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

FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Issued on March 23, 2011

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

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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:

- Shall not be an employee of the State of Nebraska or any of its political subdivisions; and
- 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.

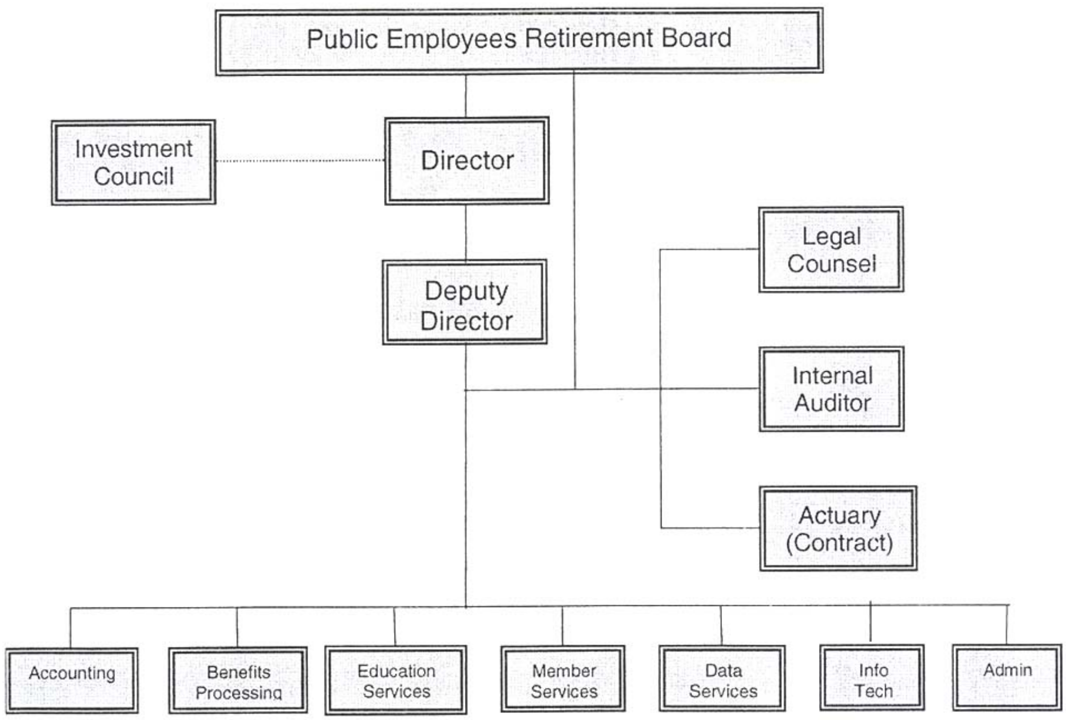
All appointed members must be Nebraska citizens. Members of the Board shall be paid fifty dollars per diem, and all members shall be reimbursed for actual and necessary expenses. The Board hires a director to manage the day-to-day operations. Expenses are to be equitably distributed among the retirement 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 March 9, 2011, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our audit. Those in attendance for NPERS were:

NAME	TITLE
Denis Blank	Board Chair
Glenn Elwell	Board Member
Phyllis Chambers	Director
Randy Gerke	Deputy Director/Accounting Manager
Jason Hayes	Legal Counsel
Miden Ebert	Benefits Manager
Teresa Zulauf	Internal Audit Manager
Maria Davis	Retirement Specialist II
Sheryl Hesseltine	Accountant III
Christine Ford	Internal Auditor

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.

1. ***Lack of Written Procedures and Proper Controls:*** NPERS did not have written policies and procedures for secondary system reviews performed by staff to ensure transactions were consistent and proper. We also noted NPERS lacked adequate procedures to ensure system errors were properly corrected. Furthermore, NPERS did not have written policies and procedures for the determination and calculation of the savings and service annuity outlined in statute.

2. ***School District Testing:*** During our review of NPERS' internal audit staff testing of school districts, we determined the procedures performed by the staff were not adequate for our audit reliance. Adequate documentation was not obtained by NPERS to support conclusions, supervisory reviews were not performed timely, adequate samples were not tested for salary exemptions, and follow-up procedures were not performed timely.

3. ***Clarity of Statutory Intent:*** We noted several State statutes related to the Plans that lacked clear statutory intent. For the Judge's Plan, benefit calculations were allowed to exceed the 70% limitation outlined in State statute. For the School Plan, employers' interpretation of compensation appeared to be applied inconsistently. Additionally, the Cost of Living Adjustment statutes, for all the Plans, lacked clear intent as to whether the three methods established were to be compared to one another or whether the third method was in addition to the larger of method one or two. This could lead to individuals receiving lesser benefit adjustments than intended by statute.

4. ***Berwyn Death Audit Review:*** Of the 34 findings noted during the January 31, 2009, attestation review of the Berwyn Death Audit, 26 were not properly resolved. There still remained $13,345 in overpayments that NPERS had not received and several accounts that had no procedures performed to resolve the prior findings. Furthermore, we reviewed NPERS' January and July 2010 Berwyn Death Audit reports and noted procedures were not adequate and follow-up was not timely on deceased members with account balances. Furthermore, the query used to generate the death audit was not complete.

5. ***Lack of Adequate Procedures Regarding Required Minimum Distributions:*** NPERS lacked adequate procedures for the review and payment of required minimum distributions for individuals age 70½ or older. One member had not received the required distributions for calendar years 2006 through 2009. The second member had not received the distribution for calendar year 2009 as required by Federal and State regulations. The members' payments would have totaled $1,157 for calendar year 2009.

6. ***Resolution of Prior Year School Audit Findings:*** There were 7 of 23 prior audit findings that were not properly resolved. Findings included overpayments and underpayments to deceased members or their estates, improper reporting of hours, wages, and/or contributions to the Plan, and an overpayment of purchased service made by a member.

SUMMARY OF COMMENTS
(Continued)

7. ***Inconsistent Plan Documents:*** We noted several plan documents (State statutes, Plan Handbooks, Rules and Regulations, and Applications for Retirement) that were not consistent. We further noted seven State statutes that required corresponding rules and regulations to be established by the Board for which there were none.

8. ***Disaster Recovery Plan:*** NPERS did not have a completed disaster recovery plan to safeguard data of the Plans.

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.

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. Lack of Written Procedures and Proper Controls

A good internal control plan requires written policies and procedures to ensure staff are knowledgeable of job requirements and to ensure member benefit calculations and account balances and transactions are accurate, consistent, and properly reviewed.

Secondary Reviews

Each member of the Retirement System has an account within the Nebraska Public Retirement Information System (NPRIS). When changes are made to member accounts, for instance, to adjust interest earned or process a benefit payment, NPRIS requires a secondary review be performed by an individual separate from the individual who initiated the transaction. NPRIS simply required the secondary reviewer to check a box that the audit was performed. As reported in the previous audit, NPERS did not have written procedures to ensure staff performed the secondary review processes adequately and consistently.

During testing we noted four of ten School Plan member benefit payments did not have all audit fields completed during the secondary review to document the member was eligible to receive the benefit. Without procedures to ensure staff review and document the proper information, there is an increased risk member transactions will not be made properly.

System Error Controls

NPRIS flags transactions that error due to lack of or improper information submitted by the employers. For instance, NPRIS would flag transactions for members with no hours reported or contributions submitted that did not agree to NPRIS's calculated contributions based upon the wages reported by the employer. NPRIS then required an NPERS' staff member to manually clear the flag. A good internal control plan requires staff members research the errors and verify the proper information before clearing the flags.

During testing we noted two School Plan members did not have hours reported for their first payroll contribution. There was nothing documented in the members' file to indicate NPERS had researched the issues. During discussions with NPERS' staff they indicated they will clear flags during busy times and then go back and research the information. It appears the issues were overlooked and NPERS did not do further research. After the issues were brought to NPERS' and the schools' attention during the audit one school made the proper adjustment of hours that were not reported. The second individual's hours were determined to be proper after further documentation was obtained.

Without adequate procedures to ensure the proper follow-up of NPRIS identified errors, there is an increased risk incorrect data will be recorded in NPRIS. For the instances noted above, the number of hours reported can have an effect on the member's service credit used in the calculation of their final benefit payment. If hours are under-reported, the member could receive a lower benefit upon retirement.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Lack of Written Procedures and Proper Controls</u> (Concluded)

<u>Savings and Service Annuity Procedures</u>

Neb. Rev. Stat. § 79-933(1) (Reissue 2008) states, "A member or emeritus member shall receive a school retirement allowance which shall consist of the sum of: (a) A savings annuity which shall be the actuarial equivalent, as determined by the retirement board, of the member's accumulated contributions at the time of his or her retirement or, in the case of an emeritus member, the savings annuity fixed by the retirement board at the time of his or her original retirement; and (b) a service annuity to be paid by the State of Nebraska."

A member is either eligible for a savings and service annuity as outlined in the statute above or a formula annuity as stated in Neb. Rev. Stat. § 79-934 (Reissue 2008), whichever is greater. However, as reported during the previous audit, NPERS did not have documented policies and procedures for the determination and calculation of the savings and service annuity. The calculation had to be performed manually as NPRIS did not calculate savings and service annuities properly. NPERS did not have written guidelines as to when a savings and service annuity calculation was to be performed and what rates were to be used. Without clear policies and procedures there is an increased risk a member will not have the savings and service annuity calculated or calculated properly to ensure they receive the greatest benefit at retirement.

> We recommend NPERS develop written policies and procedures to ensure: 1) Secondary reviews are performed consistently and properly. 2) System identified errors are properly reviewed and corrective actions are documented. 3) The savings and service annuities are calculated properly for all members that qualify.

NPERS' Response: NPERS will develop written policies and procedures to ensure that secondary reviews are performed consistently and properly. NPERS will develop written procedures to ensure savings and service annuities are calculated for all members that qualify. NPERS will not clear flags before system identified errors are properly reviewed and researched.

