AUDIT REPORT
OF THE
NEBRASKA INVESTMENT COUNCIL

JULY 1, 2000 THROUGH JUNE 30, 2001
AND FOR THE PERIOD JULY 1, 2001
THROUGH JANUARY 31, 2002

NEBRASKA INVESTMENT COUNCIL

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NEBRASKA INVESTMENT COUNCIL

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BACKGROUND

The Nebraska Investment Council was established under 1969 laws as a centralized State investment agency. The Council provides investment management services for the State. Most provisions governing its activities are contained in the Nebraska State Funds Investment Act and the Nebraska Capital Expansion Act.

The agency is governed by a seven-member council. Five voting members are appointed by the Governor and confirmed by the Legislature. Council members serve five-year terms, with one expiring each year. The State Treasurer and the Director of the Public Employees Retirement Systems serve as non-voting members. Voting members receive $20 per meeting, plus expenses.

The Council determines investment strategies for all funds and sets guidelines for specific portfolios. It determines the allocation of funds among managers. It selects external managers and consultants, subject to approval by the Governor. It also selects the State Investment Officer, subject to approval by the Governor and the Legislature. The Council establishes policies for the Investment Officer, staff, and external managers.

Funds managed include the following: 1) the State's general and cash funds; 2) retirement funds for School employees (except for Omaha Public Schools), Nebraska State Patrol, and Judges, and 3) State trust funds such as the Permanent School Fund, the Veterans' Aid Fund and the Nebraska Tobacco Settlement Trust Fund. The Council is also responsible for investing: 1) the Deferred Compensation Plan assets; 2) the State Employees and Counties Retirement Systems funds; and 3) funds of the College Savings Plan.

MISSION STATEMENT

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

NEBRASKA INVESTMENT COUNCIL

ORGANIZATIONAL CHART

INVESTMENT COUNCIL

Bruce Bisson	(Chairman)	
DiAnn Kolkman	Term expired 10/15/00	
Carol Kontor		
W. Don Neslon	re-appointed 9/18/01	
Greg Stine	resigned 12/28/01	
John Maddux	appointed 12/21/01	
Ken Green	appointed 10/16/00	
(non-voting)		
David Heineman	term. – appointed Lt. Gov	10/1/01
Lorelee Byrd	Appointed St. Treasurer	10/1/01
Anna Sullivan	Director, Retirement Systems	

STATE INVESTMENT OFFICER

Rex W. Holsapple

BUSINESS MANAGER

Kathy Dawes

SECRETARY

Mary Shefferd Term. 4/6/01
Brandee Freauf started 5/26/01

SECURITY ANALYSTS II/III

Gayle A. Wrasse
Joseph P. Jurich started 1/8/01
JoLynn Winkler

SUMMARY OF COMMENTS

During our audit of the Nebraska Investment Council, we noted certain matters involving the internal control over financial reporting and other operational matters which are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Commission Recaptures*:** The Council earns "commission recapture dollars" through commission sales. We noted the following in our review of the Council's commission recapture records:

- The commission recapture balance had doubled from a balance of $316,888 as of June 30, 1999 to a balance of $634,598 as of June 30, 2001.

- The Council did not have written policies specifying the types of disbursements for which earned commission recaptures may be used, nor how the commission recapture dollars should be considered in the Council's operating budget.

- A current contract with an investment firm was not on file to support the commission recaptures being received.

2. ***Internal Control:*** In our audit of the Council we reviewed the internal controls of the Council in two areas: 1) the controls over the accounting for the operating disbursements, receipts, and fixed assets, and 2) the internal controls over investment policies and procedures to ensure compliance with those investment policies and procedures. We noted a general lack of segregation of duties, the lack of review/monitoring of internal controls, and a lack of internal control procedure documentation.

3. ***Investment Contracts:*** In June 2001, the Nebraska Investment Council (NIC) entered into a contract with WG Trading Company Limited Partnership in which $160,000,000 of retirement funds were invested. The Council also entered into an agreement for investment management services with Westridge Capital Management, Inc., which involved the investment of an additional $40,000,000. There was a difference in legal opinions on whether the Council was in compliance with certain State statutes by entering into these contracts.

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

SUMMARY OF COMMENTS
(Concluded)

Draft copies of this report were furnished to the Council to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. The Council declined to respond.

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

COMMENTS AND RECOMMENDATIONS

1. Commission Recaptures

The Council earned “commission recapture dollars” through commission sales. A certain percentage of the commission was paid back to the Council and was held in an account with State Street Bank. As the Council used this money to pay disbursements, they recorded the receipts and disbursements on the State accounting system. The commission recapture balance on hand at State Street Bank has been increasing each year. The balance at June 30, 2001 was $634,598, as compared to a balance of $316,888 as of June 30, 1999, a total increase of $317,710 over two years.

Sound accounting practice requires written policies be established for the use of commission recaptures earned. Sound accounting practice also requires procedures be in place to ensure the correct amount of commission recaptures are being earned.

We noted the following during our review of the commission recapture activity:

- The Council did not have any written policies specifying the types of disbursements for which earned commission recaptures may be used, nor how the commission recapture dollars should be considered in the Council’s operating budget. According to the Investment Officer, the funds could have been used for any disbursement incurred by the Council.

- A current contract with an investment firm was not on file to support the commission recaptures being received. During the audit, a new contract was signed between the Council and the investment firm supporting the commission recapture calculation. The Council also did not have monitoring procedures in place to ensure the correct amounts of commission recaptures were being earned.

> We recommend the Council implement a written policy stating the guidelines to be followed when spending commission recaptures. The policy should address the increasing balance. We also recommend the Council implement monitoring procedures to ensure the correct amount of recaptures are being earned.

2. Internal Control

The internal controls, as outlined in auditing standards, consists of the Control Environment, which in part includes management’s philosophy and operating style, and three internal control components: Risk Assessment, Information and Communication, and Monitoring.

COMMENTS AND RECOMMENDATIONS

2. Internal Control (Continued)

Key elements in any strong internal control system are an adequate segregation of duties, and appropriate review/monitoring procedures. For an adequate segregation of duties to exist no one individual can handle all phases of a transaction from beginning to end. If an adequate segregation of duties is not possible, a compensating control should be in place to ensure an individual cannot both perpetuate and conceal errors or irregularities. Review/monitoring procedures include those procedures to ensure controls, which are in place are working effectively.

In our audit of the Council, we reviewed the internal controls of the Council in two areas: 1) the controls over the accounting for the operating disbursements, receipts, and fixed assets, and 2) the internal controls over investment policies and procedures to ensure compliance with those investment policies and procedures.

Internal Controls over Disbursements (including payroll), Receipts, and Fixed Assets (Operating Internal Controls

The Council has a staff of six, which includes the State Investment Officer, with an operating budget of approximately $790,000.

During our review of the Council's control environment we noted there was generally a lack of segregation of duties in the above areas. This means, even though there were two people involved in some transactions, there was one individual who could handle all phases of some transactions from beginning to end. Thus, there was more risk an error or misappropriation would occur and not be detected. In addition, there seemed to be no compensating controls. The State Investment Officer and the Council did not review the detail transactions of the agency. The State Investment Officer reviewed the budget status report (which shows summary data of disbursements) on a quarterly basis; however, this review was not documented.

Our testing in the above areas revealed minor coding errors, and the incorrect allocation of investment fees to the proper investment accounts, which went undetected. Someone other than the person performing the transaction/procedure may have caught these errors had review/monitoring procedures been in place.

A similar comment was noted in our prior audit of the Council for the fiscal year ended June 30, 1999.

The Council determines investment strategies for all funds and sets guidelines for specific portfolios. It determines the allocation of funds among managers. It selects external managers

COMMENTS AND RECOMMENDATIONS

2. Internal Control (Continued)

Internal Control Over Investments

and consultants. Some funds are managed internally, but the majority of the funds are managed externally. As of December 31, 2000, the Council was responsible for an investment balance of over $7.7 billion.

During our review of the internal controls over compliance with the Council's investment policies and procedures we noted, per discussion with the Investment Officer, monitoring of the Council investment policies were either not being done, or were not documented by him. Our testing also revealed that:

- Several months of Operating Investment Cash Pool data was accumulated incorrectly, resulting in the incorrect allocation of interest to the various State funds. Someone other than the person performing the transaction/procedure may have caught this error had a review/monitoring procedure been in place.

- The custodian fees charged to each investment account by State Street Bank (SSB), the custodian, was not being reviewed to ensure the fee being charged was in accordance with the SSB contract.

In addition to our review of the above internal controls, the accounting firm of KPMG issued an Agreed-Upon Procedures report on April 12, 2001, which addressed internal controls over the investment function of the Council. Per discussion with the Investment Officer, many of the findings and recommendations in this report had not yet been implemented. The recommendations based upon those findings which were not implemented are included below:

1. We interviewed the Investment Officer and Council Members to gain an understanding and to document the controls related to cash and securities transfers.

Finding:

We noted limited review procedures were performed on transactions related to transfers of cash to the short or medium-term investment pools, as well as transfers from the short or medium-term investment pools to banks within the State of Nebraska under the Time Deposit On Account program.

Recommendation:

Adequate segregation of duties and review procedures are key elements of any strong internal control system. To help reduce the risk of errors and potential misappropriation of assets, we recommend management establish a policy that requires a separate

COMMENTS AND RECOMMENDATIONS

2. <u>Internal Control</u> (Continued)

individual review transfer activity for propriety, compliance with the Council's investment policy, and compliance with any Time Deposit on Account program requirements and document such review by signing off on the respective documents.

Finding:

We noted that there are no procedures currently followed to ensure that no errors occurred in the instructions the custodian receives from the managers. We noted that staff previously performed or reviewed monthly reconciliation's between manager reports and custodian reports to detect such errors; however, these procedures are no longer performed.

Recommendation:

State Street's SAS 70 report provides some evidence that State Street's reports are reliable. However, the SAS 70 does not address the possibility that State Street is reliably acting on the recording instructions that contain errors. We recommend that manager reports and custody reports be reconciled. This reconciliation will reveal any differences between what the manager intended and what actually happened.

Finding:

We noted no formally written documentation of the system of controls related to transfers or any other activity of the Council.

Recommendation:

To help reduce the risk of error and misunderstanding of procedures to be performed and to help identify weaknesses and strengths in the current control system, we recommend the Council prepare written documentation of the system of controls (accounting manual of procedures and controls) for all operations of the Council. Such a manual would also facilitate training of new personnel.

2. We examined the November 2000 monthly reconciliation between the Nebraska Accounting System (NAS) and State Street Bank for short-term and long-term investments for completeness and review and approval.

Finding:

We noted the short-term investment reconciliation identified permanent variance for each monthly reconciliation performed by the Department of Administrative Services (DAS).

Recommendation:

All variances after appropriate investigations should be corrected in a timely manner. We further recommend the Council obtain from DAS a copy of each month's reconciliation, investigate any variances, and coordinate appropriate adjustments through DAS.

COMMENTS AND RECOMMENDATIONS

2. <u>Internal Control</u> (Continued)

3. We gained an understanding of the policies and procedures related to the selection and monitoring of securities dealers. We selected one securities dealer to obtain supporting documentation for the selection and to obtain supporting documentation of the Council's monitoring of the securities dealer to determine compliance with the Council's selection and monitoring policies and procedures.

