bonus interest (in order to match the refund amount). A similar finding was noted in the previous audit report.

- Three purchase of service calculations tested last year were incorrect. NPERS did not recalculate or make any adjustments for these errors. Two were overpayments of $1,237 and $3,503 and one was an underpayment of $380. This was noted in the previous audit report.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Purchase of Service (Concluded)

Without adequate procedures to ensure purchase of service calculations performed by PIONEER are accurate, members may not pay the actual cost of the service purchased. If the calculated cost is too high, the member will pay too much into the system with no additional benefit.

> We recommend NPERS ensure PIONEER accurately calculates the cost to purchase service. NPERS should consider providing manual calculations as a verification of the cost in PIONEER. We also recommend NPERS recalculate all purchases of service from repayment of a refund from the date PIONEER was implemented.

NPERS' Response: We will take the auditor's recommendation of recalculating all purchase of service from repayment of a refund from the date PIONEER was implemented into consideration. We would like to consult with the Agency's Actuary as to different methods in calculating purchase of service.

2. Benefit Adjustments

Neb. Rev. Stat. Sections 24-710.07, 79-947.01, and 81-2027.03 R.S.Supp., 2006, state that beginning July 1, 2000, and each July 1 thereafter, current benefits paid to a member or beneficiary shall be adjusted so that the purchasing power of the benefit being paid is not less than 60% for the State Patrol Plan (and 75% for the School Employees and Judges Plans) of the purchasing power of the initial benefit. The amount of the adjustment shall be equal to the difference in the percentage change in the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers during the benefit payment period and 166 2/3% for the State Patrol Plan (133 1/3% for the School Employees and Judges Plans), such percentage times the initial benefit, less the total of all previous supplemental benefit and cost-of-living adjustments granted. The adjustment pursuant to this subsection shall not cause a current benefit to be reduced. The Board shall adjust the annual benefit adjustment provided in this section so that the total amount of all cost-of-living adjustments provided to the eligible retiree at the time of the annual benefit adjustment does not exceed the change in the National Consumer Price Index for Urban Wage Earners and Clerical Workers published by the Bureau of Labor Statistics for the period between June 30 of the prior year to June 30 of the present year.

The three methods of benefit adjustments that NPERS calculates all vary in the language used to describe the change in the Consumer Price Index. One section of statute refers to the "difference in the percentage change in the Consumer Price Index," as noted above. Another section refers to the "change in the Consumer Price Index." Finally, a separate statute refers to the "cumulative change in the Consumer Price Index."

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Benefit Adjustments (Continued)

Sound business practice requires clear policies and procedures to ensure benefits are correctly calculated. Good internal control requires procedures to ensure that all adjustments to benefits are processed according to statutes.

- NPERS' calculations for the benefit adjustments according to Neb. Rev. Stat. Sections 24-710.07, 79-947.01, and 81-2027.03 did not appear to be in agreement with the statutes. There were 1 of 6 retired judges tested, 1 of 5 retired patrol members tested, and 1 of 12 retired school employees tested who had an incorrect benefit adjustment for July 1, 2005, according to our reading of the statutes. We also compared 5 retired patrol members' benefit adjustments and determined 4 of the 5 had incorrect adjustments dating back as far as July 1, 2000. The variances noted were as follows:

July 1, 2005, COLA Increase Calculations

	NPERS' COLA		APA Calculated		Monthly Difference
Judge	$ 38.53	Method 1	$ 29.67	Method 2	$ 8.86
Patrol	$ 84.81	Method 1	$ 60.35	Method 2	$ 24.46
School	$ 3.87	Method 1	$ 3.02	Method 2	$ 0.85
Patrol	$ 105.33	Method 1	$ 77.63	Method 2	$ 27.70
Patrol	$ 59.53	Method 1	$ 45.68	Method 2	$ 13.85
Patrol	$ 66.34	Method 1	$ 52.65	Method 2	$ 13.69
Patrol	$ 82.49	Method 1	$ 55.78	Method 2	$ 26.71

- Additionally, NPERS did not appear to be in compliance with State statutes which limit the benefit adjustment so as not to exceed the change in CPI. It does not appear this limitation is factored into the NPERS' calculation for the benefit adjustment.

CPI Limitation on Increases Since July 2000

		Member 1		Member 2		Member 3		Member 4		Member 5	
	CPI Increase	Benefit Increase	Method Used	Benefit Increase	Method Used	Benefit Increase	Method Used	Benefit Increase	Method Used	Benefit Increase	Method Used
7/1/2000	3.93%	2.00%	# 2	57.93%	# 1	66.65%	# 1	71.45%	# 1	18.76%	# 1
7/1/2001	3.19%	2.50%	# 2	4.39%	# 1	4.20%	# 1	4.04%	# 1	4.84%	# 1
7/1/2002	0.75%	0.74%	# 2	0.99%	# 1	0.95%	# 1	0.92%	# 1	1.09%	# 1
7/1/2003	2.10%	2.10%	# 2	2.80%	# 1	2.68%	# 1	2.59%	# 1	3.07%	# 1
7/1/2004	3.17%	2.50%	# 2	4.20%	# 1	4.03%	# 1	3.88%	# 1	4.59%	# 1
7/1/2005	2.59%	2.50%	# 2	3.39%	# 1	3.26%	# 1	3.15%	# 1	3.70%	# 1

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Benefit Adjustments</u> (Concluded)

- NPERS applied the calculation of the change in the CPI inconsistently in one of the three methods to calculate the benefit adjustment. It is unclear in the statutes the exact meaning of the terms that relate to the change in the CPI.

  <u>Difference in the percentage change in the CPI (Method 1)</u>
  NPERS' calculation: CPI for current year / CPI for retirement year
  APA calculation: (CPI for current year – CPI for retirement year) / CPI for retirement year

  <u>Change in the CPI (Method 2)</u>
  NPERS' calculation: (CPI for current year – CPI for prior year) / CPI for prior year
  APA calculation: Same as NPERS

  <u>Cumulative change in the CPI (Method 3)</u>
  NPERS' calculation: (CPI for current year – CPI for prior year) / CPI for prior year
  APA calculation: Same as NPERS

  The calculation for Method 2 and Method 3 are the same, even though the language in the statutes is different.

There is an increased risk the benefit adjustments are incorrect without clear and precise statutes. Without procedures to ensure the calculations made by NPERS are accurate, there is an increased risk for errors in the calculation. Additionally, if benefit adjustments are overpaid, the plan assets may not be sufficient to cover the adjustments.

> We recommend NPERS work to modify the statute to provide clear, precise, and consistent instruction for calculating benefit adjustments. We also recommend NPERS ensure benefit adjustment calculations are performed consistently with the statutory language in the plans. We further recommend NPERS ensure all calculations are performed according to statute and that all limitations are followed. We recommend NPERS work with the Attorney General to determine the resolution to any errors in the benefit adjustments that have been made.

NPERS' Response: We will work to ensure benefit adjustment calculations are performed accurately and consistently with the statutes.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. PIONEER Concerns

Good internal control requires procedures to ensure an adequate review of access to databases is documented. Good internal control also requires procedures to ensure IT systems are used to their full capability to reduce the use of overrides in the system, which increases the risk for errors or fraud. Finally, good internal control requires changes made to members' addresses be reviewed and for the review to be documented by an individual who did not make the initial change.

We have identified concerns and areas where improvement to PIONEER (Pension Information of Nebraska for Efficient and Effective Retirement) is needed. The following are the more significant concerns or areas where improvement is needed to ensure the integrity of member data:

a. Access to the PIONEER database was not reviewed on a periodic basis. A similar finding was noted in the previous audit report.

b. PIONEER did not correctly calculate the benefit amount for judges who have elected the joint and survivor annuity option and did not correctly calculate Qualified Domestic Relations Order (QDRO) benefit payments. NPERS management implemented a manual override of PIONEER to force PIONEER to match the manual calculations.

c. Employees who work on benefits and refunds can make address changes for members with no subsequent review of the address change made to the member's account. A similar finding was noted in the previous audit report.