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

Neb. Rev. Stat. § 84-1503(1) (Reissue 2008) states, "It shall be the duty of the Public Employees Retirement Board:…(g) 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. The information necessary to determine membership shall be provided by the employer."

COMMENTS AND RECOMMENDATIONS
(Continued)

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

A good internal control plan requires adequate policies and procedures for internal audits performed to ensure individuals are properly contributing or not contributing to the School Plan in accordance with State statute.

During our audit it was noted NPERS' internal audit staff performed testing procedures on 20 of 277 school districts during the fiscal year. Of the 20 school districts tested, only 2 had been reviewed by the internal audit manager at the time of our audit fieldwork. To determine if the work of the internal audit staff was adequate for our audit reliance, we reviewed the 2 school districts which were reviewed by the internal audit manager. We noted the following:

- For both school districts tested, NPERS did not select their sample of employees for testing from the school payroll registers. Instead, an employee listing was created by the school and used by NPERS to select their sample. We compared the schools' payroll registers to the employee listings and noted one school's listing was not accurate. Five employees listed on the payroll register were not on the school employee listing. Therefore, NPERS' sample did not subject all employees of the school to testing procedures. By not using actual payroll records of the school there is an increased risk the schools will erroneously or intentionally not submit all employees for testing.

- NPERS did not test a sample of salary increase exemption forms filed by the schools, as required by Neb. Rev. Stat. § 79-902(35)(d) and (e) (Reissue 2008), during the fiscal year to ensure the salary increase exemption was properly supported. As noted in the previous three audit reports, without proper documentation obtained and verified, there is an increased risk members will have their benefit calculated on ineligible salary amounts leading to inflated benefit payments.

- Follow-up of findings reported to the schools, by NPERS, was not performed timely. For one school district tested, the school last responded to NPERS findings in March 2010. NPERS did not perform further follow up procedures until our audit fieldwork in December 2010.

We selected five contributing members and five non-contributing employees tested by NPERS from each of the two districts. There was insufficient documentation to support NPERS' conclusions as noted:

- There was insufficient documentation to support that wages reported by the schools agreed to school records for two contributing members. Furthermore, there was no documentation NPERS verified hours reported agreed to school records for four contributing members.

- NPERS reported that four of the contributing members tested had improper hours reported by the schools. When we recalculated the hours based upon the timesheets NPERS had obtained, we agreed to the schools' reported hours for three of the members.

COMMENTS AND RECOMMENDATIONS
(Continued)

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

The fourth member was improperly reported by the school and improperly recalculated by NPERS. It appeared NPERS recalculated the timesheet minutes incorrectly, for instance, 43 hours and 52 minutes was calculated by NPERS as 43.52 hours instead of calculating the minutes as a fraction of an hour or 43.87 hours.

- NPERS did not obtain sufficient documentation to verify four employees tested were properly not contributing. Three of four employees were bus drivers and were paid by the number of routes driven; hours were not recorded by the school. As the school district determined the bus drivers' compensation based upon an estimate of hours for each route, NPERS could have used this for eligibility purposes. NPERS did not have timesheets for the entire school year for the fourth employee tested; however, there was no documentation to indicate the individual did not work the entire school year.

- NPERS determined one non-contributing employee tested should have been contributing to the Plan. NPERS reported to the school that the "employee worked 15 hours per week/60 hours a month for three out of five months worked during the 08/09 school year…" NPERS did not have a formal, communicated policy regarding mandatory participation in the School Employees Retirement Plan. NPERS' informal policy during the period tested was that employees should enter the School Plan if they work more than 15 hours per week for more than two consecutive pay periods. After reviewing the individual's timesheets submitted to NPERS, it appeared the employee was properly not contributing as she did not have more than two consecutive pay periods of working 15 hours per week.

Without adequate documentation to support procedures performed, reliance cannot be placed on testing as there is no assurance testing was accurate or complete. Additionally, without adequate procedures to ensure school districts are properly adhering to State statutes and NPERS' policies and procedures there is an increased risk wages remitted will not be proper, employees will not properly contribute when required, or ineligible employees will be allowed to participate in the Plan. A similar finding was noted in the past several audit reports.

> We recommend NPERS improve testing procedures and ensure adequate documentation is obtained for conclusions drawn. Additionally, we recommend NPERS ensure school district testing is reviewed by a supervisor and follow-up procedures are performed in a timely manner. Furthermore, we recommend NPERS ensure proper education is given to the school districts to ensure employees are properly contributing or not contributing to the Plan.

COMMENTS AND RECOMMENDATIONS
(Continued)

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

NPERS' Response: NPERS has enhanced the testing procedures to ensure proper and adequate documentation is acquired from the school employers. NPERS will have a supervisor review the audit testing prior to the final letter being mailed to the school employer. Procedures have been revised to ensure that follow-up is completed in a timely manner.

NPERS provides educational seminars every summer for school reporting agents. The school employer manual is updated prior to the seminars. If a school employer reporting agent does not attend, the manual is mailed to them. In the past, NPERS would send a bi-annual newsletter to all the school reporting agents. Now NPERS sends emails to the school reporting agents to keep them informed of changes and updates.

3. <u>Clarity of Statutory Intent</u>

A good internal control plan and sound business practice requires adequate policies and procedures to ensure NPERS' practices comply with statutory requirements and that policies and procedures be communicated to employers. We noted the following:

<u>Judges Retirement Plan</u>

Neb. Rev. Stat. § 24-710(2) (Reissue 2008) states, "…Each such judge shall be entitled to receive an annuity, each monthly payment of which shall be in an amount equal to three and one-half percent of his or her final average compensation as such judge, multiplied by the number of his or her years of creditable service, except that the monthly benefits received under this subsection shall not exceed seventy percent of the final average compensation such judge was receiving when he or she last served as such judge."

NPERS' benefit calculation procedures allowed for Judge's benefits to exceed the 70% limitation set by statute. When the option selected by the member was calculated using an actuarial factor greater than one it resulted in a monthly benefit being higher than the statutory limit of 70%. Without clear statutory intent, there is an increased risk members will receive a benefit greater than allowed by law. This finding was also noted in the previous audit report.

<u>School Employees Retirement Plan</u>

Neb. Rev. Stat. § 79-902(35) (Reissue 2008) states, "(a) 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 section 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. (b) Compensation does not include (i) fraudulently obtained

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Clarity of Statutory Intent</u> (Continued)

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."

As noted in several previous audit reports, there was an inconsistency among school districts regarding the components of compensation for retirement purposes due to NPERS' lack of authoritative guidance regarding the proper interpretation and application of statutory language. We noted the following during our testing of school districts:

- Three school districts included additional benefit amounts in compensation for retirement purposes. The benefits were identified by the school districts as "in recognition of professional service," "flat salary," and "additional benefit" according to the negotiated agreements. The additional benefits could not be tied to the school districts salary schedules but were included in the members' wages resulting in the school districts overstating the members' annual compensation in amounts totaling $5,600, $11,600, and $13,750, or excess annual retirement contributions ranging from $408 to $1,001.

- One school district excluded member contributions to a § 403(b) plan. Neb. Rev. Stat. § 79-902(35)(a) specifically includes 403(b) plans in compensation for retirement purposes. The error resulted in an understatement of the member's annual compensation totaling $18,000 and an underpayment of annual retirement contributions totaling $1,490.

Without clear procedures and guidance there is an increased risk wages remitted will not be proper and ineligible contributions will be submitted to NPERS. As the benefit amount at retirement is calculated based in part on the reported salaries, members' benefits will either be greater or lessor depending on the school districts' practices.

<u>All Retirement Plans</u>

Created in law are statutes which establish the calculation of several different cost of living adjustments (COLA) for retiree benefits under the Plans. Neb. Rev. Stat. § 79-947.01 (Reissue 2008), Neb. Rev. Stat. § 24-710.07 (Reissue 2008), and Neb. Rev. Stat. § 81-2027.03 (Reissue 2008) describe the calculations used to calculate the method one and two COLA for retiree benefits. Additionally, Neb. Rev. Stat. § 79-947.05 (Reissue 2008), Neb. Rev. Stat. § 24-710.11 (Reissue 2008), and Neb. Rev. Stat. § 81-2027.07 (Reissue 2008) describe the calculation used for the method three COLA.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Clarity of Statutory Intent (Concluded)

NPERS' procedures were to calculate the three COLA methods and give the retiree the method that resulted in the greatest adjustment to the benefit; with the adjustment being no larger than the change in the Consumer Price Index (CPI) for the year. However, as reported in the previous audit report, there was a question as to whether the method three COLA stands alone from the method one and two COLAs and therefore, should be in addition to the greater of method one or two, the total adjustment being no larger than the change in CPI.

The statutes state to apply method two adjustment unless the current benefit is less than 75% purchasing power of the initial benefit for the School Employees and Judges Plan members and less than 60% purchasing power of the initial benefit for State Patrol Plan members. If the current benefit is less than the required purchasing power percentage, then the adjustment under method one is to be applied. Additionally, the method three statutes state, "The retirement 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 CPI. As the statute states "all" COLA adjustments, this could lead to an understanding that there are multiple adjustments to be applied.

Furthermore, the statutes establishing the method three COLA were created into law prior to the method one and two COLA. After method one and two COLA adjustments were created the method three statute was revised to include "all" cost-of-living adjustments. Without clear statutory intent there is an increased risk members are not receiving the proper COLA increases to their benefits as only the largest of the three methods is being applied.

> We recommend NPERS ensure the statutes of the Plans clearly state the intent to ensure benefits and benefit adjustments are properly calculated and applied to members at retirement. Additionally, we recommend NPERS ensure policies and procedures are communicated to schools to ensure compensation is proper and in accordance with State statute.