Finding:

Per discussion with management, there are no written policies and procedures in place for the selection and monitoring of securities dealers. As a result, we were unable to obtain supporting documentation from the Council for the selection and monitoring of the securities dealers. We note that it is a universal practice for investment firms to have such written policies and procedures.

Recommendation:

We recommend the Council identify the risks associated with securities dealers, as well as risks related to the selection and monitoring of securities dealers, and establish written policies and procedures accordingly or provide a reasonable explanation as to why such policies and procedures would not be beneficial to the Council.

4. We haphazardly selected and examined 25 adjustments (adjustments include transfers, income, expenses, and fees) to securities accounts for the period July 1, 2000 to November 30, 2000 for appropriate review and approval from custodial statements.

Finding:

We noted one transfer from the short-term investment pool to a long-term endowment fund was not reported by the Council to DAS for posting to NAS. However, DAS did identify the error during their monthly reconciliation of the long-term investment.

Recommendation:

To further strengthen controls, we recommend the Council develop a policy and procedure that ensures all transfers are appropriately reported to DAS. For example, this could be accomplished by maintaining a list of transfers and requiring a separate individual to verify the appropriate documentation was completed and submitted to DAS.

5. We haphazardly selected 25 securities transactions from the transaction detail on the custodial statements for the period of July 1, 2000 to November 30, 2000 and examined the selections for propriety, required documentation, compliance with the investment policy, and appropriate approvals. We obtained a list of authorized signers and determined whether signatures on the selected transactions were on the list. We examined each transaction selected to determine whether separate individuals executed, approved, posted and reconciled the transactions to the accounting system and had physical or electronic access to securities. We agreed the selected transactions to the broker's advice and the Council's required supporting documentation.

COMMENTS AND RECOMMENDATIONS

2. <u>Internal Control</u> (Concluded)

Finding:

To ensure compliance with the Council's investment policy, the person who executes the daily transactions completes an electronic spreadsheet that automatically calculates the effect of purchases or sales on compliance with the Council's investment policy. Although the electronic spreadsheet is modified daily, no review is performed and no hard copy of the spreadsheet is maintained.

Recommendation

To further strengthen controls and to help ensure controls are working as designed, we recommend maintaining hard copies of the electronic spreadsheets and establish a policy that requires a separate individual to randomly perform periodic review of the spreadsheets for compliance with the Investment Policy.

We understand the Council has budgeted for, but has not yet hired, a person for the position they have identified as a Control Specialist. We understand it is the Council's desire the Control Specialist will address the internal control issues brought up in this comment.

> We recommend the Council improve their overall internal controls by implementing the key elements of internal controls in the area of Operations internal controls and Investment internal controls as noted by Auditor of Public Accounts and in the Agreed-Upon Procedures Report prepared by the accounting firm of KPMG. The key elements are segregation of duties so no one individual can handle all phases of a transaction from beginning to end, review/monitoring procedures to ensure controls implemented are in place, and being effectively applied, and ensuring internal control procedures performed are documented.

3. <u>Investment Contracts</u>

In June 2001, the Council entered into a contract with WG Trading Company Limited Partnership in which $160,000,000 of retirement funds were invested. The Council also entered into an agreement for investment management services with Westridge Capital Management, Inc., which involved the investment of an additional $40,000,000.

Pertinent sections of the contract with WG Trading Company state as follows:

Section 5.1 . . . to buy, sell short, lend, borrow, hold, trade, invest, deal in and otherwise exercise all rights, powers, privileges, and other incidents of ownership in Securities, Options, commodities, futures and any and all other types of investments;

COMMENTS AND RECOMMENDATIONS

3. **Investment Contracts** (Concluded)

Section 5.2 . . . may engage in any transaction necessary or appropriate to the accomplishment of its purposes, including, without limitation, borrowing money, engaging in margin or short sale transactions, repurchase transactions and reverse repurchase transactions.

Section 17.1 . . . This type of investing is speculative and may involve a high degree of risk, including both market and credit risks.

The Council requested that the Nebraska Attorney General (AG) give an Opinion of Counsel after the contract had been executed. The AG reviewed the contract and declined to give the requested Opinion of Counsel. The AG communicated to the Investment Council that, in his opinion, the partnership agreement violated Neb. Rev. Stat. Section 72-1247 R.S.Supp., 2000 by allowing WG Trading Company to participate in certain investments that the Investment Council was statutorily prohibited from authorizing. Section 72-1247 states, "the state investment officer shall not buy on margin, buy call options, or buy put options," and, "any investment made by the state investment officer shall be made with the exercise of that degree of care and skill, under the circumstances then prevailing, which a person of prudence would exercise in the management of the property of another, not for speculation but for investment, considering the probable safety of capital as well as the probable income to be derived."

The Council asked the AG to authorize a request for outside counsel. The AG approved their request to contract with an outside firm, of his choice. The outside firm concluded that, in their opinion, the Council had the requisite statutory authority to enter into the contract with WG Trading Company.

The AG disagrees with this opinion and has requested the Nebraska Legislature "give this matter its immediate attention." At the date of issuance of this report this issue has not been resolved, and has been referred to the Executive Board of the Legislature.

In addition to the above contracts, our review of six other investment manager contracts noted four of those contracts contained similar terms as used in the WG Trading Company.

We will withhold any recommendation for further action until the Legislature, the Investment Council, and the Attorney General's office resolve this issue.

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NEBRASKA INVESTMENT COUNCIL

INDEPENDENT AUDITORS' REPORT

We have audited the financial statements of the Nebraska Investment Council as of and for the fiscal year ended June 30, 2001, and for the period July 1, 2001 through January 31, 2002, as listed in the Table of Contents. These financial statements are the responsibility of the Council's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

Also as discussed in Note 1, the financial statements present only the Nebraska Investment Council, and are not intended to present fairly the fund balances and the receipts and disbursements of the State of Nebraska in conformity with the cash receipts and disbursements basis of accounting.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fund balances of the Nebraska Investment Council as of June 30, 2001, the receipts and disbursements for the fiscal year then ended, the fund balances of the Nebraska Investment Council as of January 31, 2002, and the receipts and disbursements for the period July 1, 2001 through January 31, 2002, on the basis of accounting described in Note 1.

In accordance with Government Auditing Standards, we have also issued our report dated February 15, 2002, on our consideration of the Nebraska Investment Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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.

The accompanying schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on them.

Don Dunlap CPA

February 15, 2002 Manager

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF ASSETS, FUND BALANCES AND OTHER CREDITS
ARISING FROM CASH TRANSACTIONS
ALL FUND TYPES AND GENERAL FIXED ASSETS ACCOUNT GROUP

June 30, 2001

	Governmental Fund Type	Fiduciary Fund Type	Account Group	
	Special Revenue	Trust and Agency	General Fixed Assets	**Totals** (Memorandum Only)
Assets				
Cash in State Treasury (Note 5)	$ 37,719	$ (18,061,613)	$ -	$ (18,023,894)
Deposit with Vendors	504			504
Recaptured Commissions in Bank/Broker Dealer Accounts (Note 1.J.)	634,598	-	-	634,598
Property, Plant, and Equipment	-	-	16,795	16,795
Total Assets	$ 672,821	$ (18,061,613)	$ 16,795	$ (17,371,997)
Fund Balances and Other Credits				
Other Credits:				
Investment in Fixed Assets	$ -	$ -	$ 16,795	$ 16,795
Fund Balances:				-
Reserved For Postage	504	-	-	504
Unreserved, Undesignated	672,317	(18,061,613)	-	(17,389,296)
Total Fund Balances and Other Credits	$ 672,821	$ (18,061,613)	$ 16,795	$ (17,371,997)

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

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF RECEIPTS, DISBURSEMENTS,
AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 2001

	Governmental Fund Type	Fiduciary Fund Type	
	Special Revenue	Trust and Agency	**Totals** (Memorandum Only)
RECEIPTS:			
Sales and Charges (Note 1.J.)	$ 555,591	$ -	$ 555,591
Miscellaneous (Note 1.J.)	340,258	-	340,258
TOTAL RECEIPTS	895,849	-	895,849
DISBURSEMENTS:			
Personal Services	363,917	-	363,917
Operating (Note 7)	369,522	-	369,522
Travel	19,840	-	19,840
Capital Outlay (Note 7)	10,003	-	10,003
TOTAL DISBURSEMENTS	763,282	-	763,282
Excess of Receipts Over (Under) Disbursements	132,567	-	132,567
OTHER FINANCING SOURCES (USES):			
Sales of Assets	4	-	4
Distributive Activity:			
Income Received in the Operating Investment Pools (Note 5)	-	96,600,666	96,600,666
Distribution of Income from the Operating Investment Pools (Note 5)	-	(100,223,466)	(100,223,466)
TOTAL OTHER FINANCING SOURCES (USES)	4	(3,622,800)	(3,622,796)
Excess of Receipts and Other Financing Sources Over (Under) Disbursements and Other Financing Uses	132,571	(3,622,800)	(3,490,229)
FUND BALANCE, JULY 1, 2000	540,250	(14,438,813)	(13,898,563)
FUND BALANCE, JUNE 30, 2001	$ 672,821	$ (18,061,613)	$ (17,388,792)

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

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN FUND BALANCE

BUDGET AND ACTUAL

Cash Fund

For the Fiscal Year Ended June 30, 2001

	CASH FUND		
	BUDGET	ACTUAL (BUDGETARY BASIS)	VARIANCE FAVORABLE (UNFAVORABLE)
RECEIPTS:			
Sales and Charges (Note 1.J.)		$ 555,591	
Miscellaneous (Note 1.J.)		340,258	
TOTAL RECEIPTS		895,849	
DISBURSEMENTS:			
Personal Services	$ 405,247	363,917	$ 41,330
Operating (Note 7)	351,170	369,522	(18,352)
Travel	24,740	19,840	4,900
Capital Outlay (Note 7)	6,000	10,003	(4,003)
TOTAL DISBURSEMENTS	$ 787,157	763,282	$ 23,875
Excess of Receipts Over (Under) Disbursements		132,567	
OTHER FINANCING SOURCES (USES):			
Sale of Assets		4	
TOTAL OTHER FINANCING SOURCES (USES)		4	
Excess of Receipts and Other Financing Sources Over (Under) Disbursements and Other Financing Uses		132,571	
FUND BALANCE, JULY 1, 2000		540,250	
FUND BALANCE, JUNE 30, 2001		$ 672,821	

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

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF ASSETS, FUND BALANCES AND OTHER CREDITS
ARISING FROM CASH TRANSACTIONS
ALL FUND TYPES AND GENERAL FIXED ASSETS ACCOUNT GROUP

January 31, 2002

	Governmental Fund Type	Fiduciary Fund Type	Account Group	
	Special Revenue	Trust and Agency	General Fixed Assets	**Totals** (Memorandum Only)
Assets				
Cash in State Treasury (Note 5)	$ 42,997	$ (18,011,832)	$ -	$ (17,968,835)
Deposit with Vendors	504	-	-	504
Recaptured Commissions in Bank/Broker Dealer Account (Note 1.J.)	807,814	-	-	807,814
Property, Plant, and Equipment	-	-	19,053	19,053
Total Assets	$ 851,315	$ (18,011,832)	$ 19,053	$ (17,141,464)
Fund Balances and Other Credits				
Other Credits:				
Investment in Fixed Assets	$ -	$ -	$ 19,053	$ 19,053
Fund Balances:				
Reserved For Postage	504	-	-	504
Unreserved, Undesignated	850,811	(18,011,832)	-	(17,161,021)
Total Fund Balances and Other Credits	$ 851,315	$ (18,011,832)	$ 19,053	$ (17,141,464)