Although the Nebraska Information System (NIS) is the official accounting system of the State of Nebraska, 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. Without adequate internal controls, there is a risk employees may unintentionally corrupt critical data and that errors could occur and go undetected.

> We continue to recommend NPERS ensure the issues noted above are appropriately addressed as they work to strengthen PIONEER.

NPERS' Response:

A. All accesses to the PIONEER database are logged when they occur. NPERS IT team is in the process of investigating a way to review the log information on a periodic basis. The system logs are documented in the IT log book which can be found in the IT department. This logging process began in January 2006.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>PIONEER Concerns</u> (Concluded)

NPERS' Response, Concluded:

B. PIR #65678 was opened (this has transitioned into PIR # 65685) to address this issue. Regardless of whether PIONEER was matching or not matching, the practice is to replicate the Judge's calculation on the Actuary's spreadsheet. If PIONEER matches the spreadsheet, then the PIONEER data is accepted. If it doesn't match the spreadsheet, NPERS over-rides PIONEER to match the spreadsheet amount.

Data to determine Qualified Domestic Relations Order can vary so significantly and is not detailed from the employer, that it is not possible to automate all of the possibilities. Therefore, to help ensure as accurate results as possible, manual intervention is necessary. One approach that will be evaluated, from a control perspective, is to put a "reasonableness check" into PIONEER that could compare the amount entered as an override against the amount that was calculated by PIONEER and, using an algorithm, determine reasonableness. If it did not pass the reasonableness test, a lead or a manager would have to approve the override in order for it to get entered into PIONEER.

C. The functionality of audit address changes will be included in the Request for Proposal for the transition of PIONEER. The cost to add this functionality to PIONEER, at this time, is $19,600. It is considered a better business decision to not spend these funds on the current PIONEER system.

4. <u>School District Testing</u>

Neb. Rev. Stat. Section 84-1503(1)(g) R.S.Supp., 2006 states it is the Board's responsibility, "To adopt and implement procedures for reporting information by employers, as well as testing and monitoring procedures in order to verify the accuracy of such information."

Neb. Rev. Stat. Section 79-902(40) R.S.Supp., 2006 states, "Regular employee means an employee hired by a public school or under contract in a regular full-time or part-time position who works a full-time or part-time schedule on an ongoing basis for fifteen or more hours per week."

Neb. Rev. Stat. Section 79-906(1) R.S.Supp., 2006 states, "The director in charge of the retirement system shall keep a complete record of all members with respect to name, current address, age, contributions, and any other facts as may be necessary in the administration of the School Employees Retirement Act. The information in the records shall be provided by the employer in an accurate and verifiable form, as specified by the director. The director shall, from time to time, carry out testing procedures pursuant to section 84-1512 to verify the accuracy of such information."

COMMENTS AND RECOMMENDATIONS
(Continued)

4. <u>School District Testing</u> (Continued)

Neb. Rev. Stat. Section 79-902(35) R.S.Supp., 2006 defines compensation for purposes of the School Employees Retirement Act. Compensation means gross wages or salaries payable to the member for personal services performed during the plan year and includes (i) overtime pay, (ii) member retirement contributions, (iii) retroactive salary payments paid pursuant to court order, arbitration, or litigation and grievance settlements, and (iv) amounts contributed by the member to plans under sections 125, 403(b), and 457 of the Internal Revenue Code as defined in section 49-801.01 or any other section of the code which defers or excludes such amounts from income. Compensation does not include (i) fraudulently obtained amounts as determined by the retirement board, (ii) amounts for unused sick leave or unused vacation leave converted to cash payments, (iii) insurance premiums converted into cash payments, (iv) reimbursement for expenses incurred, (v) fringe benefits, (vi) bonuses for services not actually rendered, including, but not limited to, early retirement inducements, cash awards, and severance pay, or (vii) beginning on September 4, 2005, employer contributions made for the purposes of separation payments made at retirement and early retirement inducements as provided for in section 79-514.

Good internal control requires procedures to ensure the contributions remitted by school districts are complete and accurate. Good internal control also requires procedures to ensure all eligible and only eligible employees join the School Employees Retirement Plan.

NPERS did not have adequate sampling and monitoring procedures in place to ensure school districts correctly calculated and reported contributions, hours worked, and salary information. We reviewed payroll records at 30 of 509 school districts. The amounts contributed by these 30 school districts, totaling $32,461,690, represented approximately 16% of the total contributions for all school districts for the fiscal year. The sample size included 281 contributing members. The 281 members consisted of 129 members selected from NPERS' records, 129 members from the school district's records, and 23 superintendents. In addition, we tested 128 employees from the school districts' payroll registers who were not contributing to the Plan. We noted the following:

- There is an inconsistency among school districts regarding the definition of compensation and the components of compensation for retirement purposes. School districts are inconsistent in the handling of certain benefit dollars that may be used for insurance purposes or may be taken in cash. The definition of compensation in the statutes does not clearly address these benefit dollars.

- Seven of thirty school districts tested did not have all eligible employees contributing to the Plan. We noted 6 of 128 employees tested should have been contributing to the Retirement Plan because they consistently worked over 15 hours per week and need to make-up contributions. We also noted 2 of 128 employees tested should have been

COMMENTS AND RECOMMENDATIONS
(Continued)

4. <u>School District Testing</u> (Continued)

contributing to the Plan because they had previously worked full-time and had been contributing but then either retired and came back to work within 180 days or reduced their hours. We further noted 1 of 128 employees tested did not have retirement withheld from their jury duty pay. A similar finding was noted in previous audit reports.

- Five of thirty school districts tested reported compensation that was not in compliance with the definition of compensation in the School Employees Retirement Act. This included 15 of 281 contributing members tested. The school districts included long-term disability payments that were not covered under a Section 125 Plan in compensation. These errors resulted in overstatements of the members' annual compensation ranging from $59 to $628, and excess annual retirement contributions ranging from $9 to $101. A similar finding was noted in previous audit reports.

- Two of thirty school districts tested did not include all the required salary components. This included 5 of 281 members tested. The salary was reduced for long-term disability insurance which was not in the original salary amount. These errors resulted in understatements of the members' annual compensation ranging from $100 to $352 and understated annual retirement contributions ranging from $16 to $57. A similar finding was noted in previous audit reports.

Without adequate procedures in place by NPERS to ensure amounts are correctly reported, in accordance with statutes and consistent between school districts, there is a high risk errors such as those noted above will remain undetected. Also, since the benefit amount at retirement is calculated based in part on the reported salaries of the members, there is also an increased risk the benefit amount is not in accordance with statutory requirements. There is also an increased risk contributions needed to fund the plan are not adequate and service credit earned by an employee may be affected.

> We continue to recommend NPERS implement procedures to ensure the compensation and hours reported by school districts are correct and in compliance with statutes. We continue to recommend NPERS follow up with all exceptions noted during testing and communicate with the school districts to ensure items are corrected. We further recommend NPERS examine current statutory language and implement modifications due to the various interpretations of compensation by school districts.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. <u>School District Testing</u> (Concluded)

NPERS' Response: We have a full-time employee dedicated to testing the payroll of employers remitting contributions to the retirement office. We have requested and received compensation and information from schools. This includes reviewing the information entered by the school employers to ensure the accuracy of the information and ensure retirement contributions are withheld at the correct rate.

5. <u>Resolution of Prior Audit Findings - School District Testing</u>

Good internal control requires the timely and thorough resolution of prior audit findings. Good internal control also requires NPERS to obtain proper documentation to ensure that items are corrected. Government Auditing Standards and the American Institute of Certified Public Accountants (AICPA) regard the failure to follow up and correct previously identified internal control deficiencies to be a reportable condition.

NPERS did not appropriately resolve prior audit findings for school districts in a timely manner. NPERS had contacted all of the school districts from the prior audits; however, 13 of 37 school districts still had outstanding issues, as follows:

a. Findings for six school districts (one of which had two issues) from the fiscal year 2005 audit of the School Plan were not adequately resolved.

   - Four school districts were not calculating retirement contributions on the correct compensation as noted in the fiscal year 2005 audit. One of the schools tested, corrected the issue; however, another compensation issue was discovered.

   - Two school districts had employees that should have been contributing to the Plan. NPERS had contacted the schools but the employees have not made-up contributions.