NPERS' Response: NPERS is in the process of working with the Nebraska Legislature to make statutory changes to correct or clarify inconsistencies noted by the Auditor of Public Accounts. The Public Employees Retirement Systems Committee of the Nebraska Legislature introduced LB 509 during the 2011 Legislative Session, which if adopted, will make changes to Neb. Rev. Stat. § 24-710 of the Judges' Retirement Plan, and the cost of living adjustments (COLA) provisions found in the School, State Patrol and Judges' plans.

NPERS will continue to work with employers in the School Employees Retirement System, to educate them on provisions found in Neb. Rev. Stat. § 79-902(35). NPERS does recognize that employer school districts have a certain level of discretion in negotiating district contracts with its employees. As a result, there is varying uniformity among school districts and their employment contracts in specifying how compensation or fringe benefits are categorized. NPERS will create a new reporting form for greater uniformity in reporting by school districts.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Berwyn Death Audit Review

A good internal control plan requires NPERS to follow up on deceased member accounts in a timely manner to ensure the proper resolution of member accounts. Additionally, a good internal control plan and sound accounting practice requires NPERS to maintain precise and complete records on all members.

NPERS semi-annually retains a death check verification service (death audit) from The Berwyn Group. This is used to perform comparisons of the members in the five retirement plans administered by NPERS and the Deferred Compensation Plan against national death records. The Berwyn Group generates a report which includes a listing of individuals matched against the national death records and also a listing of individuals with invalid information, such as social security numbers, names, and dates of birth. NPERS is then responsible for ensuring the data records are adequately reviewed and resolved by terminating retirement benefits to deceased members, recovering ineligible retirement payments, paying the beneficiary or estate the account balance for members who have not previously received retirement benefits, and following up on inaccurate account information.

The Auditor of Public Accounts (APA) performed an Attestation Review of NPERS Death Audit Procedures as of January 31, 2009, to ensure NPERS was properly following up on the death audit report. During the fiscal year ended June 30, 2009, audit we noted 34 of the original 80 findings had not been appropriately resolved. During the current audit we reviewed the 34 findings that remained for further follow up procedures and noted only 8 findings had been resolved, therefore, 26 of the 34 findings still existed. No procedures had been performed during the fiscal year for several of the findings noted:

- Five accounts received benefit payments totaling $13,345 past the date of death and the repayments had not been received by NPERS. The member estates/beneficiaries had last been contacted by NPERS in November 2009, December 2009, and January 2010. NPERS should determine whether further contact should be made or whether NPERS should work with the State Claims Board or Attorney General's Office.

- For one account reported with a date of death and nine accounts reported with invalid information, NPERS had not made contact with the members or beneficiaries due to lack of procedures performed by NPERS, or because NPERS was unable to locate the individuals. Furthermore, NPERS had attempted contact with six accounts reported with a date of death and three accounts reported with invalid information; however, the issues still existed. The account balances totaled $16,650. NPERS should consider whether these accounts should be sent to the State of Nebraska Unclaimed Property Division.

- Two individuals with invalid social security numbers were required to take minimum distributions in accordance with the Internal Revenue Code 401(a). The distributions to the members should have been made beginning April 1, 2007, and every year thereafter. No payments have been made. The account balances totaled $3,847.

4. <u>Berwyn Death Audit Review</u> (Continued)

- Additionally, we noted beneficiaries of deceased members are not properly tracked or followed up by NPERS to ensure they are periodically contacted to resolve member account balances. Three beneficiaries were not on NPERS' death tracking spreadsheet. The beneficiaries had last been contacted in March 2009, October 2009, and January 2010. According to discussions with NPERS' staff even if members and/or beneficiaries are on the tracking spreadsheet they were not consistently followed up on to ensure resolution of the account balance. NPERS should ensure procedures are adequate to include all members and beneficiaries on the tracking spreadsheet and periodically follow up on each individual noted to ensure proper resolution of balances outstanding.

We also reviewed the semi-annual Berwyn Death Audit reports received by NPERS in January and July 2010. We tested 12 individuals and noted the following:

- NPERS did not perform timely follow up procedures for four members tested with a date of death. The member account balances totaled $4,414.

    - NPERS had not performed follow-up, as of audit fieldwork, for one member with a date of death in May 2010.
    - One member's date of death was reported as March 2009. The beneficiary was not contacted until February 2010, approximately 11 months after the date of death.
    - Two members' dates of death were in February and March 2009. The beneficiaries were contacted in September and June 2009 respectively. There had been no further contact documented by NPERS.

- Two of the members noted above were not included on NPERS death tracking spreadsheet to ensure procedures were performed to contact the members' beneficiaries to resolve the remaining account balances.

- NPERS did not send members with invalid social security numbers in NPRIS to The Berwyn Group. The individuals' information should continue to be sent to The Berwyn Group as the death audit will match individuals' names and dates of birth to deceased records. This information would be useful for NPERS continued follow up.

Without adequate procedures to ensure the Berwyn Death Audit report and prior audit findings are properly resolved in a timely manner, there is an increased risk overpayments will be made to deceased individuals, member accounts will not be properly paid out, and NPERS will not be in compliance with Federal regulations requiring distribution of members' accounts.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Berwyn Death Audit Review (Concluded)

> We recommend NPERS ensure a proper and timely review and resolution of prior audit findings. We also recommend NPERS ensure proper information is submitted to The Berwyn Group. Lastly, we recommend NPERS establish procedures to ensure all beneficiaries are periodically followed up on until the account balance is properly resolved.

NPERS' Response: NPERS' current procedure is to review the Berwyn Death Audit in January and July every year. NPERS' Berwyn Death Audit procedures will be reviewed and improved. NPERS will develop new procedures and work to resolve prior audit findings in a timely manner.

5. Lack of Adequate Procedures Regarding Required Minimum Distributions

26 U.S.C. § 401(a) and Neb. Rev. Stat. § 79-932 (Reissue 2008) require members to take a minimum distribution every year beginning when the member is 70 ½ and terminated. The first minimum distribution is to be made by April 1 of the calendar year following the later of: i) the calendar year in which the employee attains age 70½ or ii) the calendar year in which the employee retires.

NPERS ran a report in NPRIS, which showed members at age 65 and older. From this report, NPERS procedures were to review members to ensure Federal requirements were met. We selected five school members from the NPRIS report to test and noted two members did not receive required minimum distribution (RMD) payments in accordance with § 401(a) and Neb. Rev. Stat. § 79-932.

- One member was not paid an RMD for calendar years 2006, 2007, 2008, and 2009. The RMD for 2009 would have been $78 based upon the member's account balance of $1,938 at December 31, 2009.

- One member was not paid an RMD for calendar year 2009 in the amount of $1,079 based upon an account balance of $29,570 at December 31, 2009.

Without adequate procedures to ensure distributions are made timely, there is an increased risk payments will not be made in accordance with Federal and State regulations.

> We recommend NPERS establish procedures to ensure payments are made timely in accordance with Federal and State regulations.

NPERS' Response: NPERS' procedure is to review an internal report that lists all members over the age 70.5 three times per year. The RMD procedures will be reviewed and revised to ensure payments are made according to regulations.

6. Resolution of Prior Year School Audit Findings

A good internal control plan requires the timely and thorough resolution of prior audit findings.

During our review of NPERS' procedures to resolve prior audit findings we noted 7 of 23 findings remained for the School Plan. Four findings from the 2009 audit, two from the 2008 audit, and one finding from the 2007 audit were not adequately resolved as follows:

2009 Findings

- One member received payments past their date of death totaling $1,524. Payments were not to continue after death, in accordance with the option selected by the member upon retirement. NPERS contacted the member's son in August 2009 but had not received repayment and had not performed further follow up procedures.

- NPERS did not correctly calculate two estate refunds during 2009. One member's estate received an overpayment of $599. The second member's estate was underpaid $320. NPERS had not performed follow-up procedures to collect the overpayment or refund the estates.

- One member did not contribute on the proper salary composition as long term disability was included. NPERS had not followed up with the school to determine if retirement contributions should be refunded or to inform the school of the improper calculation.

2008 Findings

- One member did not have the proper hours, wages, or contributions reported to NPERS. After review of the information provided by the school to NPERS it appeared the member's hours, wages, and contributions were underreported by 11.85 hours, $40.24, and $2.93 respectively. However, NPERS had not worked with the school to correct the errors.

- One member purchased service for $16,885; however, the member should have only paid $16,338, an excess payment of $547. NPERS had not refunded the member.

2007 Finding

- One school district reported estimated hours worked instead of actual hours worked. NPERS' follow up lead to adjustments made for employees that were still actively employed. However, there were two employees who had taken refund payments, no adjustment was made to their hours in the system and no documentation was included in the members' files. If the members returned to active employment and paid their refund back their service credit would be restored improperly.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Resolution of Prior Year School Audit Findings (Concluded)

A similar finding was noted in the past several audit reports.

Without procedures to ensure prior audit findings are resolved timely, there is an increased risk that errors in plan membership and compensation will remain incorrect.

> We recommend NPERS resolve findings from prior audits, require make-up contributions or refund ineligible contributions, make appropriate adjustments to members' records as necessary, and ensure overpayments of purchases of service are properly refunded. We also recommend NPERS contact the estates and beneficiaries to attempt to collect the overpayments and correctly pay out the underpayment as noted.

NPERS' Response: NPERS will work to resolve findings from prior audits. NPERS has reduced the number of unresolved prior audit findings significantly. NPERS will contact estates and beneficiaries to attempt to collect overpayment and correctly pay out the underpayments. NPERS will work to establish procedures to turn unclaimed account balances over to the Nebraska State Treasurer.

7. Inconsistent Plan Documents

A good internal control plan requires procedures to ensure plan documents are consistent and accurate.