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

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF RECEIPTS, DISBURSEMENTS,
AND CHANGES IN FUND BALANCES

For the Period July 1, 2001 through January 31, 2002

	Governmental Fund Type	Fiduciary Fund Type	**Totals**
	Special Revenue	Trust and Agency	(Memorandum Only)
RECEIPTS:			
Sales and Charges (Note 1.J.)	$ 377,306	$ -	$ 377,306
Miscellaneous (Note 1.J.)	315,990	-	315,990
TOTAL RECEIPTS	693,296	-	693,296
DISBURSEMENTS:			
Personal Services	244,960	-	244,960
Operating	258,589	-	258,589
Travel	7,486	-	7,486
Capital Outlay	3,848	-	3,848
TOTAL DISBURSEMENTS	514,883	-	514,883
Excess of Receipts Over (Under) Disbursements	178,413	-	178,413
OTHER FINANCING SOURCES (USES):			
Sales of Assets	81		81
Distributive Activity:			
Income Received in the Operating Investment Pools (Note 5)	-	52,263,888	52,263,888
Distribution of Income from the Operating Investment Pools (Note 5)	-	(52,214,107)	(52,214,107)
TOTAL OTHER FINANCING SOURCES (USES)	81	49,781	49,862
Excess of Receipts and Other Financing Sources Over (Under) Disbursements and Other Financing Uses	178,494	49,781	228,275
FUND BALANCE, JULY 1, 2001	672,821	(18,061,613)	(17,388,792)
FUND BALANCE, JANUARY 31, 2002	$ 851,315	$ (18,011,832)	$ (17,160,517)

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

NEBRASKA INVESTMENT COUNCIL

STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN FUND BALANCE

BUDGET AND ACTUAL

CASH FUND

For the Period July 1, 2001 through January 31, 2002

	CASH FUND		
	BUDGET	ACTUAL (BUDGETARY BASIS)	VARIANCE FAVORABLE (UNFAVORABLE)
RECEIPTS:			
Sales and Charges		$ 377,306	
Miscellaneous		315,990	
TOTAL RECEIPTS		693,296	
DISBURSEMENTS:			
Personal Services	$ 268,395	244,960	$ 23,435
Operating	258,408	258,589	(181)
Travel	14,932	7,486	7,446
Capital Outlay	3,050	3,848	(798)
TOTAL DISBURSEMENTS	$ 544,785	514,883	$ 29,902
Excess of Receipts Over (Under) Disbursements		178,413	
OTHER FINANCING SOURCES (USES):			
Sale of Assets		81	
TOTAL OTHER FINANCING SOURCES (USES)		81	
Excess of Receipts and Other Financing Sources Over (Under) Disbursements and Other Financing Uses		178,494	
FUND BALANCE, JULY 1, 2001		672,821	
FUND BALANCE, JANUARY 31, 2002		$ 851,315	

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

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2001 And
For the Period July 1, 2001 Through January 31, 2002

1. Summary of Significant Accounting Policies

The accounting policies of the Nebraska Investment Council are on the basis of accounting as described in the Nebraska Accounting System Manual.

A. Reporting Entity. The Nebraska Investment Council (Council) is a State agency established under and governed by the laws of the State of Nebraska. As such, the Council is exempt from State and Federal income taxes. The financial statements include all funds of the Council. The Council has also considered all potential component units for which it is financially accountable, and other organizations which are fiscally dependent on the Council, or the significance of their relationship with the Council are such that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Council to impose its will on that organization, or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Council.

These financial statements present the Nebraska Investment Council. No component units were identified. The Nebraska Investment Council is part of the primary government for the State of Nebraska's reporting entity.

B. Basis of Accounting. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The accounting records of the Council are maintained and the Council's financial statements were prepared on the basis of cash receipts and disbursements. As such, the measurement focus includes only those assets and fund balances arising from cash transactions on the Combined Statement of Assets and Fund Balances for all funds of the Council. This differs from governmental generally accepted accounting principles (GAAP) which require all governmental funds to be accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financial sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Under the cash receipts and disbursement basis of accounting, revenues are recognized when received and expenditures are recognized when paid. This presentation differs from governmental generally accepted accounting principles

1. Summary of Significant Accounting Policies (Continued)

(GAAP), which requires the use of the modified accrual basis for governmental, and agency fund types. Under the modified accrual basis of accounting, revenues are recognized when they are considered susceptible to accrual and expenditures are recognized when the liability is incurred.

C. **Fund Accounting.** The accounts and records of the Council are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a self-balancing set of accounts which records receipts, disbursements, and the fund balance. The fixed asset account group is a financial reporting device designed to provide accountability over fixed assets. The fund types and account group presented on the financial statements are those required by GAAP, and include:

Special Revenue Funds. Reflect transactions related to resources received and used for restricted or specific purposes.

Trust and Agency Funds. Reflect transactions related to assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds.

General Fixed Assets Account Group. Used to account for general fixed assets of the Council.

This fund type classification differs from the budgetary fund types used by the Nebraska Accounting System.

The fund types established by the Nebraska Accounting System that are used by the Council are:

2000 - Cash Funds - Account for receipts generated by specific activities from sources outside of State government and the disbursements directly related to the generation of the receipts. The fund for the Council is the Nebraska Investment Council Cash Fund 2751. This is the Council's operating fund.

7000 - Distributive Funds - Account for assets held by the State as an agent for individuals, private organizations, other governments, and/or other funds. No appropriation control is established for this fund type. The fund for the Council is fund 7750. This fund is used entirely to record

1. Summary of Significant Accounting Policies (Continued)

the income received and the distribution of income earned on the investment of the Operating Investment Pools. For more detailed information on this fund, see Note 5 below.

D. Budgetary Process. The State's biennial budget cycle ends on June 30 of the odd-numbered years. By September 15, prior to a biennium, the Council and all other State agencies must submit their budget request for the biennium beginning the following July 1. There are no annual budgets prepared for Distributive funds. The requests are submitted on forms that show estimated funding requirements by programs, sub-programs, and activities. The Executive Branch reviews the requests, establishes priorities, and balances the budget within the estimated resources available during the upcoming biennium.

The Governor's budget bill is submitted to the Legislature in January. The Legislature considers revisions to the bill and submits the revised appropriations bill to the Governor for signature. The Governor may: a) approve the appropriations bill in its entirety, b) veto the bill, or c) line item veto certain sections of the bill. Any vetoed bill or line item can be overridden by a three-fifths vote of the Legislature.

The appropriations that are approved will generally set spending limits for a particular program within the agency. Within the agency or program, the Legislature may provide funding from one to five budgetary fund types. Thus, the control is by fund type, within a program, within an agency. The central accounting system maintains this control. A separate publication entitled "Annual Budgetary Report" shows the detail of this level of control. This publication is available from the Department of Administrative Services, Accounting Division.

Appropriations are usually made for each year of the biennium with unexpended balances being reappropriated at the end of the first year of the biennium. For most appropriations, balances lapse at the end of the biennium.

All State budgetary disbursements for the cash fund type are made pursuant to the appropriations which may be amended by the Legislature, upon approval by the Governor. State agencies may reallocate the appropriations between major object of expenditure accounts, except that the Legislature's approval is required to exceed the personal service limitations contained in the appropriations bill. Increases in total cash fund appropriations are increased by recaptured commission disbursements and can be increased by the Legislature as a deficit appropriations bill.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

The Council utilizes encumbrance accounting to account for purchase orders, contracts, and other disbursement commitments. However, State law does not require that all encumbrances be recorded in the State's centralized accounting system, and, as a result, the encumbrances that were recorded in the accounting system have not been included in the accompanying financial statements, except for the impact as described below.

Under State budgetary procedures, appropriation balances related to outstanding encumbrances at the end of the biennium are lapsed and reappropriated in the first year of the next biennium. The effect of the Council's current procedure is to include in the budget columns, Total Disbursements line, of the Statement of Receipts, Disbursements, and Changes in Fund Balances - Budget and Actual the current year's appropriations plus the amounts reappropriated for encumbrances outstanding at the end of the prior biennium. This procedure indicates the Council's intention to honor the encumbrances at the end of a biennium. The disbursements columns of the Statement include cash payments related to the appropriated and reappropriated amounts. For the year ended June 30, 2001, and for the period beginning July 1, 2001 and ending January 31, 2002, there were no budgetary funds in which disbursements exceeded appropriations.

In order to have a reasonable comparison of budget data to the actual disbursements for the seven month period of July 1, 2001 through January 31, 2002 (period), the budgeted amounts included in the Statement of Receipts, Disbursements, and Changes in Fund Balances – Budget and Actual for the period is 7/12 (58%) of the amount budgeted for the fiscal year ended June 30, 2002, plus all of the recaptured commissions recorded on the Nebraska Accounting System (NAS) for the period.

Budgets for object of expenditure accounts are included in the Nebraska Department of Administrative Services Budget Status Report. They are budgeted at the program level and not within separate budgetary fund types for the program. As a result, for financial reporting purposes, budget amounts for object of expenditure accounts are shown only for total budgeted funds.

Receipts are not budgeted. Therefore, there are no budgeted amounts shown on the Budget and Actual Statement.

There are no annual budgets prepared for Distributive Funds, and, as a result, no budgetary comparisons are presented.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

A reconciliation of the budgetary fund classifications versus GAAP fund classifications as of June 30, 2001 follows:

	BUDGETARY FUND BALANCES	FINANCIAL STATEMENT FUND BALANCES PRIMARY GOVERNMENT	
	Total	Special Revenue	Agency
PERSPECTIVE DIFFERENCES:			
Classifications of budgetary fund balances into Financial Statement fund structure:			
Cash	$ 672,821	$ 672,821	$ -
Budgetary fund balances classified into Financial Statement fund structure	$ 672,821	672,821	-
Entity Difference:			
Record funds not budgeted		-	(18,061,613)
Financial Statement Fund Balances, June 30, 2001		$ 672,821	$ (18,061,613)

A reconciliation of the budgetary fund classifications versus GAAP fund classifications as of January 31, 2002 follows:

	BUDGETARY FUND BALANCES	FINANCIAL STATEMENT FUND BALANCES PRIMARY GOVERNMENT	
	Total	Special Revenue	Agency
PERSPECTIVE DIFFERENCES:			
Classifications of budgetary fund balances into Financial Statement fund structure:			
Cash	$ 853,315	$ 851,315	$ -
Budgetary fund balances classified into Financial Statement fund structure	$ 853,315	851,315	-
Entity Difference:			
Record funds not budgeted		-	(18,011,832)
Financial Statement Fund Balances, January 31, 2002		$ 851,315	$ (18,011,832)

E. Fixed Assets. General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as disbursements in governmental funds, and the related assets are reported in the general fixed assets account group. All purchased fixed assets are valued at cost, where historical records are available, and at an estimated historical cost, where no historical records exist. Donated fixed assets are valued at their estimated fair market value on the date received. Assets on hand as of June 30, 2001, and as of January 31,

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

2002 have been recorded at cost or estimated cost by the Council. Generally, equipment which has a cost in excess of $1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized.