   - One school district tested had an incorrect amount of retirement contributions withheld from an employee's paycheck. NPERS contacted the school district; however, the amount has not been deducted from the employee's pay.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Resolution of Prior Audit Findings - School District Testing (Continued)

b. Findings for four school districts from the fiscal year 2004 audit of the School Plan were not adequately resolved.

- Two school districts were not calculating retirement contributions on the correct compensation as noted in the fiscal year 2004 audit. NPERS contacted the two schools and the issues tested were corrected; however, two new issues regarding compensation were discovered.

- One school district tested had an employee that should have been contributing to the Plan. NPERS contacted the school and the employee is now contributing; however, make-up contributions have not been completed.

- One school district was still not handling fringe benefits correctly pertaining to cash-in-lieu of insurance. We do not agree with the school's interpretation of the components of compensation regarding insurance under a Section 125 plan when an employee chooses to forego the insurance coverage.

c. Findings for three school districts from the fiscal year 2003 audit of the School Plan were not adequately resolved.

- Two school districts were not calculating retirement contributions on the correct compensation as noted in the fiscal year 2003 audit. One school corrected the issue that had been tested; however, a new issue regarding compensation was discovered. The other school was contacted by NPERS but was not informed that the calculation was incorrect.

- One school district had an employee who was identified in the fiscal year 2003 audit as an employee who should be contributing to the School Plan. This employee was still not contributing to the School Plan during the fiscal year 2006 audit fieldwork.

A similar finding has been noted in the past several audit reports.

There is an increased risk that errors in plan membership and compensation will remain incorrect, unless adequate procedures are developed to follow up on prior audit findings and resolve them in a timely manner.

> We recommend NPERS continue to follow up on audit findings in a timely manner. We also recommend NPERS implement procedures to ensure adequate documentation is obtained from schools to ensure they have resolved the issues.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Resolution of Prior Audit Findings - School District Testing (Concluded)

NPERS' Response: We have addressed and corrected many of the prior audit findings. We will review and update our procedures to ensure adequate documentation is obtained from the schools to make sure the schools have resolved the issues correctly. We will continue to work with the School Employers to resolve prior audit findings and research the individuals identified by the auditors and to ensure the necessary changes are made.

6. Segregation of Duties Over School Contributions

Good internal control requires procedures to ensure no one individual is in a position to both perpetrate and conceal errors or irregularities.

One individual in the accounting area was able to process school contributions, had access to the checks, and also performed the follow up of school districts that had not remitted contributions between March 2006 and October 2006, after the departure of another individual in the accounting area.

Without adequate procedures to ensure an adequate segregation of duties over school contributions, there is an increased risk for errors or fraud in the processing of contributions.

> We recommend NPERS implement procedures to ensure an adequate segregation of duties over the processing of school contributions. This would include procedures to ensure segregation of duties is possible in the event of employee turnover.

NPERS' Response: NPERS will work to ensure there is always adequate segregation of duties. We will incorporate more cross training into our procedures so that in the event there is employee turnover there are others that can perform the functions.

7. Notarized Applications

Good internal control requires retirement applications be notarized to ensure the individual requesting benefit payments is the actual member and to decrease the risk for fraudulent payments.

There were 7 of 14 retirement applications for Judges' benefit payments tested and 10 of 15 retirement applications for School benefit payments tested that were not notarized.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Notarized Applications (Concluded)

When retirement applications are not notarized, there is an increased risk for fraudulent benefit payments.

> We recommend NPERS implement procedures to ensure all retirement applications are notarized prior to the issuance of benefit payments.

NPERS' Response: Procedures have been updated and staff has been informed not to accept any old versions of retirement applications.

8. Member Interest

Good internal control requires procedures to ensure the allocation of interest to individual member accounts is fair and accurate.

In December 2003, the NPERB approved a method to post interest to member accounts based on the balance at the beginning of the month and the interest rate in effect at the time of the interest posting until such time as the cost of converting to an actual basis was known. In January 2004, two estimates were brought before the Board, one to make the change to calculate interest on the average daily balance and the second to change back to the balance at the end of the month. Neither change was implemented, but the project manager at the time, suggested revisiting the policy in a year to determine whether NPERS staff could make the change when they took over the system. This policy has not been revisited by the Board.

Members who take a refund prior to the interest posting may miss interest on their last contribution since interest is posted based on the balance at the beginning of the month. If a contribution posted and the member received a refund in the same month, there would be no interest on the final contribution.

> We recommend NPERS revisit the alternative methods of posting interest to members' accounts since the alternatives would be more accurate to each member.

NPERS' Response: The alternative methods of posting interest will be included in the Request for Proposal for the transition of PIONEER. When all information is received it will be brought to the Boards attention for discussion.

COMMENTS AND RECOMMENDATIONS
(Continued)

9. Travel Expenses

Meal Expenses

Good internal control requires procedures to ensure meal expenses charged to the Plans are reasonable.

We noted meal expenses were not reasonable for four of six documents tested, as follows:

- One employee was reimbursed $47 for one meal on one day and was also reimbursed $54 for two meals on a separate day, which are unreasonable amounts to be charged to the Plans.
- One employee was reimbursed $41 for one meal on one day and $48 for one meal on a separate day, which are unreasonable amounts to be charged to the Plans.
- One employee was reimbursed $44 for one meal and a total of $59 for the day, which is an unreasonable amount to be charged to the Plans. The employee was also reimbursed $8 for lunch, when lunch was provided by the conference.
- One employee was reimbursed $41 for one meal, which is an unreasonable amount to be charged to the Plans.

This has been a finding in the past several audit reports.

The cost to each plan increases unnecessarily when unreasonable meals are claimed for reimbursement.

> We recommend NPERS implement procedures to ensure only reasonable expenses are charged to each plan.

NPERS' Response: Staff will be reminded not to exceed the federal per diem breakdown when claiming reimbursement of expenses.

Lodging Expenses

Neb. Rev. Stat. Section 84-1503.03 R.S.Supp., 2006, allows the Director of NPERS to hire employees to carry out the duties of the Board. Such employees are deemed State employees and are covered by the State Personnel system. The statute states, "All employees shall comply with state accounting regulations and applicable state and federal laws in the discharge of their duties."

COMMENTS AND RECOMMENDATIONS
(Continued)

9. Travel Expenses (Continued)

Lodging Expenses (Concluded)

DAS Accounting Division State Accounting Manual states, "It is State Accounting policy that a person generally must be more than 60 miles from his or her workplace in order to be eligible for lodging." Lodging may be reimbursed when an employee is "away from home overnight." The Internal Revenue Service states, "You are away from home overnight if your duties require you to be away from the general area of employment for substantially longer than an ordinary day's work and, during released time while away, it is reasonable for you to need and get sleep or rest to meet the demands of your employment or business. The absence must be of such duration that you can not reasonably leave and return to that location before and after each day's work."

NPERS paid lodging for 7 of 14 employees/NPERB members tested for the annual Board retreat who were less than 60 miles from their headquarter city. There were three State employees and four Board members. The total lodging for these individuals was $623. We have noted this finding for the past several audits.

NPERS was not in compliance with DAS policies for State employees whose lodging was reimbursed when they were less than 60 miles from their headquarter city.

> We recommend NPERS ensure compliance with State policies for its employees and ensure lodging expenses are only reimbursed when employees are more than 60 miles from his or her workplace.

NPERS' Response: The PERB has addressed the issue.

Miscellaneous Travel Expenses

Good internal control requires procedures to ensure only reasonable and necessary costs are charged to the Plans.

- One of four documents tested with mileage expenses was not reasonable. State vehicles were rented for 19 days in September 2005 and 17 days in October 2005. However, the State vehicles were only used 13 days in September and 10 days in October. NPERS paid $18 for each day they rented the State vehicle. This resulted in extra daily charges for 13 days in the amount of $228 when the car was not in use.

- These vehicles also exceeded the allowable mileage variances in four different cases. The variances ranged from 17 to 49 miles respectively.

9. Travel Expenses (Concluded)

Miscellaneous Travel Expenses (Concluded)

Unreasonable expenses charged to the Plan decrease the plan assets available for benefits.