As noted in the previous two audit reports, there are several plan documents (State statutes, Plan Handbooks, Rules and Regulations, Employer Manuals and Applications for Retirement) that were not consistent as follows:

- Neb. Rev. Stat. § 79-902(30)(a) (Reissue 2008) indicates, the members three highest 12-month periods of salary, counting back from the final month of pay, are used to determine the final average compensation for calculating the benefit. However, Title 303 NAC 23-002.01 indicates the salaries should be based on the State's fiscal year. NPERS currently calculates the final average compensation based upon statutory language.

- Neb. Rev. Stat. § 79-927(2)(a) (Reissue 2008) states, "For each year during which a member provides compensated service to one or more school districts for <u>one thousand or more hours</u>, the member shall be credited one year of service credit." However Title 303 NAC 11-001.02 states, "July 1, 1986 and after, <u>one thousand thirty-two hours</u> in one fiscal year shall be the equivalent of one year of service credit." NPERS currently credits members one year of service for one thousand or more hours based upon the statutory language.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Inconsistent Plan Documents (Continued)

- NPERS did not consider school district contribution remittances to be late if submitted by the 10th of the month following the paycheck date. However, the School Employer Manual stated the "Wage and Contribution Report and payment must be submitted to NPERS no later than 10 calendar days after the payroll period end date." Furthermore Title 303 NAC 2-001.01 does not state whether the paycheck or payroll period end date is to be used. It stated, "The envelope containing the Remittances must be postmarked by the 10th of the following month."

- According to Title 303 NAC 24-002 and the Judges Application for Retirement/ Disability, the Joint and Survivor Annuity options are for an annuity at 50%, 66⅔%, or 100%. However, the Judges Member Handbook stated the Joint and Survivor Annuities were offered at the rates of 50%, 75%, and 100%.

- The Judges Plan Handbook had not been updated since July 2003; however, there have been several changes to the Plan over the past seven years including changes to the contribution rates.

- NPERS had Draft Rules and Regulations which had been approved by the Nebraska Public Employees Retirement Board in 2002 but had not been approved by the Secretary of State. The draft rules and regulations still had not been approved during fiscal year 2010. In the APA's review of the Draft Rules and Regulations, we noted a number of irregularities as follows:

  - The Draft Rules and Regulations, Title 303 NAC 4-003.03(a) states, "The date of distribution of a refund to a member in the School Plan shall not occur earlier than four (4) calendar months after the member's termination date or three (3) working days after the receipt of the application for a refund, whichever date is later." However, the School Plan Handbook states, "You are eligible to receive a refund approximately four months after your termination of employment, or no sooner than 20 days after NPERS receives your completed Application for Refund, whichever is later." Additionally, we noted the system does not calculate four months but rather 120 days. Four months may be more or less than 120 days.

  - The Draft Rules and Regulations, Title 303 NAC 4-004.03(a) states, "The date of distribution of a refund to a member in the Judges Plan or the Patrol Plan shall not occur earlier than sixty (60) days after the member's termination date or three (3) working days after the receipt of an application for a refund, whichever date is later." However, the State Patrol Handbook states, "… your payment will be processed approximately: 60 days after your termination date…or two weeks after

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Inconsistent Plan Documents (Concluded)

receipt of your application, whichever is later." Additionally, the Judges Plan Handbook states, "You are eligible to receive a refund approximately 60 days after either your last working day OR receipt of your completed application by NPERS, whichever is later."

- We also noted seven State statutes for the Plans that required corresponding rules and regulations to be established by the Nebraska Public Employees Retirement Board for which there were none. The statutes were Neb. Rev. Stat. § 79-907 (Reissue 2008), Neb. Rev. Stat. § 79-926 (Reissue 2008), Neb. Rev. Stat. § 79-933.01 (Reissue 2008), Neb. Rev. Stat. § 24-710.05 (Reissue 2008), Neb. Rev. Stat. § 81-2031.03 (Reissue 2008), Neb. Rev. Stat. § 81-2034 (Reissue 2008), and Neb. Rev. Stat. § 81-2041 (Reissue 2008).

Without consistent policies and information provided to members there is an increased risk benefit payments will not be properly calculated. Furthermore, there is an increased risk members may have a misunderstanding of the benefits available if information is not consistent between the different plan documents.

We recommend NPERS ensure Rules and Regulations, Plan Handbooks, State Statutes, and Applications for Retirement are consistent for the Plans. We further recommend NPERS ensure rules and regulations approved by the Nebraska Public Employees Retirement Board are properly submitted and approved by the Secretary of State in a timely manner and in compliance with State statute. We also recommend NPERS establish procedures to ensure handbooks and manuals contain clear and accurate information which is then communicated to the members and employers.

NPERS' Response: NPERS continuously updates plan documents and provides access to them on the Agency's website. Printed plan booklets are updated periodically on a rotating basis. The Judges' plan booklet is scheduled for updating during the summer of 2011. The School Employees plan booklet was updated in February of 2011. The State Patrol plan booklet was updated in July of 2009. Members and employers are provided with updated inserts for plan booklets so all information is current. New statutory or regulatory changes are communicated to members in quarterly newsletters.

NPERS has prepared revisions for six of our Rules and Regulations. These revisions need to follow the process codified in the Administrative Procedure Act, Neb. Rev. Stat. §§ 84-901, et seq., and will have hearings scheduled. NPERS will continue to update our Rules and Regulations on an ongoing and regular basis as needed.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Disaster Recovery Plan

Nebraska Information Technology Commission (NITC) Standards and Guidelines, Information Technology Disaster Recovery Plan Standard 8-201, Section 1.0 states, in part, "Each agency must have an Information Technology Disaster Recovery Plan that supports the resumption and continuity of computer systems and services in the event of a disaster. The plan will cover processes, procedures, and provide contingencies to restore operations of critical systems and services as prioritized by each agency. The Disaster Recovery Plan for Information Technology may be a subset of a comprehensive Agency Business Resumption Plan which should include catastrophic situations and long-term disruptions to agency operations."

A good internal control plan requires a formalized, tested plan of procedures and organization designed to safeguard assets and minimize the risk of lost data.

NPERS did not have a completed disaster recovery plan in place. A plan has been started, but not completed and implemented. When business continuity plans are not in place there is an increased risk for the loss of data.

> We recommend NPERS develop a complete formalized business continuity plan to ensure data retention is effective.

NPERS' Response: NPERS is in the process of completing a disaster recovery plan. NPERS currently has back-up servers and data storage at a secure offsite location.

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

INDEPENDENT AUDITOR'S 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, 2010, which collectively comprise NPERS' basic financial statements 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plans' internal control over financial reporting. Accordingly, we express no such opinion. 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 of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans, are intended to present the financial position and changes in financial position of only that portion of the State that is attributable to the transactions of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans. They do not purport to, and do not, present fairly the financial position of the State of Nebraska as of June 30, 2010, and its changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans, as of June 30, 2010, and the respective changes in financial position thereof 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 March 21, 2011, 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 other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

The Schedules of Funding Progress and Schedules of Contributions From Employers and Other Contributing Entities are not a required part of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board. The Schedules of Funding Progress and Schedules of Contributions From Employers and Other Contributing Entities have been subjected to the auditing procedures applied in the audit of the Statements of Plan Net Assets and the related Statements of Changes in Plan Net Assets and, in our opinion, are fairly stated in all material respects in relation to the financial statements referred to above, taken as a whole.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' basic financial statements. 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 basic financial statements. 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 basic financial statements taken as a whole.

Signed Original on File

March 21, 2011

Pat Reding, CPA, CFE
Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
STATEMENTS OF PLAN NET ASSETS
AS OF JUNE 30, 2010

	School Employees	Judges	State Patrol
ASSETS			
Cash in State Treasury	$ 4,710,199	$ 73,202	$ 115,889
Deposits with Vendors	9,091	94	94
Receivables:			
Contributions	46,090,158	399,741	2,116,410
Interest and Dividend Income	12,048,310	207,127	456,548
Other Investment Receivables (Note 4)	189,093,790	3,256,934	7,234,308
Total Receivables	247,232,258	3,863,802	9,807,266
Investments, at fair value (Note 4):			
U.S. Treasury Bills	5,922,066	102,001	226,565
U.S. Treasury Notes and Bonds	171,210,278	2,948,910	6,550,125
Government Agency Securities	29,242,995	503,679	1,118,772
Corporate Bonds	507,227,161	8,736,432	19,405,383
International Bonds	69,601,632	1,198,812	2,662,804
Asset Backed Securities	86,696,804	1,493,258	3,316,827
Guaranteed Investment Contracts	-	-	258,929
Short Term Investments	72,301,489	1,245,314	3,080,081
Commingled Funds	2,980,860,668	51,342,061	115,390,899
Mortgages	446,493,876	7,690,373	17,082,142
Municipal Bonds	32,000,386	551,172	1,224,264
Private Equity Funds	133,362,311	2,297,020	5,102,146
Equity Securities	1,314,332,487	22,637,938	50,283,439
Options	(724,663)	(12,482)	(27,724)
Private Real Estate Funds	78,450,200	1,351,219	3,001,330
Total Investments	5,926,977,690	102,085,707	228,675,982
Invested Securities Lending Collateral (Note 4)	355,430,380	6,121,899	13,631,259
Capital Assets (Note 10):			
Equipment	12,041,987	2,099,333	2,054,925
Less: Accumulated Depreciation	(9,538,013)	(2,033,013)	(1,989,940)
Total Capital Assets	2,503,974	66,320	64,985
TOTAL ASSETS	6,536,863,592	112,211,024	252,295,475
LIABILITIES			
Compensated Absences (Note 5 and Note 8)	190,106	2,825	2,933
Accounts Payable and Accrued Liabilities	4,550,040	59,975	129,930
Obligations under Securities Lending (Note 4)	355,430,380	6,121,899	13,631,259
Capital Lease Obligations (Note 7 and Note 8)	257,327	75,315	72,462
Other Investment Payables (Note 4)	232,183,088	3,999,099	8,884,253
Contributions for Omaha Public Schools (Note 6)	3,851,004	-	-
TOTAL LIABILITIES	596,461,945	10,259,113	22,720,837
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A schedule of funding progress for each plan is presented on page 43.)	$ 5,940,401,647	$ 101,951,911	$ 229,574,638