Assets in the general fixed assets account group are not depreciated. Fixed assets do not include infrastructure, such as roads and bridges, as these assets are immovable and of value only to the government. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

F. **Cash in State Treasury.** Cash in the State Treasury for the Council's operating cash fund represents the cash balance reflected on the Nebraska Accounting System. Investment of all available cash in this fund, and all other funds of the State, is made by the State Investment Officer, on a daily basis, based on total bank balances. Investment income is distributed based on the average daily book cash balance of funds designated for investment. Determination of whether a fund is considered designated for investment is done on an individual fund basis. The Council's operating cash fund was designated for investment during fiscal year 2001 and during the period July 1, 2001 through January 31, 2002.

G. **Distributive Activity.** Distributive Activity transactions are those recorded directly to a fund's liability accounts rather than through a receipt or disbursement account. The Distributive Activity recorded in Fund 7750 was the recording of income received and the distribution of income earned on the investment of the Operating Investment Pools. For more detailed information on this activity, see Note 5 below.

H. **Inventories.** Disbursements for items of an inventory nature are considered expended at the time of purchase rather than at the time of consumption.

I. **Compensated Absences.** All permanent employees working for the Council earn sick and annual leave. Temporary and intermittent employees and Council members are not eligible for paid leave. Under GAAP, the vested portion of the employee's compensated absences is recorded in the Long Term Debt Account Group for governmental funds. Under the receipts and disbursements basis of accounting, the balances which would otherwise be reported in the Long Term Debt Account Group are not reported since they do not represent balances arising from Cash Transactions.

J. **Receipts.** The major account titles and descriptions as established by the Nebraska Accounting System that are used by the Council are:

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

Sales and Charges. The Sales and Charges account was income derived from investment services rendered. Through the budget process, the Legislature approves an operating budget for the Council. To fund this operating budget, the Council charges each general class of investment (Operating Investment Pool, various Retirement Plans, various Trust funds etc.) an investment fee based on the ratio of the market value of the investment portfolio of an investment class to the total market value of all investments. For fiscal year ended June 30, 2001 the total fee charges to all investment classes were $555,591, and for the period July 1, 2001 through January 31, 2002 the fee charges were $377,306.

Miscellaneous. The miscellaneous receipt account includes interest earned on the Council's operating fund of $6,505, miscellaneous adjustments of $1,008, recaptured commissions of $166,708, recorded on the Nebraska Accounting System (NAS), and recaptured commissions of $166,037 received and held at State Street Bank (SSB, the State's Custodial Bank), and at a Broker/Dealer, for a total of $340,258 for the fiscal year ended June 30, 2001. The amounts for the period July 1, 2001 through January 31, 2002 are interest earned of $2,274, recaptured commissions recorded on NAS of $175,497, and recaptured commissions of $138,219 received and held by SSB and at a Broker/Dealer, for a total of $315,990. The Council earned recaptured commissions from investment managers by receiving a certain percentage of the Council's commission payments paid back to them. The amount to be paid back was negotiated between the Council and individual investment managers. The recaptured commissions earned for fiscal year ended June 30, 2001 and for the period July 1, 2001 through January 31, 2002 were paid into or transferred to SSB. As the Council used this money to pay investment related disbursements, they recorded the receipts, and disbursements on the NAS. The following schedules reconcile the recaptured commissions account of the Council for fiscal year ended June 30, 2001 and for the period July 1, 2001 through January 31, 2002:

RECONCILIATION OF RECAPTURED COMMISSIONS ACCOUNT
FISCAL YEAR ENDED JUNE 30, 2001

Beginning Balance (July 1, 2000)	$	492,811
Recaptured Commissions Receipts		332,745
Recaptured Commissions Disbursements		(190,958)
Ending Balance (June 30, 2001)	$	634,598

NOTES TO FINANCIAL STATEMENTS
(Continued)

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

RECONCILIATION OF RECAPTURED COMMISSIONS ACCOUNT
FOR THE PERIOD JULY 1, 2001 THROUGH JANUARY 31, 2002

Beginning Balance (July 1, 2000)	$	634,598
Recaptured Commissions Receipts		313,716
Recaptured Commissions Disbursements		(140,500)
Ending Balance (January 31, 2002)	$	807,814

K. **Disbursements.** The major account titles and descriptions as established by the Nebraska Accounting System that are used by the Council are:

Personal Services. Salaries, wages, and related employee benefits provided for all persons employed by a government.

Operating. Disbursements directly related to a program's primary service activities.

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

Capital Outlay. Disbursements which result in the acquisition of or an addition to fixed assets. Fixed assets are resources of a long-term character, owned or held by the government.

L. **Fund Balance Reservations.** Reservations of fund balances are established to identify the existence of assets that have been legally segregated for specific purposes. Reservations of fund balances are also established for assets which are not current in nature, such as deposits with vendors, which represents the Council’s postage deposit.

2. <u>Totals</u>

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Contingencies and Commitments

Risk Management. The Council 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. The Council, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance, programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

A. Motor vehicle liability, which is insured for the first $5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State Agencies have the option to purchase coverage for physical damage to vehicles.

B. The DAS-Personnel Division maintains health care and life insurance for eligible employees.

C. Crime coverage, with a limit of $1 million for each loss, and a $10,000 retention per incident.

D. Real and personal property on a blanket basis for losses up to $250,000,000, with a self-insured retention of $200,000 per loss occurrence. Newly-acquired properties are covered up to $1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to $10,000,000.

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

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Compensation Insurance Trust Fund 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 Investment Council's financial statements.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Contingencies and Commitments (Concluded)

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

4. State Employees Retirement Plan (Plan)

The Plan is a single-employer defined contribution plan administered by the Public Employees Retirement Board in accordance with the provisions of the State Employees Retirement Act and may be amended by legislative action. In the defined contribution plan, retirement benefits depend on total contributions, investment earnings, and the investment options selected. Membership in the Plan is mandatory for all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service. Full time employee is defined as an employee who is employed to work one-half or more of the regularly scheduled hours during each pay period. Voluntary membership is permitted for all permanent full-time or permanent part-time employees upon reaching age twenty and completion of twelve months of permanent service within a five-year period. Any individual appointed by the Governor may elect to not become a member of the Plan.

Employees contribute 4.33% of their monthly compensation until such time as they have paid during any calendar year a total of eight hundred sixty four dollars, after which time they shall pay a sum equal to 4.8% of their monthly compensation for the remainder of such calendar year. The Council matches the employee's contribution at a rate of 156% of the employee's contribution.

The employee's account is fully vested. The employer's account is vested 100% after five years participation in the plan or at retirement.

For the Fiscal Year Ended June 30, 2001, employees contributed $12,596 and the Council contributed $19,651.

For the period July 1, 2001 through January 31, 2002, employees contributed $7,847 and the Council contributed $11,680.

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. Distributive Activity

The Distributive Activity recorded in Fund 7750 is the recording of income received and the distribution of income earned on the investment of the Operating Investment Pools. The earnings on this fund are distributed proportionately to all funds designated for investment. The amount distributed was less Nebraska Investment Council fees, and State Street Bank (SSB) custodian fees.

The Council and the Department of Administrative Services Accounting Department allocate investment income over the earning period of the investment from the date the investment is purchased. The income earned is recorded on a daily basis. Income earned is distributed monthly to the State agencies and to the State general fund 1000, based on the average daily cash balance of the agencies' funds plus the average cash balance of the State's general fund. Investment income was not recorded on the Nebraska Accounting System until the income was deposited with the Nebraska State Treasurer, usually at the redemption of the investment. This method of distributing investment income as earned results in income being distributed before it is received, and results in a negative fund balance for Fund 7750. The State believes this method of distributing investment income was reasonable since it evens out the income flow.

6. Fixed Assets

The following is a summary of changes in the general fixed assets account group during the fiscal year ended June 30, 2001 and for the period July 1, 2001 through January 31, 2002:

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	Balance July 1, 2000	Additions	Retirements	Balance June 30, 2001
Equipment	$ 14,292	$ 2,503	$ -	$ 16,795

FOR THE PERIOD JULY 1, 2001 THROUGH JANUARY 31, 2002

	Balance July 1, 2001	Additions	Retirements	Balance January 31, 2002
Equipment	$ 16,795	$ 2,258	$ -	$ 19,053

For the fiscal year ended June 30, 2001 the difference between the Capital Outlay purchases recorded on the financial statements of $10,003, and the Additions to the fixed asset records of $2,503 above, was due to the Council's purchase of computer software, which was not a Capital Outlay recorded on the fixed assets records.

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. Fixed Assets (Concluded)

For the period July 1, 2001 through January 31, 2002, the difference between the capital outlay purchases recorded on the financial statements and the additions to fixed assets records was due to the Council's purchase of $1,590 of computer software, which was not recorded as an addition to fixed asset records.

7. Audit Adjustment

For the fiscal year ended June 30, 2001, the Capital Outlay and Operating disbursements record on the Nebraska Accounting System (NAS) were $16,753 and $338,552 respectively. Capital Outlay was decreased by $6,750, and Operating disbursements were increased on the financial statements by $6,750 due to coding errors on NAS.

8. Operating lease

The Council has entered into an operating lease for computer equipment. The payments made on this lease for the fiscal year ended June 30, 2001 and for the period July 1, 2001 through January 31, 2002 respectively were $15,900 and $9,275.

9. Investment Fees

There are three types of investment fees that are charged against investments. They are outside manager fees, State Street Bank custodian fees, and Nebraska Investment Council fees. The outside manager fees and the custodian fees are not recorded on the Council's financial statements. Investment income is recorded net of these fees on the State of Nebraska's financial statements (Investment transactions and Investment balances are not recorded on the Council's financial statements). The Council's fees are recorded on the financial statements of the Council, and were reported as Sales and Charges. The following schedules show the investment fees for the fiscal year ended June 30, 2001 and for the period July 1, 2001 through January 31, 2002:

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

Outside Manager Fees **Manager**		**Manager** **Total**
Alliance Capital	$	1,138,916
Brinson Partners		1,313,143
First National Bank of Omaha		194,036
Husic		756,611
BGI		193,641
Dimensional Fund Advisors		414,720
Ariel Capital Management		509,750

NOTES TO FINANCIAL STATEMENTS
(Continued)

9. Investment Fees (Continued)

Rowe Price Fleming	1,420,291	
America First	247,533	
Blackrock Financial Management	1,126,717	
J.P. Morgan Investment	845,124	
PIMCO	1,442,694	
SSGA	169,573	
T. Rowe Price	188,630	
Total Outside Managers' Fees		9,961,379
Custodian Fees		930,317
Nebraska Investment Council Fees		555,591
Total Investment Fees for the Fiscal Year Ended June 30, 2001		$ 11,447,287

FOR THE PERIOD JULY 1, 2001 THROUGH JANUARY 31, 2002

Outside Manager Fees **Manager**	**Manager** **Total**	
Alliance Capital	$ 540,605	
Brinson Partners	286,198	
First National Bank of Omaha	94,142	
Husic	365,020	
BGI	137,491	
Dimensional Fund Advisors	369,564	
Ariel Capital Management	227,539	
Rowe Price Fleming	652,540	
America First	118,618	
Blackrock Financial Management	419,581	
J.P. Morgan Investment	387,647	
PIMCO	671,838	
SSGA	83,331	
T. Rowe Price	101,268	
Westridge Capital Management	116,442	
Total Outside Managers' Fees		4,571,824
Custodian Fees		785,691
Nebraska Investment Council Fees		377,306
Total Investment Fees for the period July 1, 2001 through January 31, 2002		$ 5,734,821

10. GASB 34

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. The State of Nebraska is planning to implement the Statement for the fiscal year ending June 30, 2002. The new accounting and reporting standards will impact the State's revenue and expenditure recognition, and assets, liabilities, and fund equity reporting. The financial statements will be reformatted to reflect the new standards.