> We recommend NPERS ensure State vehicles are only checked out when the vehicle is actually needed and mileage driven in State vehicles is reasonable.

NPERS' Response: There was a misunderstanding between our agency and the TSB attendants about rental charges of vehicles. We have cleared the misunderstanding and will be checking vehicles in and out properly. We will discuss with staff about reducing unnecessary miles and documenting extra miles.

10. Minimum Accrual Rate

For the School Plan, Neb. Rev. Stat. Section 79-947.04 R.R.S. 2003 states, "The minimum accrual rate is eighteen dollars until adjusted pursuant to this section. Commencing on June 30, 1999, the retirement board shall annually adjust the minimum accrual rate to reflect the cumulative change in the National Consumer Price Index … from the last adjustment of the minimum accrual rate."

For the Judges Plan, Neb. Rev. Stat. Section 24-710.10 R.S.Supp., 2006 states, "The minimum accrual rate is thirty-five dollars until adjusted pursuant to this section. Commencing on June 30, 1999, the retirement board shall annually adjust the minimum accrual rate to reflect the cumulative change in the National Consumer Price Index … from the last adjustment of the minimum accrual rate."

For the Patrol Plan, Neb. Rev. Stat. Section 81-2027.06 R.R.S. 1999 states, "The minimum accrual rate is thirty dollars until adjusted pursuant to this section. Commencing on June 30, 1999, the retirement board shall annually adjust the minimum accrual rate to reflect the cumulative change in the National Consumer Price Index … from the last adjustment of the minimum accrual rate."

NPERS was not calculating the minimum accrual rates in accordance with State statutes 79-947.04, 24-710.10, and 81-2027.06. In July 1999, NPERS used the original minimum accrual rate stated in the statutes instead of adjusting the original rate as required, which affected the minimum accrual rate used for the COLA calculations for every year after 1999. Although NPERS adjusted the minimum accrual rate on PIONEER for the 2006 benefit adjustments, the

10. Minimum Accrual Rate (Concluded)

rate was still one year off in their system. The minimum accrual rate does not affect the amount of the benefit adjustment, it affects whether or not a member is eligible to receive the adjustment calculated under this section of statute.

Additionally, NPERS did not properly follow up on this issue from the prior year. NPERS compiled a list of members who were eligible to receive the adjustment under this section of statute but did not get the adjustment because it was either not the largest adjustment available under the statutes, or because the minimum accrual rate was not higher than the monthly accrual rate. However, NPERS did not determine if using the correct minimum accrual rate (as noted above) would affect whether or not these members should have received the adjustment under this section of statute.

When the incorrect minimum accrual rate is used in a member's benefit adjustment calculation, there is an increased risk the member's benefit may not be adjusted by the correct amount.

> We recommend NPERS ensure the minimum accrual rate used under these sections of statute is correct. In addition, we recommend NPERS determine the effect of using the incorrect minimum accrual rate for those eligible members and whether any adjustments need to be made since the first benefit adjustments were given in 2000.

NPERS' Response: We will work to ensure the minimum accrual rate used is correct according to statute. We will determine if any adjustments need to be made to the first benefit adjustments that were given in 2000.

11. Reconciliation of Bank Records to the Nebraska Information System

During the audit of the Comprehensive Annual Financial Report (CAFR) of the State of Nebraska, we noted the absence of a completed reconciliation between the State Treasurer's bank statements and the accounting records on the Nebraska Information System (NIS). This has been an issue for the Department of Administrative Services Accounting Division (State Accounting) for many years. Our previous comments noted monthly reconciliations were not completed in a timely manner and showed significant unknown variances with bank records short compared to accounting records. Although State Accounting continues to work on the reconciliation of bank records to NIS accounting records, we continue to note areas where improvement is needed in the reconciliation process to ensure NIS integrity and operational efficiency.

COMMENTS AND RECOMMENDATIONS
(Continued)

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

As of October 31, 2006, State Accounting has developed a very detailed process of analyzing bank activity compared to activity recorded on NIS to identify reconciling items, but continued progress is needed. State Accounting continues to work on reconciliations for the months of June 2005 through June 2006 to determine the reasons for the continuing unknown variances. We have reviewed the reconciliations and noted the month of June 2006 shows an unknown variance of $2,657,411. Again, the reconciliations show bank records short compared to accounting records.

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 NIS accounting records, there is a greater risk for fraud or errors to occur and to remain undetected.

> We recommend State Accounting continue the reconciliation process to ensure all financial information is correct on NIS. We also recommend, when a consistent cash variance between bank records and accounting records is obtained, State Accounting should submit the shortage amount to the Governor and the Legislature. The Governor and the Legislature should then develop a plan to correct NIS accounting records and resolve the shortage noted.

This issue is the responsibility of State Accounting; however, as the variance has 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 Department of Administrative Services (DAS) and the NIS implementation team. NPERS does not have the authority to address this issue.

STATE OF NEBRASKA
Auditor of Public Accounts

Mike Foley
State Auditor
Mike.Foley@apa.ne.gov

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

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

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) – School Employees, Judges, and State Patrol Retirement Plans as of and for the fiscal year ended June 30, 2006, as listed in the Table of Contents. These financial statements are the responsibility of NPERS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol 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 – School Employees, Judges, and State Patrol Retirement Plans as of June 30, 2006, and the results of each Plan's operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 8, 2007, on our consideration of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and 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.

NPERS has not presented Management Discussion and Analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

The "Schedules of Funding Progress," "Schedules of Contributions from Employers and Other Contributing Entities," and "Notes to Required Supplementary Information" are not a required part of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board. For the "Schedules of Funding Progress" and "Notes to Required Supplementary Information," 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. For the "Schedules of Contributions from Employers and Other Contributing Entities," the information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans, taken as a whole. The accompanying supplementary schedule of Service Efforts and Accomplishments and related graphs are presented for purposes of additional analysis and are not a required part of the financial statements of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Pat Reding, CPA

January 8, 2007 Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
STATEMENTS OF PLAN NET ASSETS
June 30, 2006

	School Employees	Judges	State Patrol
ASSETS			
Cash in State Treasury (Note 1)	$ 2,457,894	$ 62,519	$ 68,667
Deposits with Vendors	9,091	94	94
Receivables:			
Contributions	47,439,247	470,219	1,977,890
Interest and Dividend Income	8,999,192	158,214	364,635
Other Investment Receivables (Note 11)	26,796,486	467,586	1,080,330
Total Receivables	83,234,925	1,096,019	3,422,855
Investments, at fair value (Note 3):			
US Treasury Securities	73,838,126	1,288,432	2,976,830
Government Agency Securities	415,365,736	7,247,890	16,745,729
Corporate Bonds	219,019,939	3,821,770	8,829,926
Equity Securities	760,467,160	13,269,708	30,658,709
Options	(640,435)	(11,175)	(25,820)
Taxable Municipal Bonds	17,442,158	304,355	703,191
Real Estate Investment Trusts	42,387,281	739,633	1,708,870
Collateralized Mortgage Obligations	123,329,679	2,152,099	4,972,403
Asset Backed Securities	105,373,654	1,838,709	4,248,205
Mutual Funds	649,929,077	11,340,883	26,202,297
Pooled Funds	3,390,085,813	59,155,019	136,673,429
Commercial Paper, Money Market, and Foreign Currency	206,512,764	3,603,552	8,325,798
Total Investments	6,003,110,952	104,750,875	242,019,567
Invested Securities Lending Collateral (Note 3)	168,867,589	2,946,643	6,808,015
Capital Assets (Note 10):			
Equipment	7,483,576	2,036,889	1,992,481
Less: Accumulated Depreciation	(3,796,506)	(1,026,775)	(1,005,926)
Total Capital Assets	3,687,070	1,010,114	986,555
TOTAL ASSETS	6,261,367,521	109,866,264	253,305,753
LIABILITIES			
Compensated Absences (Note 4)	196,756	2,741	2,879
Accounts Payable and Accrued Liabilities	2,105,687	44,310	94,236
Obligations Under Securities Lending (Note 3)	168,867,589	2,946,643	6,808,015
Capital Lease Obligations (Note 7)	4,073,117	1,052,992	1,042,620
Other Investment Payables (Note 11)	107,975,728	1,884,113	4,353,109
Contributions for Omaha Public Schools (Note 5)	2,660,140	-	-
TOTAL LIABILITIES	285,879,017	5,930,799	12,300,859
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A schedule of funding progress for each plan is presented on page 42.)	$ 5,975,488,504	$ 103,935,465	$ 241,004,894