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, 2010

	School Employees	Judges	State Patrol
ADDITIONS:			
Contributions:			
Member (Note 9)	$ 130,054,861	$ 1,391,111	$ 4,143,743
Employer	128,845,427	-	4,143,712
Court Fees	-	3,543,047	-
State	25,231,356	72,244	2,116,410
Total Contributions	284,131,644	5,006,402	10,403,865
Investment Income:			
Net appreciation (depreciation) in fair value of investments	626,979,462	10,769,284	24,541,339
Interest & Dividends	108,746,261	1,871,827	4,207,636
Total Investment Income	738,407,067	12,687,294	28,851,783
Investment Expenses	(16,500,628)	(284,443)	(648,786)
Securities Lending Expenses	(1,025,570)	(17,664)	(39,337)
Net Investment Income	720,880,869	12,385,187	28,163,660
Other Additions	25,220	-	4,280
Total Additions	1,005,037,733	17,391,589	38,571,805
DEDUCTIONS:			
Benefits	308,630,269	5,576,749	13,646,360
Refunds of Contributions	10,678,593	-	110,401
Administrative Expense	5,925,090	169,228	167,999
Other Deductions (Note 6)	5,051,842	-	-
Total Deductions	330,285,794	5,745,977	13,924,760
Net Increase (Decrease)	674,751,939	11,645,612	24,647,045
Net assets held in trust for pension benefits:			
Beginning of year	5,265,649,708	90,306,299	204,927,593
End of year	$ 5,940,401,647	$ 101,951,911	$ 229,574,638

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

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2010

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying basic financial statements of the Nebraska Public Employees Retirement Systems (NPERS) – School Employees, Judges, and State Patrol Retirement Plans have been prepared in conformity with accounting principles generally accepted in the United States of America (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.

B. Reporting Entity

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 for the calendar year ended December 31, 2009, and the Deferred Compensation Plan for the calendar year ended December 31, 2009.

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.

C. Measurement Focus, Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus and basis of accounting. 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.

1. Summary of Significant Accounting Policies (Continued)

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 when a liability is incurred. Employee and employer contributions are recognized in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each Plan.

D. Cash in State Treasury

Cash in State Treasury represents the cash balance of a fund as reflected in the State's General Ledger. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on the balance of the three Plans is allocated to funds based on their percentage of the investment pool.

E. Investments

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

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

F. 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

1. <u>Summary of Significant Accounting Policies</u> (Concluded)

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 over three to ten years using the straight-line method.

G. Compensated Absences

All permanent employees working for NPERS earn sick and vacation leave. Temporary and intermittent employees and Board members are not eligible for paid leave. The liability has been calculated using the vesting method, in which leave amounts, for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included.

NPERS employees accrue vested vacation leave at a variable rate based on years of service. Generally, accrued vacation 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. There is no maximum limit on the accumulation of sick leave days for employees under certain labor contracts. Sick leave is not vested except upon death or upon reaching the retirement eligibility age of 55, or of a younger age if the employee meets all criteria necessary to retire under the primary retirement plan covering his/her State employment, at which time the State is liable for 25 percent of the employee's accumulated sick leave. Employees under certain labor contracts can only be paid a maximum of 50 or 60 days.

The Plans recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave is expected to be paid as termination payments.

H. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at fiscal-year-end and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

2. <u>Plan Descriptions and Contribution Information</u>

Membership of each plan consisted of the following at June 30, 2010, the date of the last actuarial valuation:

2. Plan Descriptions and Contribution Information (Continued)

	School Employees	Judges	State Patrol
Retirees and beneficiaries receiving benefits	16,912	154	390
Terminated plan members entitled to but not yet receiving benefits	19,762	8	13
Active plan members	39,764	153	444
Total	76,438	315	847

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. §§ 79-901 through 79-977.03 for the School Employees Retirement Plan, Neb. Rev. Stat. §§ 24-701 through 24-714 for the Judges Retirement Plan and Neb. Rev. Stat. §§ 81-2014 through 81-2041 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 plans 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 2010, there were 277 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.

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.

2. Plan Descriptions and Contribution Information (Continued)

Contributions. The State's contribution is based on an annual actuarial valuation. In addition, the State contributes an amount equal to 1.0 percent of the compensation of all members. The employees' contribution was equal to 7.28 percent from July 1, 2009, to August 31, 2009, and increased to 8.28 percent from September 1, 2009, to June 30, 2010. The school districts' (employer) contribution is 101 percent of the employees' contribution.

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 percent; subject to a maximum of 70 percent of the 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 six 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 10 percent charge on certain fees collected in the County Courts. The State's contribution is based on an annual actuarial valuation. Each new member after July 1, 2004, and those active members that elected within 90 days of July 1, 2004, contribute 9 percent of their monthly salary until the maximum benefit has been earned. After the maximum benefit has been earned, such member contributes 5 percent of their monthly salary for the remainder of his or her active service. All other members contribute 7 percent of their monthly salary until the maximum benefit has been earned. After the maximum benefit had been earned, such member contributes 1 percent of their monthly salary for the remainder of his or her active service.

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 benefits are based on a percentage of the final average salary multiplied by years of

2. Plan Descriptions and Contribution Information (Concluded)

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 compensation was the greatest multiplied by years of service and the formula factor of 3 percent. Calculation will vary with early retirement. Benefits vest after 10 years of service.

Contributions. Members are required to contribute 15 percent of their annual pay, plus, for a State Patrol officer employed on or before January 4, 1979, 15 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.

Deferred Retirement Option Plan (DROP). Neb. Rev. Stat. § 81-2041 (Reissue 2008) established the Patrol DROP effective September 1, 2008. The DROP is a voluntary deferred retirement plan that a member can enter between the ages of 50 and 60, with 25 years of service. If the member chooses to participate in DROP, the member is deemed to have retired; however, the member continues in active employment for up to a five-year period with no retirement contributions withheld from their paychecks. When the member enters DROP the individual's monthly benefit is calculated and paid into an IRC § 457 Deferred Compensation Plan (DCP), held by the record keeper, Ameritas. After the member retires (60 years of age) or has been in DROP for five years, whichever occurs first, the member then has the option to receive a lump sum payment and/or rollover the funds in the DCP account to another qualified plan. Thereafter, future retirement benefit payments are made directly to the member.

3. Funded Status and Funding Progress

The funded status of each plan as of June 30, 2010, the most recent actuarial valuation date, is as follows:

	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL) - Entry Age	(b-a) Unfunded Accrued Liabilities (UAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAL as a Percentage of Covered Payroll
School	$ 7,040,908,599	$ 8,542,119,000	$ 1,501,210,401	82.4%	$ 1,543,930,532	97.2%
Judges	121,406,463	121,309,682	(96,781)	100.0%	18,773,203	(0.5%)
State Patrol	273,306,925	321,901,446	48,594,521	84.9%	26,765,816	181.6%

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Funded Status and Funding Progress (Concluded)

The schedules of funding progress, presented as required supplementary information immediately following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Additional information regarding the plans actuarial methods and significant assumptions, as of the latest actuarial valuation date, is as follows:

	School Employees	Judges	State Patrol
Valuation date	June 30, 2010	June 30, 2010	June 30, 2010
Actuarial cost method	Entry Age	Entry Age	Entry Age
Amortization method	Level Dollar Closed	Level Dollar Closed	Level Dollar Closed
Remaining amortization period	28 Years	30 Years	28 Years
Asset valuation method	5 year smoothing	5 year smoothing	5 year smoothing
Actuarial assumptions:			
Investment rate of return*	8.0%	8.0%	8.0%
Projected salary increases*	4.5% to 7.46%	4.5%	4.5% to 9.0%
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

* Includes assumed inflation of 3.5% per year.

4. Investments

Investments. Listed below is a summary of the investment portfolio that comprises the Investments on the Statements of Plan 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. § 72-1239.01 (Reissue 2009) authorizes the appointed members of the Nebraska Investment 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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Investments (Continued)

NPERS' investments for the School Employees, Judges, and State Patrol Retirement Plans at June 30, 2010, 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 State Patrol Retirement Plan Investments at June 30, 2010

	Fair Value	Effective Duration
Debt Securities		
U.S. Treasury Notes and Bonds	$ 180,709,313	6.74
U.S. Treasury Bills	6,250,632	0.44
Government Agency Securities	30,865,446	4.29
Guaranteed Investment Contracts	258,929	3.12
Corporate Bonds	535,368,976	4.84
International Bonds	73,463,248	5.14
Asset Backed Securities	91,506,889	3.34
Short Term Investments	76,626,884	0.07
Commingled Funds	537,006,651	4.12
Mortgages	471,266,391	3.96
Municipal Bonds	33,775,822	11.19
	2,037,099,181	
Other Investments		
Private Equity Securities	140,761,477	
Equity Securities	1,387,253,864	
Commingled Funds	2,610,586,977	
Options	(764,869)	
Private Real Estate Funds Trust	82,802,749	
Total Investments	6,257,739,379	
Invested Securities Lending Collateral	375,183,538	
Total	$ 6,632,922,917	

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Investments (Continued)

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the 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.