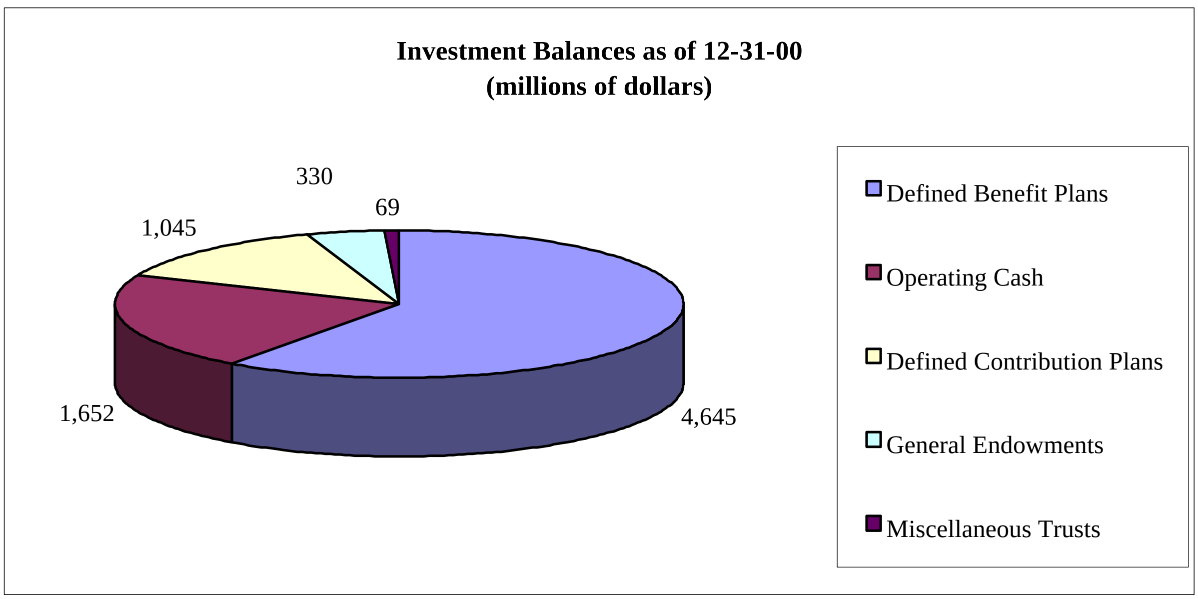
NEBRASKA INVESTMENT COUNCIL

SUMMARY OF INVESTMENT ACTIVITY

For the Calendar Years Ending December 31, 1994 through 2000

UNAUDITED

	Opening Balance	Contribution (Withdrawal)	Investment Result	Closing Balance	Rate of Return
Defined Benefit Plans	4,575	29	41	4,645	0.9%
Operating Cash	1,477	57	118	1,652	7.8%
Defined Contribution Plans	1,057	3	(15)	1,045	-1.2%
General Endowments	334	(5)	2	330	0.3%
Miscellaneous Trusts	71	(7)	6	69	10.6%
2000 Totals	7,512	76	152	7,741	2.0%
1999 Totals	6,871	(22)	664	7,512	9.8%
1998 Totals	5,993	95	783	6,871	13.0%
1997 Totals	5,074	140	780	5,993	15.2%
1996 Totals	3,740	178	388	4,306	9.6%
1995 Totals	3,047	88	582	3,717	15.5%
1994 Totals	2,893	118	37	3,048	1.2%



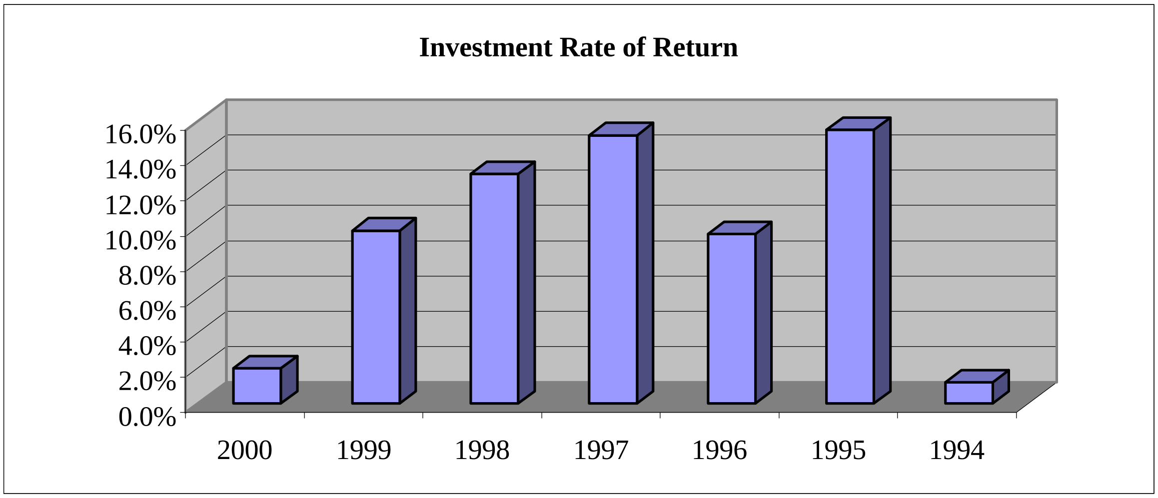
The information above and the information and tables on pages 36 through 46 is intended to provide an overview of the investment management activities of the Council. All data above and on pages 36 through 46 are UNAUDITED. Some items are estimated. Some items are not prepared in accordance with generally accepted accounting principals.

NEBRASKA INVESTMENT COUNCIL

SUMMARY OF INVESTMENT ACTIVITY

For the Calendar Years Ending December 31, 1994 through 2000

UNAUDITED



The Nebraska Investment Council manages the investments of roughly two dozen different entities, not counting the many separate departments of State government. These entities fall into the five major categories displayed above. For example, the pension plans for the employees of the public schools, the State Patrol, and Judges have similar characteristics and are grouped under “defined benefit plans." The pension plans for other State and County employees have different characteristics and are categorized as “defined contribution plans." For all these entities, the Council’s responsibilities are limited to asset management. It does not determine the amount of funds contributed to or disbursed from the funds it manages.

The Investment Council portfolios experienced a $76 million net cash inflow during 2000, after a $22 million net cash outflow in 1999. However, the year 2000 inflow was still somewhat below the seven year average of approximately $100 million per annum. 1999 and 2000 cash flows are below average primarily due to the impact of early retirement subsidies in the defined benefit plans.

Total investment earnings have averaged approximately $500 million over the past six years. This represents an average rate of return of approximately 9 ¼%. This historically high rate of return is attributable in large part to the strong stock market returns from 1995 through 1999. In the long term, we expect to earn approximately 7% on the assets we manage. However, there will be wide variations from year to year. Approximately one year in five, we expect to earn in excess of 14%, and one year in five we expect to have a negative return.

During the seven years displayed above, assets have more than doubled from $2.9 billion to $7.7 billion. Approximately $3.4 billion of this increase is attributable to the compounded effect of the high rates of return during the period. Approximately $0.8 billion was due to the Investment Council assuming responsibility for the Defined Contribution Plan assets in 1997. Approximately $0.7 billion was due to net cash inflows to the various funds.

The State holds title to all assets through its custodian, State Street Bank and Trust in Boston, Massachusetts.

NEBRASKA INVESTMENT COUNCIL

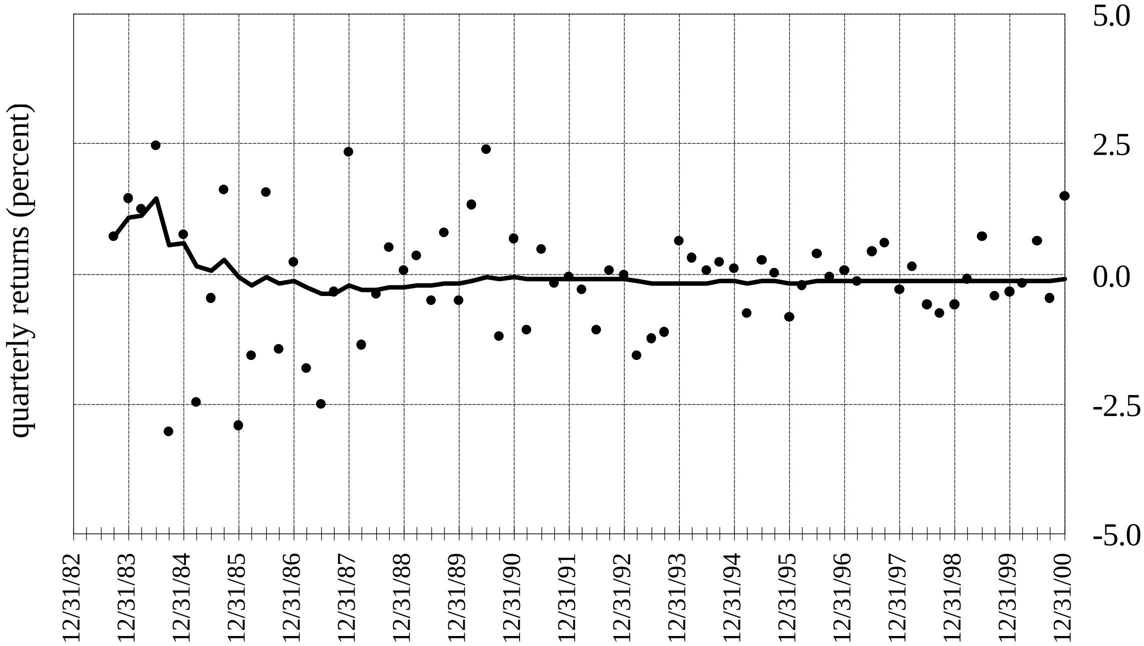
SUMMARY OF INVESTMENT PERFORMANCE

For the Calendar Years Ending December 31, 1983 through 2000

UNAUDITED

	1 Year	3 Year	5 Year	10 Year	Since 6/30/83
Actual Return	2.0%	8.1%	10.0%	10.6%	11.2%
Benchmark Return	0.5%	8.3%	9.9%	11.3%	11.6%
Performance	1.5%	-0.2%	0.0%	-0.6%	-0.4%

Actual versus Benchmark



The Council's allocation of funds among the various asset classes seldom changes over time. Therefore, the investment results are largely determined by the behavior of the markets as a whole. Analyzing investment performance requires distinguishing between the results due to market conditions in general and those attributable to the specific portfolios. For example, if the domestic stock portfolio returns 30% in a year when the domestic stock market as a whole returned 40%, then portfolio performance is below standard. On the other hand, if the bond market falls 4% but the Council's bond portfolio falls only 2%, then portfolio performance is above standard. Thus, actual returns are compared with performance benchmarks. The benchmark portfolio for total assets is a weighted average of the benchmarks for the assets of each entity. Because different entities have different investment objectives, different benchmarks are used for each entity.