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	School Employees	Judges	State Patrol
ADDITIONS:			
Contributions:			
Employee	$ 104,376,870	$ 1,061,263	$ 3,178,502
Employer	102,161,426	-	3,669,394
Court Fees	-	3,048,084	-
State	30,716,843	72,244	1,413,786
Total Contributions	237,255,139	4,181,591	8,261,682
Investment Income:			
Net appreciation (depreciation) in fair value of investments	454,221,471	8,001,898	18,631,531
Interest & Dividends	120,928,896	2,124,168	4,930,296
Securities Lending Income	8,747,410	152,638	352,658
Total Investment Income	583,897,777	10,278,704	23,914,485
Investment Expenses	(9,559,791)	(167,205)	(387,323)
Securities Lending Expenses	(8,366,378)	(145,989)	(337,296)
Net Investment Income	565,971,608	9,965,510	23,189,866
Other Additions	22,767	32	62
Total Additions	803,249,514	14,147,133	31,451,610
DEDUCTIONS:			
Benefits	206,222,696	4,703,966	11,168,135
Refunds of Contributions	11,629,343	20,086	145,501
Administrative Expense	3,830,708	436,753	432,283
Total Deductions	221,682,747	5,160,805	11,745,919
Net Increase	581,566,767	8,986,328	19,705,691
Net assets held in trust for pension benefits			
Beginning of year	5,393,921,737	94,949,137	221,299,203
End of year	$ 5,975,488,504	$ 103,935,465	$ 241,004,894

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

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2006

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 State Employees and County Employees Retirement Plans and the Deferred Compensation Plan for fiscal year ended December 31, 2005.

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

Basis of Presentation. The accompanying financial statements of NPERS – School Employees, Judges, and State Patrol 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 all liabilities associated with the operation of these funds are included on the Statements of Plan Net Assets.

The School Employees, Judges, and State Patrol 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 as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each Plan.

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 School Employees, Judges, and State Patrol Retirement Plans were designated for investment during fiscal year 2006.

Investments. Investments as reported in the financial statements include long-term investments. Law or legal instruments may restrict these investments. Investments are stated at fair value based on quoted market prices. For investments where no readily ascertainable fair value exists, management has received an estimate of fair value from the investment fund manager based, in part, on real estate appraisals. 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 and Contribution Information

Membership of each plan consisted of the following at June 30, 2006, the date of the last actuarial valuation:

	School Employees	Judges	State Patrol
Retirees and beneficiaries receiving benefits	13,727	162	331
Terminated plan members entitled to but not yet receiving benefits	17,755	10	14
Active plan members	36,414	154	477
Total	67,896	326	822

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions and Contribution Information (Continued)

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

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

School Employees Retirement

Plan Description. The School Employees Retirement Plan is a cost-sharing multiple-employer defined benefit pension plan. The Legislature in 1945 enacted the law establishing a retirement plan for school employees of the State. During fiscal year 2006, there were 509 participating school districts. These were the districts that had contributions during the fiscal year. All regular public school employees in Nebraska, other than those who have their own retirement plan (Class V school districts, Nebraska State Colleges, University of Nebraska, Nebraska Community Colleges), are members of the plan. The benefits are based on both service and salary.

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

Contributions. The State’s contribution is based on an annual actuarial valuation. In addition, the State contributes an amount equal to 0.7 percent of the compensation of all members. The employees’ contribution was equal to 7.25 percent of their compensation from July 1, 2005, to August 31, 2005, and was equal to 7.98 percent from September 1, 2005, to June 30, 2006. The school district’s (employer) contribution is 101 percent of the employees’ contribution.

2. Plan Descriptions and Contribution Information (Continued)

Judges Retirement

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

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

Contributions. The plan is funded by members' contributions, a portion of the court fees and the State's contributions. A five dollar fee for each case is collected from District and County courts, Juvenile courts, Workers' Compensation court, Supreme Court, and the Court of Appeals, plus a ten percent charge on certain fees collected in the County Courts. The State's contribution is based on an annual actuarial valuation. The members hired after July 1, 2004, or who elected an enhanced Joint and Survivor Benefit as of July 1, 2004, are required to contribute eight percent of their monthly salary until the maximum benefit has been earned. After the maximum benefit has been earned, such member contributes four percent of their monthly salary for the remainder of his or her active service. All other members contribute six percent of their monthly salary until the maximum benefit had been earned. After the maximum benefit had been earned, such member makes no further contributions to the fund, except that any time the maximum benefit is changed, a member who has previously earned the maximum benefit will contribute six percent of their salary until the maximum benefit as changed has been earned.

State Patrol Retirement

Plan Description. The State Patrol Retirement Plan is a single-employer defined benefit pension plan which was created in 1947 for officers of the patrol. The State Patrol is an agency of the State of Nebraska. The benefits are based on a percentage of the final average salary multiplied by years of service, not to exceed 75 percent of the final average salary. To receive maximum benefits officers are required to have 25 years of service and be at least 50 years old. Normal benefits are calculated using the average monthly salary for the three 12-month periods of service in which

2. Plan Descriptions and Contribution Information (Concluded)

compensation was the greatest multiplied by years of service and the formula factor of 3%. Calculation will vary with early retirement. Benefits vest after ten years of service.

Contributions. Members are required to contribute 13 percent of their annual pay from July 1, 2005, to June 30, 2006, plus, for a State Patrol officer employed on or before January 4, 1979, 13 percent of pay received at termination for unused sick leave and vacation leave. The State Patrol's (employer) contribution is 15 percent of the employees' annual pay. The State's contribution is based on an annual actuarial valuation.

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, 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.

The investment amounts presented in the statements of net assets for the School Employees, Judges, and State Patrol Retirement Plans do not agree to the investment risk disclosures noted below. The investment risk disclosures presented below include the Defined Benefit Plans and the Cash Balance Benefit portion of the State and County Retirement Plans, as these funds are commingled for investment purposes.

3. Investments (Continued)

NPERS' investments for the School Employees, Judges, and State Patrol Retirement Plans at June 30, 2006, are presented below. All investments are presented by investment type and debt securities are presented with effective duration presented in years.

School Employees, Judges, and Patrol Retirement Plan Investments at June 30, 2006

	Fair Value	Effective Duration
Debt Securities		
U.S. Treasury Notes and Bonds	$ 67,128,849	5.18
U.S. Treasury Bills	6,977,812	0.23
U.S. Treasury Strips	3,996,729	15.44
Government Agency Securities	439,359,355	4.68
Corporate Bonds	231,671,635	4.04
Collateral Mortgage Obligations	130,454,180	4.31
Asset Backed Securities	111,460,568	1.37
Commercial Paper	82,323,760	2.17
Money Market Funds	127,967,010	4.82
Municipal Bonds	18,449,705	11.68
	1,219,789,603	
Other Investments		
Equity Securities	804,395,577	
Pooled Funds	3,585,914,260	
Mutual Funds	687,472,257	
Options	(677,430)	
Foreign Currency	8,151,344	
Real Estate Investment Trust	44,835,783	
Total Investments	6,349,881,394	
Securities Lending Short-term Collateral Investment Pool	178,622,247	
Total	$ 6,528,503,641	

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 investment's 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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Investments (Continued)

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 June 30, 2006, 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.