(Continued on Next Page)

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. 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 average quality ratings for its core fixed income accounts at an A and BB- for its high yield fixed income account. NPERS' rated debt investments as of June 30, 2010, were rated by Standard and Poor's and/or an equivalent national rating organization and the ratings are presented below using the Standard and Poor's rating scale.

School Employees, Judges, and State Patrol Retirement Plan Investments
at June 30, 2010

		Quality Ratings						
	Fair Value	**AAA**	**AA**	**A**	**BBB**	**BB**	**B**	**Unrated**
Asset Backed Securities	$ 91,506,889	$ 74,827,589	$ 2,359,447	$ 5,193,619	$ 1,561,128	$ -	$ 857,555	$ 6,707,551
Mortgages	471,266,391	205,854,704	2,924,463	11,792,236	4,632,273	4,966,195	13,635,233	227,461,287
International Bonds	73,463,248	26,540,867	11,286,478	2,829,810	20,262,106	7,109,034	1,384,019	4,050,934
Corporate Bonds	535,368,976	80,615,411	65,316,023	138,332,543	114,883,596	60,224,350	47,296,133	28,700,920
Government Agency Securities	30,865,446	29,703,879	-	-	-	-	-	1,161,567
Municipal Bonds	33,775,822	4,366,166	11,544,084	16,491,503	399,517	-	-	974,552
Short Term Investments	76,626,884	-	-	-	-	-	-	76,626,884
Commingled Funds	537,006,651	-	-	-	-	-	-	537,006,651

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, 2010, NPERS had no debt security investments with more than 5 percent of total investments.

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Investments (Continued)

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The State does not have a formal policy to limit foreign currency risk. NPERS' exposure to foreign currency risk is presented on the following table.

School Employees, Judges, and State Patrol Retirement Plan
Foreign Currency at June 30, 2010

	Asset Backed Securities	Short Term Investments	Equity Securities	International Bonds	Options	Corporate Bonds
Argentine Peso	$ -	$ 10,321	$ -	$ -	$ -	$ -
Australian Dollar	-	410,607	22,042,143	1,641,380	-	-
Brazilian Real	-	1,045,909	2,224,376	790,305	-	-
Canadian Dollar	-	23,011	18,827,148	21,583,165	-	-
Czech Koruna	-	30,574	701,939	-	-	-
Danish Krone	-	427	4,115,606	-	-	-
Euro Currency	1,357,461	535,041	201,174,001	5,983,640	(212,857)	5,072,214
Hong Kong Dollar	-	85,520	16,533,652	-	-	-
Hungarian Forint	-	4	1,420,606	-	-	-
Iceland Krona	-	(105)	-	98,151	-	-
Indian Rupee	-	-	-	-	-	1,305,876
Indonesian Rupiah	-	-	1,745,213	-	-	1,260,450
Israeli Shekel	-	112,349	1,763,631	-	-	-
Japanese Yen	-	547,925	111,671,685	-	-	-
Mexican Peso	-	375,019	2,398,157	2,083,389	-	334,766
New Zealand Dollar	-	19	-	-	-	552,409
Norwegian Krone	-	1,124	2,175,492	-	-	-
Philippine Peso	-	19,015	233,031	-	-	-
Polish Zloty	-	401	1,400,347	-	-	-
Pound Sterling	-	26,107	109,639,307	-	-	1,410,850
Singapore Dollar	-	3,846	9,706,761	-	-	1,929,616
South African Rand	-	212	145,822	-	-	-
South Korean Won	-	37	24,644,526	-	-	1,987,333
Swedish Krona	-	10,332	13,194,707	-	-	-
Swiss Franc	-	69,447	70,263,643	-	-	-
Thailand Baht	-	99,068	6,801,744	-	-	-
Total	$ 1,357,461	$ 3,406,210	$ 622,823,537	$ 32,180,030	$ (212,857)	$ 13,853,514

4. Investments (Continued)

Securities Lending Transactions. The State participates in securities lending transactions, where securities are loaned to broker-dealers and banks with a simultaneous agreement to return the collateral for the same securities in the future. The State's primary custodial bank administers the securities lending program and receives collateral in the forms of cash, United States government or government agency obligations, sovereign debt rated A or better, or convertible bonds at least equal in value to the market value of the loaned securities. Securities on loan at year end consisted of United States government obligations, equity securities, corporate bonds, and non-US fixed income. 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 cannot be pledged or sold by the State unless the borrower defaults. There are no restrictions on the amount of securities that can be loaned, and there were no losses from borrower default during the year.

Either the State or the borrowers can terminate all securities loans on demand. Cash collateral is invested in one of the lending agent's short-term investment pools that had average durations of 25 and 30 days. Because loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. The custodian indemnifies the State against default by the borrower of securities, but does not indemnify against the default by an issuer of a security held in the short term investment funds where cash collateral is invested.

Derivative Financial Instruments. Derivative instruments are financial contracts whose underlying values depend on the values of one or more underlying assets, reference rates, or financial indices. These instruments are used primarily to enhance performance and/or reduce the volatility of the portfolio, in accordance with the Nebraska Investment Council-approved Derivatives Policy. The State invests in futures contracts, options, and swaps. Futures represent commitments to purchase or sell securities or money market instruments at a future date and at a specific price. Options represent the right, but not the obligation, to purchase or sell securities at a future date and at a specific price. The State invests in these contracts related to securities of the U.S. government or Government Agency obligations based on reference notes, which are traded on organized exchanges, thereby minimizing the State's credit risk. The net change in the contract value is settled daily in cash with the exchanges. Swaps represent an exchange of streams of payments over time according to specified terms. All changes in fair value of derivatives are reflected in Investment Income and the fair value of derivatives at June 30, 2010, is reflected in Investments. The fair value balances and notional amounts of investment derivative instruments outstanding at June 30, 2010, classified by type, and the changes in fair value of such derivative instruments for the year then ended are as follows:

4. <u>Investments</u> (Continued)

DERIVATIVE INVESTMENTS AT JUNE 30, 2010

Derivative	Change in Fair Value	Fair Value	Notional
Credit Default Swaps	$ 1,561,579	$ 376,492	$ 34,833,350
Fixed Income Futures	9,796,157	-	168,999,963
Fixed Income Options	5,269,561	(764,869)	(189,912,703)
Futures Options	816,317	-	-
FX Forwards	7,164,135	2,879,339	712,121,744
Fixed Interest Rate Swaps	1,714,050	3,093,183	152,198,275
Rights	859,375	145,237	620,787

The change in fair value denotes the net realized and unrealized gains and losses recognized during the period. The fair value of the derivative instruments at June 30, 2010, denotes the market value, with the exception of FX Forwards, which denotes the net realized and unrealized gains and losses recognized during the period. Furthermore, the Notional amount for Futures and Options was calculated as contract size times the number of contracts.

The Plans are exposed to credit risk on derivative instruments that are in asset positions. To minimize its exposure to loss related to credit risk, it is the Nebraska Investment Council's policy to require counterparty collateral posting provisions in its non-exchange-traded derivative instruments. These terms require full collateralization of the fair value of derivative instruments in asset positions. Collateral posted is to be in the form of U.S. Treasury securities held by a third-party custodian. The Plans have never failed to access collateral when required.

The aggregate fair value of derivative instruments in asset positions at June 30, 2010, was $7,026,585. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. There is no collateral held or liabilities included in netting arrangements with those counterparties; therefore, the net exposure to credit risk is $7,026,585.

Although the Plans execute derivative instruments with various counterparties, there is approximately 85 percent of the net exposure to credit risk, held with four counterparties. The counterparties are rated A or AA.

The Plans are exposed to interest rate risk on its interest rate swaps. Interest rate swaps are agreements between two counterparties to exchange future cash flows. These are generally fixed versus variable flows, and can be either received or paid. These swaps are used to adjust interest rate and yield curve exposure and substitute for physical securities. Long swap positions (receive fixed) increase exposure to long-term interest

4. Investments (Concluded)

rates; short positions (pay fixed) decrease exposure. Counterparty risk is limited to monthly exchanged or netted cash flows. All of the Plans interest rate swaps were fixed with a LIBOR (London Interbank Offered Rate) or SIFMA (Securities Industry and Financial Markets Association) reference rate.

Foreign currency risk for derivative instruments at June 30, 2010, are as follows:

DERIVATIVES FOREIGN CURRENCY AT JUNE 30, 2010

Currency	Credit Default Swaps	Fixed Income Options	Fixed Income Rate Swaps	Rights
Australian Dollar	$ -	$ -	$ 360,302	$ -
Brazilian Real	-	-	188,339	-
Euro Currency	(1,575)	(212,857)	-	145,237
Mexican Peso	-	-	181,641	-
Total	$ (1,575)	$ (212,857)	$ 730,282	$ 145,237

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

Securities are recorded on a trade date basis. On the trade date, the Plans own the asset. However, if the security has not settled, payment has not been received or made. Receivables and payables for investments sold and purchased represent securities in which the asset had been recorded as of June 30, 2010, but the security had not settled.

5. Compensated Absences

The liability for the vested portion of compensated absences for each Plan at June 30, 2010, is as follows:

	School Employees	Judges	State Patrol
Annual Leave	$ 104,301	$ 1,550	$ 1,609
Sick Leave	85,798	1,275	1,324
Compensatory Leave	7	-	-
	$ 190,106	$ 2,825	$ 2,933

6. Payments to Omaha Public Schools

Neb. Rev. Stat. § 79-916(2) (Reissue 2008) requires an annual payment, for one percent of members' compensation, to be made to Omaha Public Schools (OPS) as a result of that school system having a separate retirement system. The amount is included on the Statement of Changes in Plan Assets in State Contributions additions and as Other Deductions for the July 2010 appropriation for the fiscal year ended June 30, 2010. Additionally, on the Statement of Plan Net Assets, the amount is included as a Contribution Receivable and a liability for contributions due to OPS as the appropriation was not received until July 2010.