This report displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

NEBRASKA INVESTMENT COUNCIL

DEFINED BENEFIT PLANS

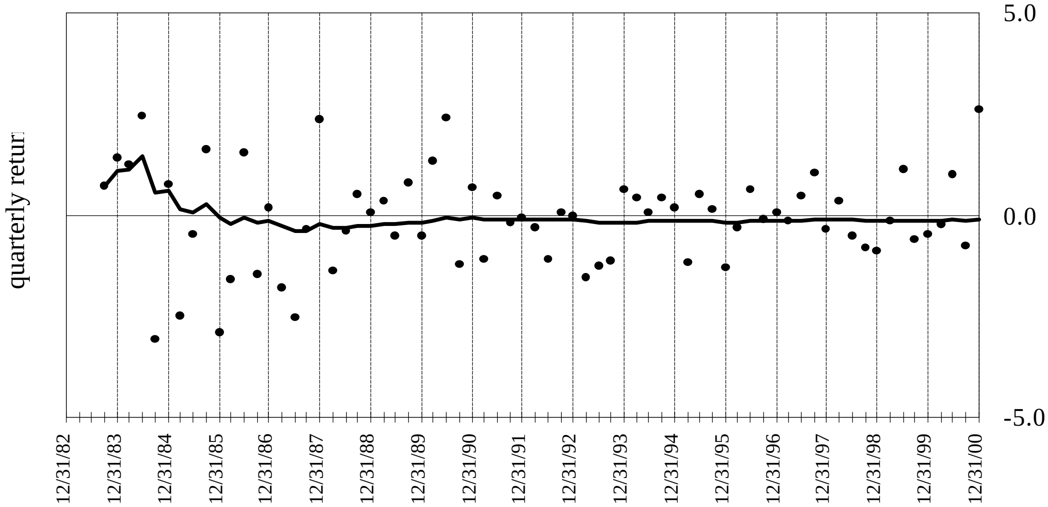
HISTORICAL PERFORMANCE

For the Calendar Years Ending December 31, 1983 through 2000

UNAUDITED

	1 Year	3 Year	5 Year	10 Year	Since 6/30/83
Actual Return	0.9%	9.1%	11.7%	11.9%	11.9%
Benchmark Return	-1.7%	8.9%	11.2%	12.3%	12.2%
Performance	2.7%	0.3%	0.4%	-0.4%	-0.3%

Actual versus Benchmark



The assets for the three defined benefit plans are invested identically. Since the Council does not try to anticipate, or time, market movements, investment earnings will generally reflect overall market conditions. As a result of weaknesses in U.S. and foreign stock markets, 2000 investment returns were only $41 million or 0.9% per annum. In the long term, the Council expects returns to average about 8%. However, returns for any particular year may vary widely from this expected long-term average. The Council expects returns to exceed 15% in one year out of four. The Council also expects to lose money in about one year out of four. Investment strategies having lower risk also have lower expected return. The Council believes the strategy used has a reasonable and prudent trade off between risk and return.

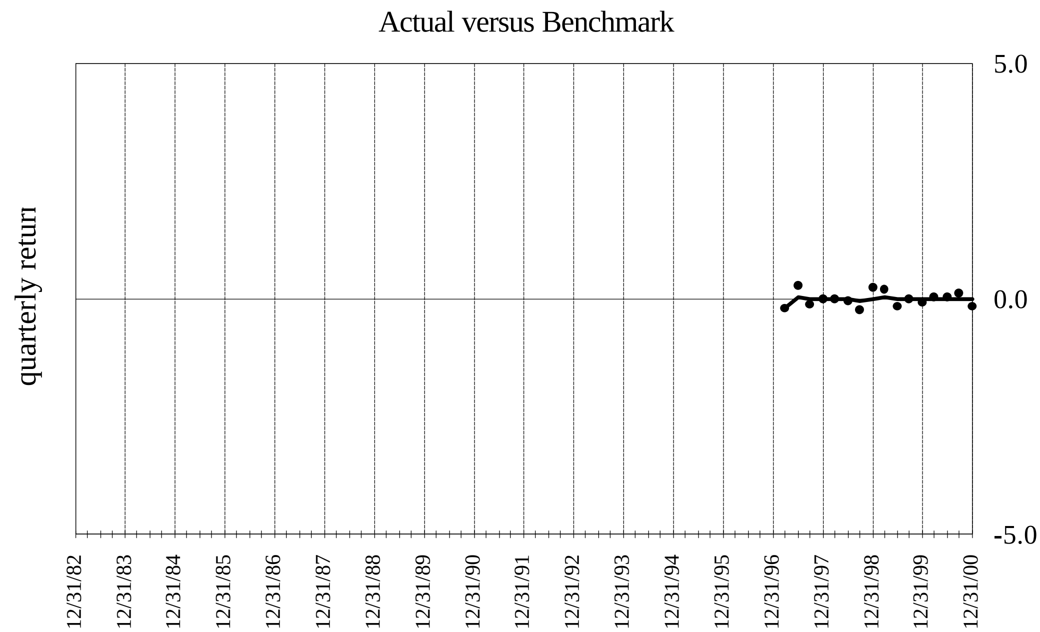
Performance versus benchmark for 2000 was positive 2.7%. However, performance for longer periods remains negative. Many factors influence performance, but both the recent and longer term performance relative to benchmark is attributable primarily to the domestic equity portfolio, offset somewhat by positive performance of the international equities and fixed income. Prior to 1994, the internally managed domestic equity portfolio comprised 75% or more of the total domestic equities. To address under performance, in 1993 and 1994 the Council increased the number of equity managers and decreased the allocation to the internally managed portfolio. However, some of these new managers also contributed to continuing under performance of the domestic equity portfolio. In our continuing attempt to achieve superior returns while maintaining prudent levels of risk, the Council has terminated one domestic equity manager in 2000, two in 1999, and one in 1998.

This report displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

Source- Nebraska Investment Council’s Calendar Year 2000 Annual Report.

NEBRASKA INVESTMENT COUNCIL
OPERATING CASH
HISTORICAL PERFORMANCE
For the Calendar Years Ending December 31, 1997 through 2000
UNAUDITED

	1 Year	3 Year	5 Year	10 Year	Since 12/31/96
Actual Return	7.8%	5.8%			5.8%
Benchmark Return	7.8%	5.8%			5.9%
Performance	0.1%	0.0%			0.0%



(Consistently prepared performance figures are not available prior to 1997.)

During 2000, falling interest rates produced capital gains in the Medium Term Portfolio, resulting in a 7.8% return on the aggregate operating cash portfolio. Given the current level of interest rates, the Investment Council expects future returns to be between 5.0% and 5.5% per annum. The performance of the aggregate operating cash portfolio has been nearly equal to the benchmark for every year since the end of 1996. During this period, the return on the Short Term Portfolio has been higher than its benchmark, but this has been offset by negative performance of the Medium Term Portfolio.

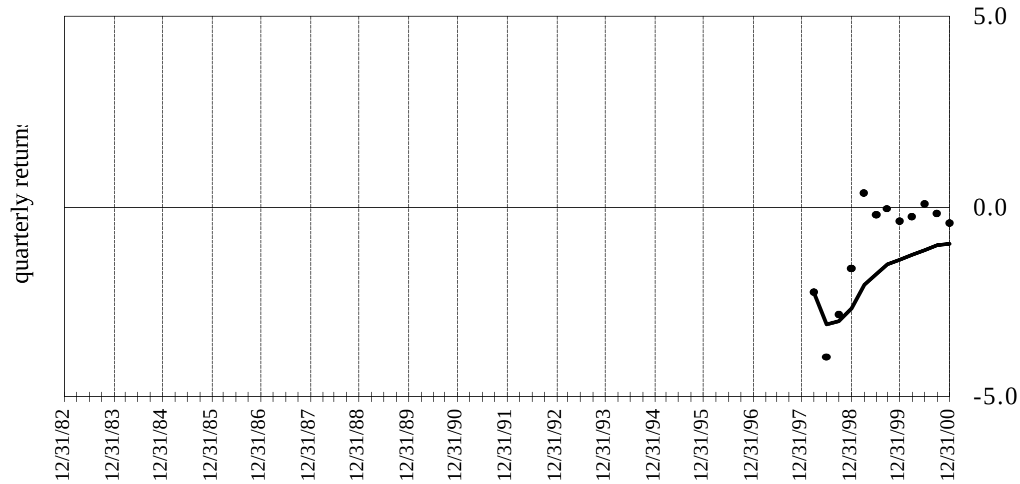
This report displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

Source- Nebraska Investment Council's Calendar Year 2000 Annual Report.

NEBRASKA INVESTMENT COUNCIL
DEFINED CONTRIBUTION FUNDS
HISTORICAL PERFORMANCE
For the Calendar Years Ending December 31, 1998 through 2000
UNAUDITED

	1 Year	3 Year	5 Year	10 Year	Since 12/31/97
Actual Return	-1.2%	4.9%			4.9%
Benchmark Return	-0.4%	9.1%			9.1%
Performance	-0.8%	-4.2%			-4.2%

Actual versus Benchmark



(Consistently prepared performance figures not available prior to 1997.)

For his or her own contributions, a participant selects among eleven investment funds offered by the plan. The fund offerings are determined by the Public Employees Retirement System. The Investment Council selects the investment management firm for each of the funds. Because participants direct the investment of the employee contributions, the participant determines the allocation to each of these funds.

The above figures represent the average performance of each manager versus benchmark for the various funds offered in the Defined Contribution Plans. The offerings in the old Hartford deferred compensation plan are not included. Because a weighted average is used, funds with larger balances have a larger impact on the average performance. Each participant's account balance is allocated among the funds according to his or her directions. Therefore, the return on each participant's account will be unique to that participant.

Actual returns are calculated net of fees, but the performance benchmarks are not burdened with costs. Total costs for our average fund offering is approximately 25 basis points per annum, including investment management fees, custody costs, record keeping costs, and other administrative costs. This compares favorably to the 100 basis point or higher cost of the typical 401(k) using retail mutual funds.

The cumulative under performance is attributable primarily to the old Quality Growth fund. The Council terminated the manager of this fund in November 1998. The under performance for the year 2000 is attributable primarily to the Small Company Stock Fund. In October 2000, the Council hired Dimensional Fund Advisors to replace Brinson Partners as manger of this fund. We expect the strategy used by the new manager to produce more consistent performance than that of the previous manager.