Defined Benefit/Cash Balance Benefit Investments at June 30, 2006

		Quality Ratings							
	Fair Value	**AAA**	**AA**	**A**	**BBB**	**BB**	**B**	**A-1**	**Unrated**
Government Agency Securities	472,897,360	323,030,986	2,144,706	1,231,453	10,498,375	20,817,233	2,271,456	-	112,903,151
Corporate Bonds	249,356,034	29,758,719	72,864,130	59,233,925	21,310,131	25,726,897	25,019,911	-	15,442,321
Collateral Mortgage Obligations	140,359,582	132,842,822	1,865,399	-	-	-	848,476	-	4,802,885
Asset Backed Securities	119,968,788	104,032,005	-	807,537	220,190	351,448	1,724,987	-	12,832,621
Commercial Paper	88,607,854	-	-	-	-	-	-	7,790,534	80,817,319
Money Market Funds	139,682,051	-	-	-	-	-	-	-	139,682,051
Municipal Bonds	19,858,043	18,694,796	901,692	-	261,555	-	-	-	-

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 June 30, 2006, NPERS had no investments that exceeded 5 percent or more of total investments.

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 has contracts with investment managers that limit foreign currency risk. NPERS exposure to foreign currency risk is presented on the following table.

Defined Benefit/Cash Balance Benefit Foreign Currency at June 30, 2006

	Cash	Equity Securities	Debt Securities
Argentine Peso	$ 2,659	$ -	$ 207,330
Australian Dollar	11,544	7,661,073	-
Canadian Dollar	68,646	1,284,679	247,758
Danish Krone	-	220,167	-
Euro Currency	1,484,055	80,993,062	6,855,990
Hong Kong Dollar	36,695	7,356,119	-
Indonesian Rupiah	-	646,670	-
Japanese Yen	6,891,580	28,969,803	-
Mexican Peso	150,560	-	2,519,602
Polish Zloty	418	1,504,064	-
Pound Sterling	79,936	36,742,940	587,893
Singapore Dollar	416	1,823,236	-
South Korean Won	2,000	7,932,894	-
Swedish Krona	26,443	5,611,022	-
Swiss Franc	16,363	22,140,893	-
Thailand Baht	2,253	869,616	-
Total	$ 8,773,568	$ 203,756,238	$ 10,418,573

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

3. Investments (Concluded)

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 38 and 50 days. Because loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. There is no loss indemnification provided to 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 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 obligation, to purchase or sell securities 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 and 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 June 30, 2006, the State held futures contracts with a notional value of $(334,850,000) and a market value of $0. In addition, the State held options with a notional value of $(15,078,500) and a market value of $(729,141) and swaps with a notional value of $8,900,000 and a market value of $(1,507,015).

4. Compensated Absences

All permanent employees working for the retirement systems earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees and board members are not eligible for paid leave.

4. **Compensated Absences** (Concluded)

Employees accrue vested annual leave at a variable rate based on years of service. Generally, accrued annual leave cannot exceed 35 days at the end of a calendar year.

Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days for employees under the Nebraska Classified System Personnel Rules and Regulations. In general, there is no maximum limit on the accumulation of sick days for employees under a labor contract. Sick leave is not vested except upon death or upon reaching the retirement eligibility age of 55, at which time, the State is liable for 25 percent of the employee's accumulated sick leave. Employees under labor contracts can be paid a maximum of 50 days.

All Plans recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave becomes vested.

The liability for the vested portion of compensated absences for each Plan at June 30, 2006, is as follows:

	School Employees	Judges	State Patrol
Annual Leave	$ 106,740	$ 1,487	$ 1,562
Sick Leave	90,008	1,254	1,317
Compensatory Leave	8	0	0
	$ 196,756	$ 2,741	$ 2,879

5. **Contribution for Omaha Public Schools**

Neb. Rev. Stat. Section 79-916, R.S.Supp., 2006 required an annual payment to be made to Omaha Public Schools as a result of that school system having a separate retirement system. The contribution amount represents the July payment to Omaha Public Schools. This amount is included in State Contributions Additions and recorded as benefits when payment is made.

6. **Six-Year Historical Trend Information**

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

7. Contingencies and 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 DAS Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident 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. The DAS Personnel Division maintains health care and life insurance for eligible employees.

C. Crime coverage, with a limit of \$1 million for each loss, and a \$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 DAS Division of Risk Management.

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

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the 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

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Contingencies and Capital Lease Commitments (Continued)

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 15, 2002, was for $6,029,861 including interest costs of $644,861, a rate of 3.129%. The first Master Lease Agreement was refinanced 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 February 12, 2004, was for $4,062,231, including interest costs of $326,708, a rate of 2.530%. The minimum annual lease payments and the present value of future minimum payments for all capital leases as of June 30, 2006, are as follows:

Fiscal Year	School Employees	Judges	State Patrol
2007	$ 1,225,145	$ 330,751	$ 324,126
2008	1,167,541	313,891	307,904
2009	1,032,874	274,477	269,983
2010	657,641	164,652	164,318
2011	204,610	32,058	36,746
Total Minimum Payments	4,287,811	1,115,829	1,103,077
Less: Interest and Executory costs	214,694	62,837	60,457
Present value of net minimum payments	$ 4,073,117	$ 1,052,992	$ 1,042,620

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Contingencies and Capital Lease Commitments (Concluded)

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

8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended June 30, 2006, are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
School Employees:					
Compensated Absences	$ 173,231	$ 23,525	$ -	$ 196,756	$ 28,392
Capital Lease Obligations	5,113,596	-	1,040,479	4,073,117	1,065,173
Totals	$ 5,286,827	$ 23,525	$ 1,040,479	$ 4,269,873	$ 1,093,565
Judges:					
Compensated Absences	$ 5,958	$ -	$ 3,217	$ 2,741	$ 396
Capital Lease Obligations	1,357,522	-	304,530	1,052,992	311,758
Totals	$ 1,363,480	$ -	$ 307,747	$ 1,055,733	$ 312,154
State Patrol:					
Compensated Absences	$ 7,085	$ -	$ 4,206	$ 2,879	$ 415
Capital Lease Obligations	1,335,615	-	292,995	1,042,620	299,949
Totals	$ 1,342,700	$ -	$ 297,201	$ 1,045,499	$ 300,364

9. School Employee Contributions

Employee contributions for the School Plan exceeded employer contributions due to purchase of service payments totaling $3,255,776. Members can purchase service credit for reinstatement of service, out-of-state service, for a leave of absence, or within twelve months of retirement in accordance with Neb. Rev. Stat. Sections 79-921, 79-933.05, 79-933.06, and 79-933.08.

NOTES TO FINANCIAL STATEMENTS
(Continued)

10. Capital Assets

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

	Beginning Balance	Increases	Decreases	Ending Balance
School Employees:				
Equipment	$ 7,483,576	$ -	$ -	$ 7,483,576
Less: Accumulated Depreciation	2,727,424	1,069,082	-	3,796,506
Total Capital Assets, Net	$ 4,756,152	$ (1,069,082)	$ -	$ 3,687,070
Judges:				
Equipment	$ 2,036,889	$ -	$ -	$ 2,036,889
Less: Accumulated Depreciation	735,791	290,984	-	1,026,775
Total Capital Assets, Net	$ 1,301,098	$ (290,984)	$ -	$ 1,010,114
State Patrol:				
Equipment	$ 1,992,481	$ -	$ -	$ 1,992,481
Less: Accumulated Depreciation	721,286	284,640	-	1,005,926
Total Capital Assets, Net	$ 1,271,195	$ (284,640)	$ -	$ 986,555

11. Other Investment Receivables/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 June 30, 2006, 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 fiscal year ended June 30, 2006. These fees include both the Defined Benefit Plans and Cash Balance Benefit option managed by the Nebraska Investment Council.

NOTES TO FINANCIAL STATEMENTS
(Continued)

12. Fees on Investments (Concluded)

External Manager Fees	Defined Benefit Plans
Abbott Capital	$ 220,000
Acadian Asset Management, Inc.	597,620
Alliance Bernstein Institutional Investment Management	1,037,597
Ariel Capital Management, LLC.	660,141
Baillie Gifford	843,540
Barclays Global Investors	873,346
BlackRock Financial Management	901,639
Dimensional Fund Advisors, Inc	961,234
Goldman Sachs Asset Management	499,563
Grantham, Mayo, Van Otterloo & Co., LLC	2,609,862
Heitman	382,570
PIMCO	1,315,549
T. Rowe Price Associates, Inc.	390,641
JP Morgan Investment Management, Inc.	620,566
MFS Global Equity	459,727
UBS Global Asset Management (Americas), Inc.	460,598
Total External Manager Fees	$ 12,834,193

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

13. Subsequent Events

School Employee Contributions
Neb. Rev. Stat. Section 79-958(1) R.S.Supp., 2006 defines required contributions to the School Plan. Beginning on September 1, 2005, and ending August 31, 2006, every employee shall be required to deposit in the School Retirement Fund 7.98 percent of compensation. Beginning on September 1, 2006, and ending August 31, 2007, every employee shall be required to deposit in the School Retirement Fund 7.83 percent of compensation. After August 31, 2007, every employee shall be required to deposit in the School Retirement Fund 7.25 percent of compensation.