The School Employee Retirement Plan (School Plan) also administers a service annuity to all retired Nebraska school district employees, paid by the State of Nebraska and computed per Neb. Rev. Stat. § 79-933 (Reissue 2008). For the OPS retirees, a calculated service annuity amount is transferred from the School Plan to the Omaha School Employees' Retirement System (Omaha), who then in turn makes the actual service annuity payments to the Omaha retirees. In accordance with Neb. Rev. Stat. § 79-916 (Reissue 2008), a separate Service Annuity Fund (Fund) was established for such payments and an actuarially computed amount was transferred to the Fund from other School Plan assets. The State may transfer additional amounts to the Fund as may be necessary to pay the normal cost and amortize any unfunded actuarial accrued liability. This Fund is to be used only to reimburse Omaha for its retirees' service annuity payments and related administrative expenses. The assets of the Fund ($8,065,438, consisting almost entirely of investments) are included in the Statement of Plan Net Assets at June 30, 2010. The service annuity payments to OPS are shown as Other Deductions in the Statement of Changes in Plan Net Assets.

Other deductions from the School Plan for the year ended June 30, 2010, were as follows:

	School Employees
Omaha 1% Appropriation	$ 3,851,004
Omaha Service Annuity Payments	1,200,838
Total Other Deductions	$ 5,051,842

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 Department of Administrative Services (DAS) is responsible for maintaining the insurance and self-insurance programs for the

7. Contingencies and Capital Lease Commitments (Continued)

State. The State generally self-insures for general liability, employee healthcare, 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 for accidents involving vehicular pursuit, which have a $1,000,000, self-insured retention per accident. Insurance is also purchased for 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. Life insurance for eligible employees.

C. Crime coverage, with a limit of $31 million for each loss, and a $25,000 self-insured retention per incident subject to specific conditions, limits, and exclusions.

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.

Details of the various coverage is available from DAS - Risk Management division.

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

Capital Lease Commitment. The State of Nebraska, through State Accounting (a division of the Department of Administrative Services) has various leases under four Master Lease Indentures. Under such indentures, the State is required to make semiannual payments to trustees for principal and interest under such leases. To acquire funds for these semiannual payments to the trustees, State Accounting bills agencies in advance to ensure there are funds available to make the required payments. As of June 30, 2010, NPERS had agreed to participate in and make payments to State Accounting on four such capital leases. The agreements to pay for the leases are with NPERS, not any of the individual plans. The payments are allocated according to the

7. Contingencies and Capital Lease Commitments (Concluded)

expense allocation policy of NPERS. The minimum payments to State Accounting and the present value of future minimum payments for all capital leases as of June 30, 2010, are as follows:

	School Employees	Judges	State Patrol
Minimum Payments Due During Fiscal Year 2011	$ 262,910	$ 76,949	$ 74,034
Less: Interest and Executory costs	5,583	1,634	1,572
Present value of net minimum payments	$ 257,327	$ 75,315	$ 72,462

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

8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended June 30, 2010, are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
School Employees:					
Compensated Absences	$ 193,118	$ -	$ 3,012	$ 190,106	$ 13,307
Capital Lease Obligations	1,019,996	-	762,669	257,327	257,327
Totals	$ 1,213,114	$ -	$ 765,681	$ 447,433	$ 270,634
Judges:					
Compensated Absences	$ 2,929	$ -	$ 104	$ 2,825	$ 198
Capital Lease Obligations	298,535	-	223,220	75,315	75,315
Totals	$ 301,464	$ -	$ 223,324	$ 78,140	$ 75,513
State Patrol:					
Compensated Absences	$ 4,533	$ -	$ 1,600	$ 2,933	$ 205
Capital Lease Obligations	287,227	-	214,765	72,462	72,462
Totals	$ 291,760	$ -	$ 216,365	$ 75,395	$ 72,667

9. School Employee Contributions

Member contributions for the School Plan exceeded employer contributions due to purchase of service payments totaling $2,544,177. Members can purchase service credit for reinstatement of service, out-of-state service, for a leave of absence, or within 12 months of retirement in accordance with Neb. Rev. Stat. § 79-921 (Reissue 2008), Neb. Rev. Stat. § 79-933.05 (Reissue 2008), Neb. Rev. Stat. § 79-933.06 (Reissue 2008), and Neb. Rev. Stat. § 79-933.08 (Reissue 2008).

10. Capital Assets

Capital asset activity for the year ended June 30, 2010, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
School Employees:				
Equipment	$ 11,637,651	$ 404,336	$ -	$ 12,041,987
Less: Accumulated Depreciation	7,317,138	2,220,875	-	9,538,013
Total Capital Assets, Net	$ 4,320,513	$ (1,816,539)	$ -	$ 2,503,974
Judges:				
Equipment	$ 2,093,794	$ 5,539	$ -	$ 2,099,333
Less: Accumulated Depreciation	1,855,802	177,211	-	2,033,013
Total Capital Assets, Net	$ 237,992	$ (171,672)	$ -	$ 66,320
State Patrol:				
Equipment	$ 2,049,386	$ 5,539	$ -	$ 2,054,925
Less: Accumulated Depreciation	1,816,769	173,171	-	1,989,940
Total Capital Assets, Net	$ 232,617	$ (167,632)	$ -	$ 64,985

11. Subsequent Events

State Patrol Additional Contributions. Neb. Rev. Stat. § 81-2017(3) (Supp. 2009) defines actuarially required contributions. The actuarially determined additional contribution requirement for the State Patrol Plan as of July 1, 2010, is $2,770,262.

State Patrol Contribution Rate Increase. Neb. Rev. Stat. § 81-2017(1) and (2) (Supp. 2009), increased the member contribution rate from 15% to 16% on July 1, 2010. The employer contribution also increased from 15% to 16%.

School Employee Additional Contributions. Neb. Rev. Stat. § 79-966.01 (Reissue 2008) defines actuarially required contributions. The actuarially determined additional contribution requirement for the School Employees Plan as of July 1, 2010, is $18,871,705. Furthermore, the additional contribution requirement for the Omaha Public Schools Retirement Plan as of July 1, 2010, is $967,145.

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, 2010

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded Accrued Liabilities (UAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAL as a Percentage of Covered Payroll
SCHOOL EMPLOYEES						
6/30/2010	$7,040,908,599	$ 8,542,119,000	$ 1,501,210,401	82.4%	$1,543,930,532	97.2%
6/30/2009	7,007,581,825	8,092,339,318	1,084,757,493	86.6%	1,481,568,432	73.2%
6/30/2008	6,932,918,638	7,654,536,359	721,617,721	90.6%	1,389,124,819	51.9%
6/30/2007	6,396,336,863	7,070,308,583	673,971,720	90.5%	1,325,616,322	50.8%
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%
JUDGES						
6/30/2010	$ 121,406,463	$ 121,309,682	$ (96,781)	100%	$ 18,773,203	(0.5%)
6/30/2009	120,992,600	118,558,418	(2,434,182)	102%	18,373,339	(13.2%)
6/30/2008	119,961,758	114,251,081	(5,710,677)	105%	17,990,072	(31.7%)
6/30/2007	111,006,176	103,704,250	(7,301,926)	107%	17,003,921	(42.9%)
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%
STATE PATROL						
6/30/2010	$ 273,306,925	$ 321,901,446	$ 48,594,521	84.9%	$ 26,765,816	181.6%
6/30/2009	274,119,906	305,291,065	31,171,159	89.8%	25,922,439	120.2%
6/30/2008	273,393,928	291,996,719	18,602,791	93.6%	26,979,643	69.0%
6/30/2007	254,662,819	265,846,597	11,183,778	95.8%	26,072,859	42.9%
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%

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, 2010

SCHOOL EMPLOYEES			
Year Ended	Annual Required Contribution (1)		Percentage
June 30	State (2)	School	Contributed
2010	$ 21,380,352 (3)	$ 128,845,427	100%
2009	20,620,548	110,028,942	100%
2008	15,832,941	105,977,554	100%
2007	15,314,413	107,478,977	100%
2006	30,644,522	102,161,426	100%
2005	29,816,737	90,147,174	90%

JUDGES			
Year Ended	Annual Required Contribution		Percentage
June 30	State	Court Fees	Contributed
2010	$ 72,244	$ 3,543,047	100%
2009	72,244	3,419,091	100%
2008	72,244	3,280,964	100%
2007	64,354	3,143,599	100%
2006	72,169	3,048,084	100%
2005	501,841	2,217,118	84%

STATE PATROL		
Year Ended June 30	Annual Required Contribution	Percentage Contributed
2010	$ 6,260,122 (3)	100%
2009	5,384,789	100%
2008	4,855,700	100%
2007	5,078,674	100%
2006	5,083,180	100%
2005	3,868,904	82%

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 appropriations for plan year ended June 30 paid after end of plan year.