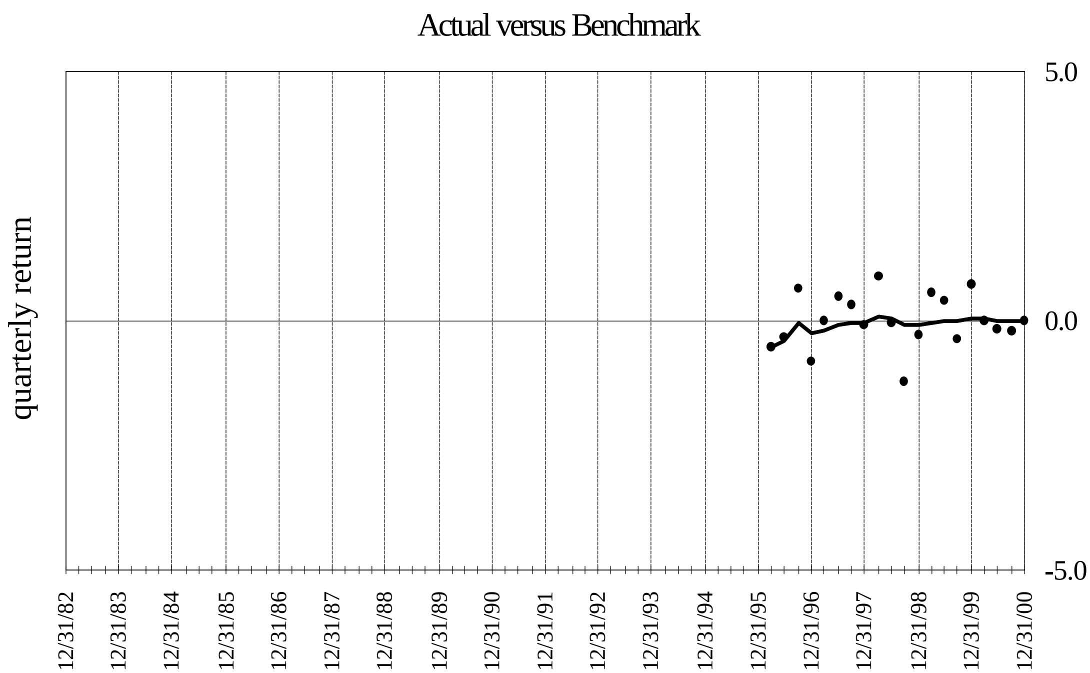
This report displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

Source- Nebraska Investment Council's Calendar Year 2000 Annual Report.

NEBRASKA INVESTMENT COUNCIL
GENERAL ENDOWMENT FUNDS
HISTORICAL PERFORMANCE
For the Calendar Years Ending December 31, 1996 through 2000
UNAUDITED

	1 Year	3 Year	5 Year	10 Year	Since 12/31/95
Actual Return	0.3%	9.8%	12.6%		12.6%
Benchmark Return	0.7%	9.7%	12.6%		12.6%
Performance	-0.3%	0.1%	0.0%		0.0%

The General Endowment Funds include the Permanent School Fund, Nebraska Veterans' Aid Fund, Cultural Preservation Endowment Fund, Permanent University Endowment Fund, State College Endowment Fund, and The Bessey Memorial Fund. The assets of these endowments are commingled to achieve administrative efficiencies and economies of scale.



During 2000, the General Endowment Funds under performed their benchmark by 0.3%. The Investment Council established a benchmark for the overall performance of its General Endowment Funds at the end of 1995. Cumulative returns since that time have been the same as the benchmark.

This report displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

Source- Nebraska Investment Council's Calendar Year 2000 Annual Report.

NEBRASKA INVESTMENT COUNCIL
MISCELLANEOUS TRUST FUNDS
HISTORICAL PERFORMANCE
For Various Calendar Years
UNAUDITED

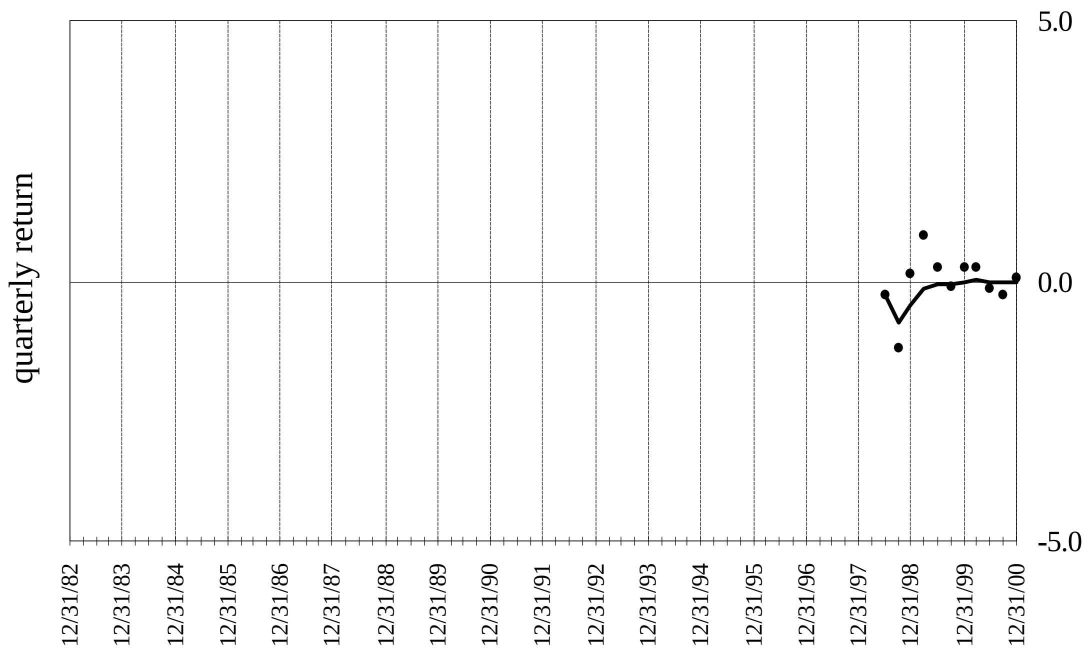
The Miscellaneous Trust Fund category consists of the following trust funds: Excess Liability Fund, Health Care Endowment Fund, Aeronautics Trust Fund, Department of Environmental Quality Funds, Agricultural Development Fund, and the Joseph J. Soukup Trust Fund. The following is the historical performance for each fund:

EXCESS LIABILITY FUND
HISTORICAL PERFORMANCE
UNAUDITED

Periods Ending 12/31/00

	1 Year	3 Year	5 Year	10 Year	Since 3/31/98
Actual Return	11.5%				6.3%
Benchmark Return	11.6%				6.4%
Performance	-0.1%				-0.1%

Actual versus Benchmark



The Excess Liability Fund is invested in the same portfolio as the fixed income assets of the General Endowment Funds. Falling interest rates during 2000 resulted in capital gains and increase portfolio returns. The Investment Council expects the fund to return roughly 6.5% in the long term. The Council has maintained a consistently calculated history of performance for this fund since the end of 1997. Actual returns during this entire period have been slightly below the benchmark.

NEBRASKA INVESTMENT COUNCIL
HEALTH CARE ENDOWMENT FUND
HISTORICAL PERFORMANCE
UNAUDITED

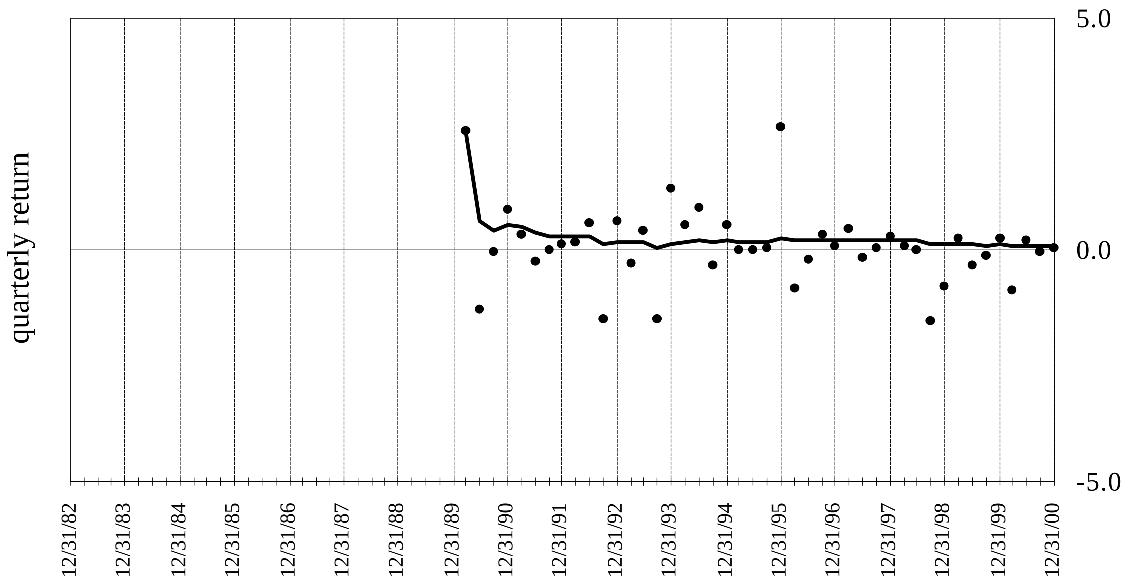
The Investment Council generates performance figures only for full calendar quarters. Because the equity portion of the fund was not created until the fourth quarter of 2000, no performance figures have been calculated. During the first three quarters of 2000, these assets experienced the same performance as the aggregate Operating Cash portfolio.

AERONAUTICS TRUST FUND
HISTORICAL PERFORMANCE
UNAUDITED

Periods Ending 12/31/00

	1 Year	3 Year	5 Year	10 Year	Since 12/31/89
Actual Return	12.8%	5.7%	6.1%	8.2%	8.5%
Benchmark	13.5%	6.7%	6.7%	8.1%	8.2%
Performance	-0.7%	-1.0%	-0.6%	0.2%	0.3%

Actual versus Benchmark



The Aeronautics Trust Fund is invested in a segregated portfolio managed by the staff of the Investment Council. Falling interest rates during 2000 resulted in capital gains for this portfolio. As a result, the return on the portfolio greatly exceeded the roughly 6.5% which the Council expects to earn in the long term. Falling interest rates had an even greater impact on the performance benchmark, so the portfolio under performed its benchmark in 2000. The Council has maintained a consistently calculated history of performance for this fund since the end of 1989. Actual returns during this entire period have exceeded the benchmark by 0.3%. This positive performance is due primarily to having an average maturity longer than that of the benchmark in an environment of generally falling interest rates.