State Patrol Contributions
Neb. Rev. Stat. Section 81-2017 (1) and (2) defines required contributions to the Patrol Plan. Commencing July 1, 2005, and through June 30, 2007, each officer while in the service of the Nebraska State Patrol shall pay or have paid on his or her behalf a sum equal to 13 percent of his or her monthly compensation. There shall also be assessed against the appropriation of the State Patrol a sum equal to 15 percent of each officer's monthly compensation. Commencing July 1, 2007, each officer while in the service of the Nebraska State Patrol shall pay or have paid on his or her behalf a sum equal to 12 percent of his or her monthly compensation. There shall also be assessed against the appropriation of the State Patrol 13 percent of each officer's monthly compensation.

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

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULES OF FUNDING PROGRESS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

UNAUDITED

SCHEDULE 1

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
SCHOOL EMPLOYEES						
6/30/2006	$5,739,048,994	$6,584,275,406	$845,226,412	87.2%	$1,247,684,378	67.7%
6/30/2005	5,335,197,409	6,234,657,830	899,460,421	85.6%	1,214,227,197	74.1%
6/30/2004	5,118,011,165	5,868,266,970	750,255,805	87.2%	1,170,601,127	64.1%
6/30/2003	4,952,902,870	5,464,572,876	511,670,006	90.6%	1,138,776,241	44.9%
6/30/2002	4,799,789,893	5,055,867,993	256,078,100	94.9%	1,065,515,857	24.0%
6/30/2001	1,486,008,665	1,704,201,512	218,192,847	87.2%	995,348,331	21.9%

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

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
JUDGES						
6/30/2006	$ 100,565,893	$ 101,438,239	$ 872,346	99%	$ 16,422,894	5.3%
6/30/2005	94,922,714	98,512,876	3,590,162	96%	16,285,137	22.0%
6/30/2004	92,810,699	95,671,391	2,860,692	97%	16,655,342	17.2%
6/30/2003	91,863,620	85,387,839	(6,475,781)	108%	16,402,342	(39.5%)
6/30/2002	92,596,279	81,191,724	(11,404,555)	114%	16,062,274	(71.0%)
6/30/2001	90,685,851	90,685,851	-	100%	15,188,085	0.0%
STATE PATROL						
6/30/2006	$ 231,740,772	$ 245,373,102	$ 13,632,330	94.4%	$ 24,057,960	56.7%
6/30/2005	219,831,273	236,026,471	16,195,198	93.1%	22,882,413	70.8%
6/30/2004	216,422,556	222,161,512	5,738,956	97.4%	22,640,907	25.3%
6/30/2003	214,657,454	210,930,784	(3,726,670)	101.8%	21,929,399	(17.0%)
6/30/2002	214,527,994	197,615,091	(16,912,903)	108.6%	18,846,776	(89.7%)
6/30/2001	208,372,640	187,284,490	(21,088,150)	111.3%	16,727,477	(126.1%)

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF CONTRIBUTIONS FROM EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

SCHEDULE 2

SCHOOL EMPLOYEES			
Year Ended	Annual Required Contribution (1)		Percentage
June 30	State (2)	School	Contributed
2006	$ 30,644,522	$ 102,161,426	100%
2005	29,816,737	90,147,174	90%
2004	14,154,879	87,438,804	100%
2003	13,119,888	84,467,330	100%
2002	12,659,281	80,288,662	100%
2001	12,225,219	77,062,544	100%

JUDGES			
Year Ended	Annual Required Contribution		Percentage
June 30	State	Court Fees	Contributed
2006	$ 72,169	$ 3,048,084	100%
2005	501,841	2,217,118	84%
2004	72,244	2,002,153	100%
2003	712,518	579,145	50%
2002	72,244	492,613	100%
2001	72,244	487,012	100%

STATE PATROL		
Year Ended	Annual Required	Percentage
June 30	Contribution	Contributed
2006	$ 5,083,180 (3)	100%
2005	3,868,904	82%
2004	3,018,366	96%
2003	2,652,857	100%
2002	2,428,025	100%
2001	2,257,609	100%

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

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

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

(3) Additional State funding is required for the State Patrol Plan in the amount of $813,159, as of July 1, 2007.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
UNAUDITED

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

	School Employees	Judges	State Patrol
Valuation Date	June 30, 2006	June 30, 2006	June 30, 2006
Actuarial Cost Method	Entry Age	Entry Age	Entry Age
Amortization Method	Level Dollar Closed	Level Dollar Closed	Level Dollar Closed
Remaining Amortization Period	30 Years	30 Years	30 Years
Mortality	1994 Group Annuity Table Setback 2 Years	1994 Group Annuity Table Setback 2 Years	1994 Group Annuity Table
Asset Valuation Method	5 year smoothing	5 year smoothing	5 year smoothing
Actuarial Assumptions:			
Investment Rate of Return (1)	8.0%	8.0%	8.0%
Projected Salary Increases (1)	Graded 10.5% to 4.5%	5.0%	Graded 12% to 4.5%
Cost-Of-Living Adjustments (COLA)	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 60% purchasing power of original benefit

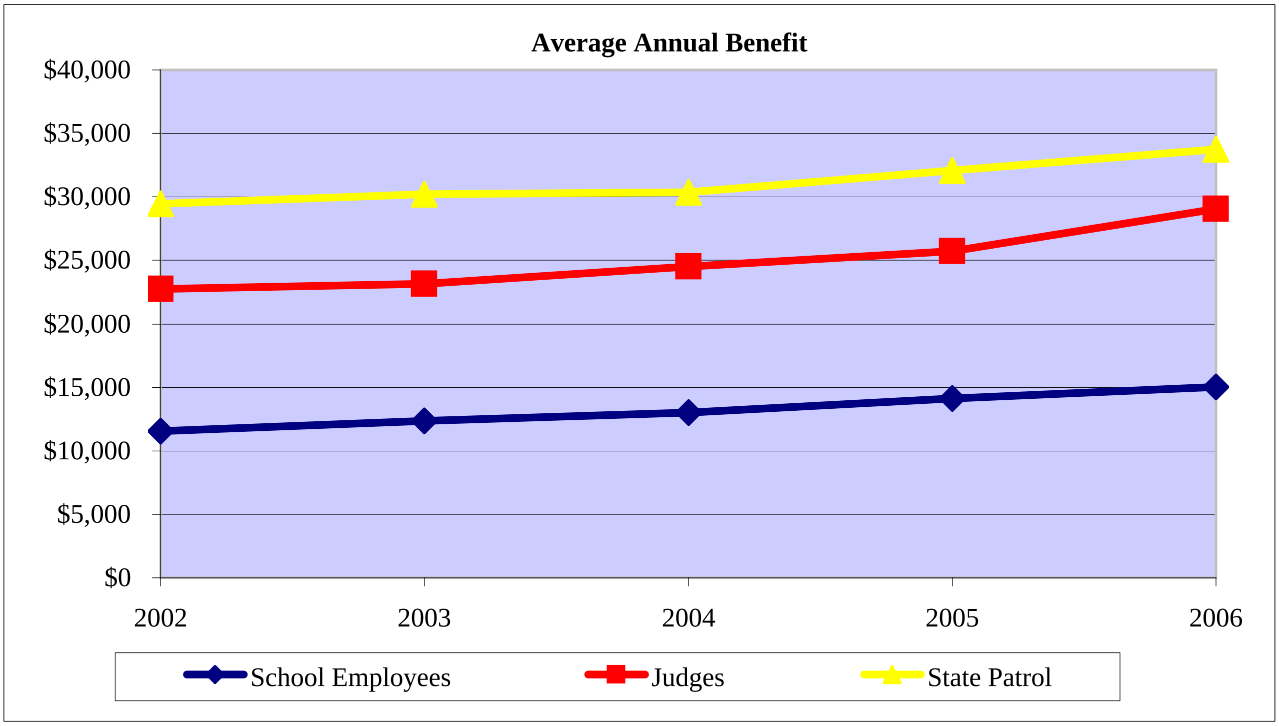
(1) Includes assumed inflation of 3.5% per year.