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

(3) Additional State funding is required for the School Employees Plan in the amount of $18,871,705 and for the State Patrol Plan in the amount of $2,770,262, as of July 1, 2010.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS

SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS

SCHEDULE OF SERVICE EFFORTS AND ACCOMPLISHMENTS

Fiscal Years Ended June 30, 2006 Through 2010

	2006	2007	2008	2009	2010
SCHOOL EMPLOYEES					
Active Members	36,414	37,152	37,832	39,231	39,764
Inactive Members	17,755	18,147	18,995	19,413	19,762
Retirees	13,727	14,408	15,339	15,949	16,912
Total Benefits Paid (3)	$ 206,222,696	$ 234,129,493	$ 261,336,738	$ 289,529,736	$ 308,630,269
Average Annual Benefit (1)	$ 15,023	$ 16,250	$ 17,037	$ 18,153	$ 18,249
Average Monthly Benefit (4)	$ 1,252	$ 1,354	$ 1,420	$ 1,513	$ 1,521
Administrative Expenses	$ 3,830,708	$ 3,833,125	$ 5,104,501	$ 2,675,297	$ 5,925,090
Average Admin. Expense Per Member (2)	$ 56.42	$ 54.99	$ 70.73	$ 35.87	$ 77.51
JUDGES					
Active Members	154	154	157	154	153
Inactive Members	10	10	9	8	8
Retirees	162	159	155	157	154
Total Benefits Paid (3)	$ 4,703,966	$ 5,068,066	$ 5,277,937	$ 5,433,233	$ 5,576,749
Average Annual Benefit (1)	$ 29,037	$ 31,875	$ 34,051	$ 34,607	$ 36,213
Average Monthly Benefit (4)	$ 2,420	$ 2,656	$ 2,838	$ 2,884	$ 3,018
Administrative Expenses	$ 436,753	$ 419,300	$ 362,628	$ 421,682	$ 169,228
Average Admin. Expense Per Member (2)	$ 1,339.73	$ 1,298.14	$ 1,129.68	$ 1,321.89	$ 537.23
STATE PATROL					
Active Members	477	484	496	468	444
Inactive Members	14	15	9	11	13
Retirees	331	341	352	372	390
Total Benefits Paid (3)	$ 11,168,135	$ 11,969,795	$ 12,781,649	$ 13,347,738	$ 13,646,360
Average Annual Benefit (1)	$ 33,741	$ 35,102	$ 36,312	$ 35,881	$ 34,991
Average Monthly Benefit (4)	$ 2,812	$ 2,925	$ 3,026	$ 2,990	$ 2,916
Administrative Expenses	$ 432,283	$ 433,960	$ 366,917	$ 582,678	$ 167,999
Average Admin. Expense Per Member (2)	$ 525.89	$ 516.62	$ 428.14	$ 684.70	$ 198.35

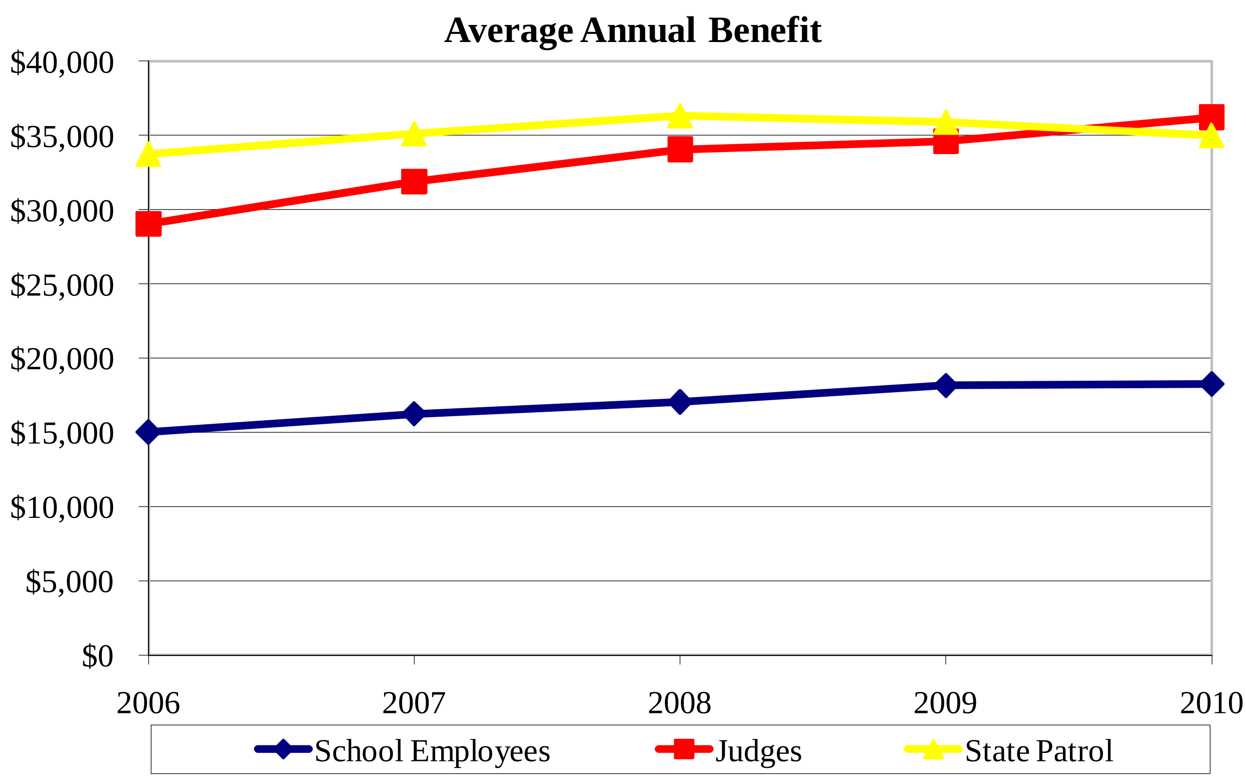
Notes:

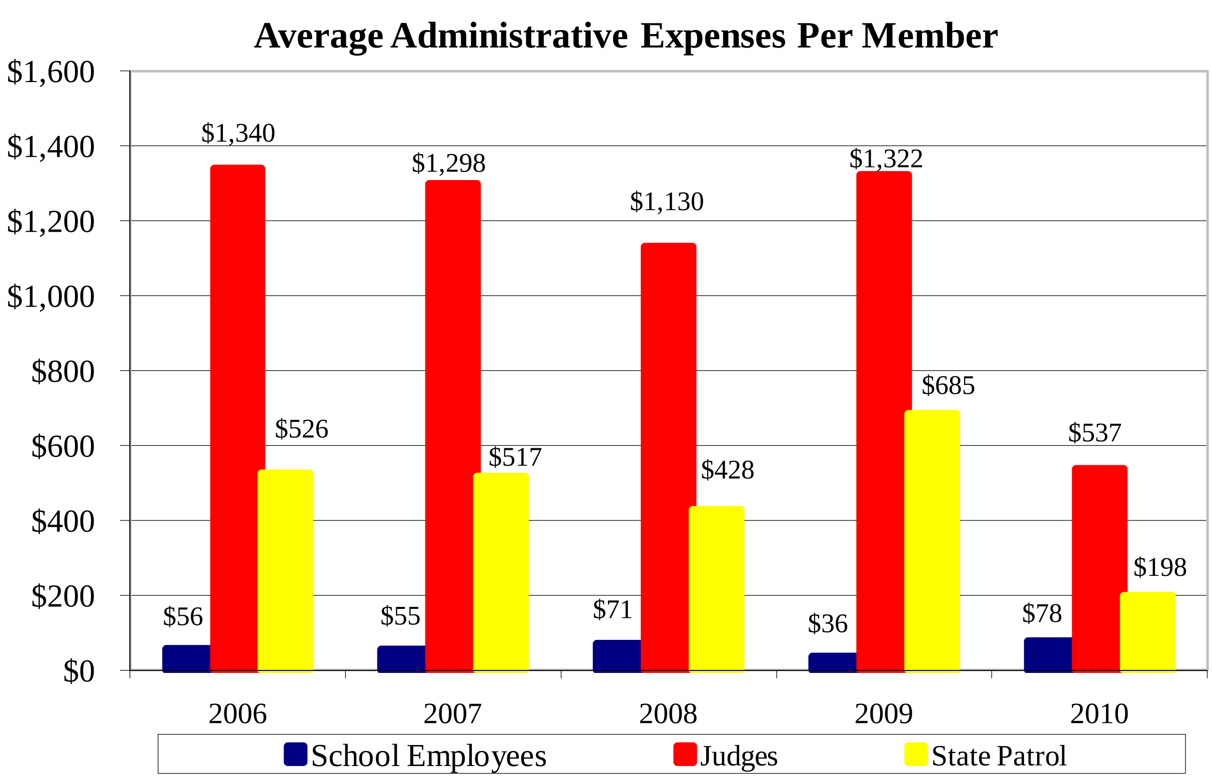
(1) Calculated: Total Benefits Paid/#Total Retirees = Average Annual Benefit

(2) Calculated: Administrative Expenses/Total Members = Average Admin Expense Per Member

(3) Total benefits paid does not include refunds

(4) Calculated: Average Annual Benefit/12 = Average Monthly Benefit


Average Annual Benefit
$40,000
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
2006
2007
2008
2009
2010
School Employees
Judges
State Patrol


Average Administrative Expenses Per Member
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
$56
$1,340
$526
$55
$1,298
$517
$71
$1,130
$428
$36
$1,322
$685
$78
$537
$198
2006
2007
2008
2009
2010
School Employees
Judges
State Patrol

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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, 2010, and have issued our report thereon dated March 21, 2011. The report was modified to disclose that Management Discussion and Analysis was not presented and to emphasize the financial statements present only the funds of the Nebraska Public Employees Retirement Systems - 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 (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but, not for the purpose of expressing an opinion on the effectiveness of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies that are described in the Comments Section of the report: Comment Number 1 (Lack of Written Procedures and Proper Controls) and Comment Number 2 (School District Testing). A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

<u>Compliance and Other Matters</u>

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 certain additional items that we 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 3 (Clarity of Statutory Intent), Comment Number 4 (Berwyn Death Audit Review), Comment Number 5 (Lack of Adequate Procedures Regarding Required Minimum Distributions), Comment Number 6 (Resolution of Prior Year School Audit Findings), Comment Number 7 (Inconsistent Plan Documents) and Comment Number 8 (Disaster Recovery Plan).

The Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' written response to the findings identified in our audit are described in the Comments Section of the report. We did not audit Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' response and, accordingly, we express no opinion on it.

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

Signed Original on File

March 21, 2011

Pat Reding, CPA, CFE
Assistant Deputy Auditor