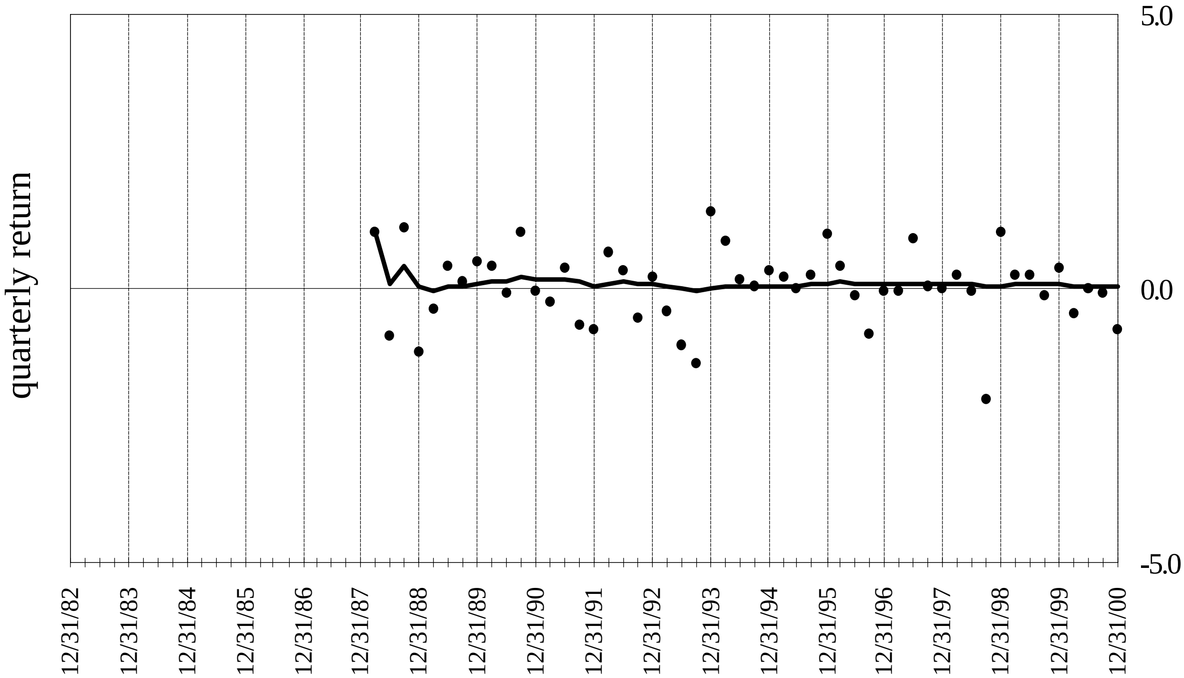
NEBRASKA INVESTMENT COUNCIL

AGRICULTURAL DEVELOPMENT FUND
HISTORICAL PERFORMANCE
UNAUDITED

Periods Ending 12/31/00

	1 Year	3 Year	5 Year	10 Year	Since 12/31/87
Actual	12.1%	6.3%	6.5%	8.1%	8.8%
Benchmark	13.5%	6.7%	6.7%	8.1%	8.6%
Performance	-1.4%	-0.4%	-0.2%	0.0%	0.2%

Actual versus Benchmark



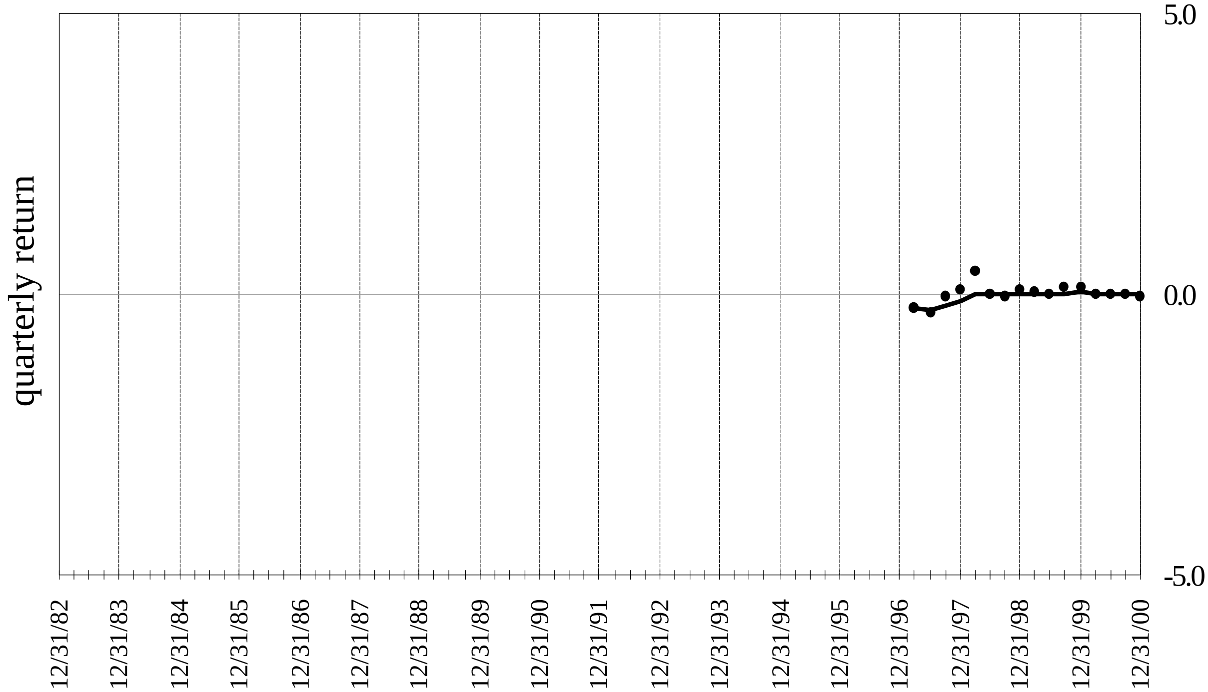
The Agricultural Development Fund is invested in a segregated portfolio managed by the staff of the Investment Council. Falling interest rates during 2000 resulted in capital gains for this portfolio. As a result, the return on the portfolio greatly exceeded the roughly 6.5% which the Council expects to earn in the long term. Falling interest rates had an even greater impact on the performance benchmark, so the portfolio under performed its benchmark in 2000. The Council has maintained a consistently calculated history of performance for this fund since the end of 1989. Actual returns during this entire period have exceeded the benchmark by 0.2%. This positive performance is due primarily to having an average maturity longer than that of the benchmark in an environment of generally falling interest rates.

NEBRASKA INVESTMENT COUNCIL
DEPARTMENT OF ENVIRONMENTAL QUALITY FUNDS
HISTORICAL PERFORMANCE
UNAUDITED

Periods Ending 12/31/00

	1 Year	3 Year	5 Year	10 Year	Since 12/31/96
Actual	1.6%	4.1%			4.3%
Benchmark	1.6%	3.8%			4.2%
Performance	0.0%	0.2%			0.1%

Actual versus Benchmark



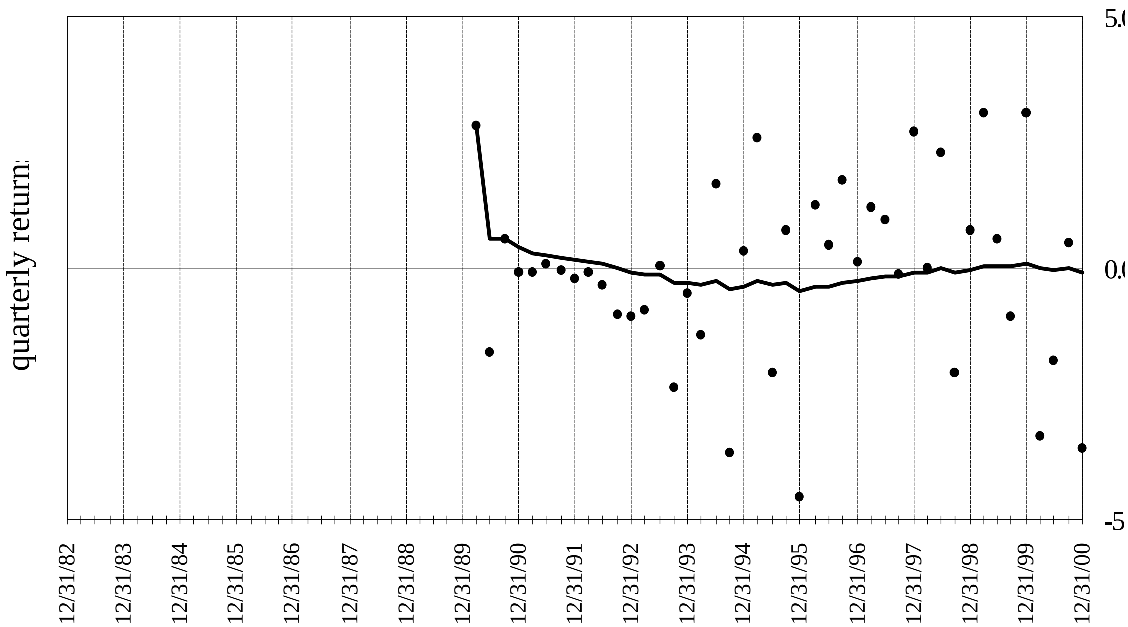
During the first three quarters of 2000, there were no assets in the DEQ funds. Therefore, the year 2000 return and performance reflect only the fourth quarter. In the near term, the Council expects the fund to return roughly 5.0% per annum. In the longer term the Council expects the fund to return roughly 4.5% per annum. The DEQ funds are invested in short term fixed income mutual funds managed by Goldman Sachs. The Council has maintained a consistently calculated history of performance for this fund since the end of 1996. During this entire period, actual returns have been very close to benchmark returns.

NEBRASKA INVESTMENT COUNCIL
JOSEPH J. SOUKUP TRUST FUND
HISTORICAL PERFORMANCE
UNAUDITED

Periods Ending 12/31/00

	1 Year	3 Year	5 Year	10 Year	Since 12/31/89
Actual	11.5%	4.6%	7.1%	7.0%	7.3%
Benchmark	20.7%	4.9%	5.6%	7.5%	7.7%
Performance	-9.2%	-0.3%	1.5%	-0.6%	-0.4%

Actual versus Benchmark



The Soukup Trust Fund is invested in a segregated portfolio managed by the staff of the Investment Council. In 1997, the Investment Council adopted an investment strategy designed to provide Mr. Soukup with a stable income stream over his lifetime. Due to the unusual maturity structure used in this strategy, changing interest rates can have a dramatic impact on the market value of the portfolio. During 2000, falling interest rates resulted in significant unrealized capital gains in the portfolio. However, increasing credit risk premiums limited the size of the gains. The benchmark return in 2000 was not impacted by the widening credit spreads. Unless the portfolio actually suffers defaults, the under performance in 2000 will not affect Mr. Soukup's income stream.

Each Miscellaneous Trust report above displays historical performance in two ways. A table of returns is presented which covers a variety of time periods ending on December 31, 2000. The dots on the return graph show the difference, by quarter, between the actual return and the benchmark return. The line on the return graph shows the cumulative average performance per quarter. The graph assists in identifying when periods of over and under performance occurred.

Source- Nebraska Investment Council's Calendar Year 2000 Annual Report.

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NEBRASKA INVESTMENT COUNCIL

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

We have audited the financial statements of the Nebraska Investment Council as of and for the year ended June 30, 2001, and as of January 31, 2002, and for the period July 1, 2001 through January 31, 2002, and have issued our report thereon dated February 15, 2002. The report notes the financial statements were prepared on the basis of cash receipts and disbursements and was modified to emphasize that the financial statements present only the funds of the Nebraska Investment Council. 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.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Investment Council's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Investment Council's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Investment Council's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the Comments Section of the report as Comment Number 2 (Internal Control).

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the Council, the appropriate Federal and regulatory agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties.

Don Dunlap CPA

February 15, 2002 Manager