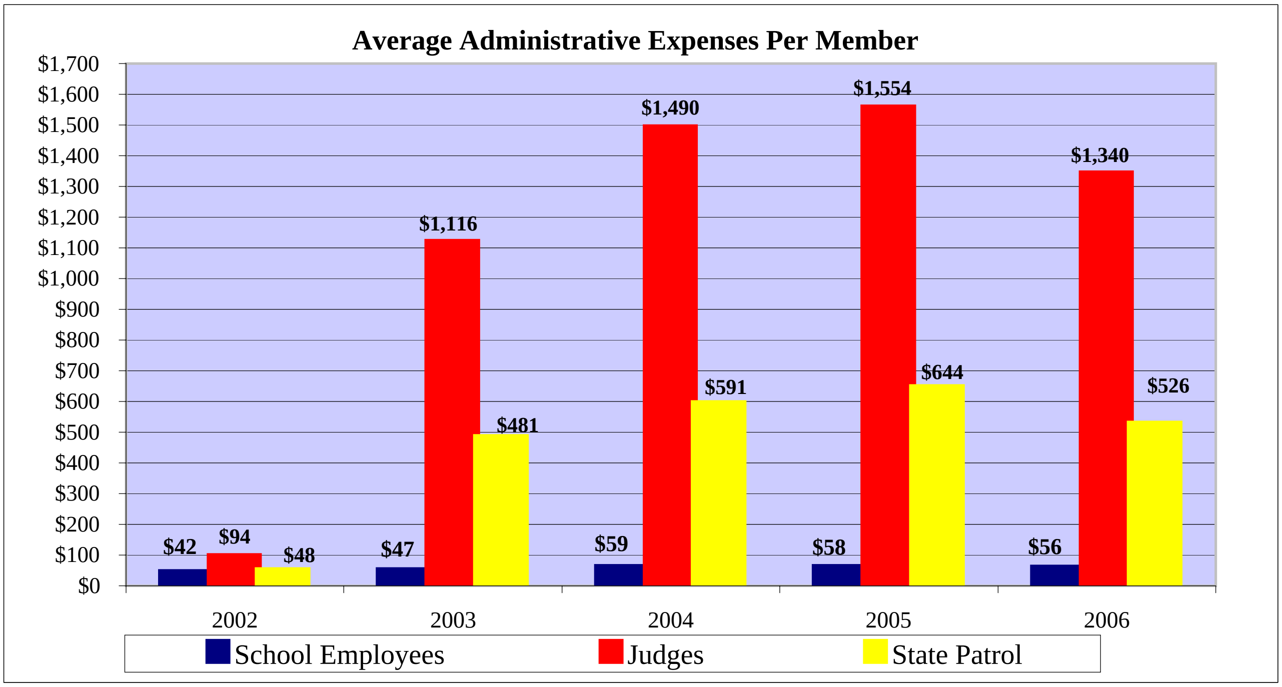
Changes in methods and assumptions:
Nebraska statutes were amended for each Plan such that the unfunded liability is reinitialized as of July 1, 2006, and amortized over a 30-year period.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
SCHEDULE OF SERVICE EFFORTS AND ACCOMPLISHMENTS
Fiscal Years Ended June 30, 2002 through 2006

	2002	2003	2004	2005	2006
SCHOOL EMPLOYEES					
Active Members	35,974	36,779	36,353	36,042	36,414
Inactive Members	14,302	14,531	15,245	16,924	17,755
Retirees	11,360	11,837	12,730	13,049	13,727
Total Benefits Paid (3)	$ 131,499,136	$ 146,337,041	$165,347,079	$ 184,360,473	$ 206,222,696
Average Annual Benefit (1)	$ 11,576	$ 12,363	$ 12,989	$ 14,128	$ 15,023
Average Monthly Benefit (4)	$ 965	$ 1,030	$ 1,082	$ 1,177	$ 1,252
Administrative Expenses	$ 2,601,071	$ 2,995,158	$ 3,786,591	$ 3,829,772	$ 3,830,708
Average Admin. Expense Per Member (2)	$ 42.20	$ 47.43	$ 58.86	$ 58.01	$ 56.42
JUDGES					
Active Members	166	162	163	159	154
Inactive Members	12	13	8	9	10
Retirees	163	160	158	164	162
Total Benefits Paid (3)	$ 3,709,728	$ 3,700,867	$ 3,872,082	$ 4,214,817	$ 4,703,966
Average Annual Benefit (1)	$ 22,759	$ 23,130	$ 24,507	$ 25,700	$ 29,037
Average Monthly Benefit (4)	$ 1,897	$ 1,928	$ 2,042	$ 2,142	$ 2,420
Administrative Expenses	$ 31,934	$ 373,723	$ 490,116	$ 516,027	$ 436,753
Average Admin. Expense Per Member (2)	$ 93.65	$ 1,115.59	$ 1,489.71	$ 1,554.30	$ 1,339.73
STATE PATROL					
Active Members	415	486	489	473	477
Inactive Members	11	13	15	10	14
Retirees	280	288	301	316	331
Total Benefits Paid (3)	$ 8,254,431	$ 8,697,575	$ 9,146,637	$ 10,142,646	$ 11,168,135
Average Annual Benefit (1)	$ 29,480	$ 30,200	$ 30,387	$ 32,097	$ 33,741
Average Monthly Benefit (4)	$ 2,457	$ 2,517	$ 2,532	$ 2,675	$ 2,812
Administrative Expenses	$ 33,578	$ 378,697	$ 475,551	$ 514,411	$ 432,283
Average Admin. Expense Per Member (2)	$ 47.56	$ 481.19	$ 590.75	$ 643.82	$ 525.89

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





Note: Effective December 2002, NPERS reallocated expenses related to the technology plan using a different allocation method than in past years. At June 30, 2004, NPERS allocated 45.1%, 13.2%, and 12.7% of the technology project expenses to the School, Judges, and Patrol Plans, respectively. NPERS reallocated technology expenses back to December 2001 using the June 30, 2003, allocation percentages. Prior to December 2002, NPERS allocated 69%, 1%, and 1% of the technology project expenses to the School, Judges, and State Patrol Plans, respectively.

STATE OF NEBRASKA
Auditor of Public Accounts

Mike Foley
State Auditor
Mike.Foley@apa.ne.gov

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL 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 Board
Lincoln, Nebraska

We have audited the financial statements of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated January 8, 2007. The Independent Auditors' Report was modified to disclose that some of the Required Supplementary Information was unaudited and to emphasize the financial statements present only the School Employees, Judges, and State Patrol Retirement Plans. 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.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide 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 - School Employees, Judges, and State Patrol Retirement Plans' ability to record, process, summarize and report

financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Comments Section of the report as Comment Number 1 (Purchase of Service), Comment Number 2 (Benefit Adjustments), Comment Number 3 (PIONEER Concerns), Comment Number 4 (School District Testing) Comment Number 5 (Resolution of Prior Audit Findings – School District Testing), and Comment Number 6 (Segregation of Duties Over School Contributions).

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 believe none of the reportable conditions described above are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted additional items that we have reported to management of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans in the Comments Section of the report as Comment Number 7 (Notarized Applications), Comment Number 8 (Member Interest), Comment Number 9 (Travel Expenses), Comment Number 10 (Minimum Accrual Rate), and Comment Number 11 (Reconciliation of Bank Records to the Nebraska Information System).

This report is intended solely for the information and use of NPERS 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

January 8, 2007 Assistant Deputy Auditor