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

JULY 1, 2003 THROUGH JUNE 30, 2004

Issued on January 26, 2005

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

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
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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 seven members appointed by the Governor, with legislative approval, to five-year terms. Members include:

- Three participants of retirement systems administered by the Board;
- A retired participant of a retirement system administered by the Board;
- Three public representatives who are not State employees or employees of its subdivisions; and
- The State Investment Officer as a nonvoting, ex officio member.

All appointed members must be Nebraska citizens.

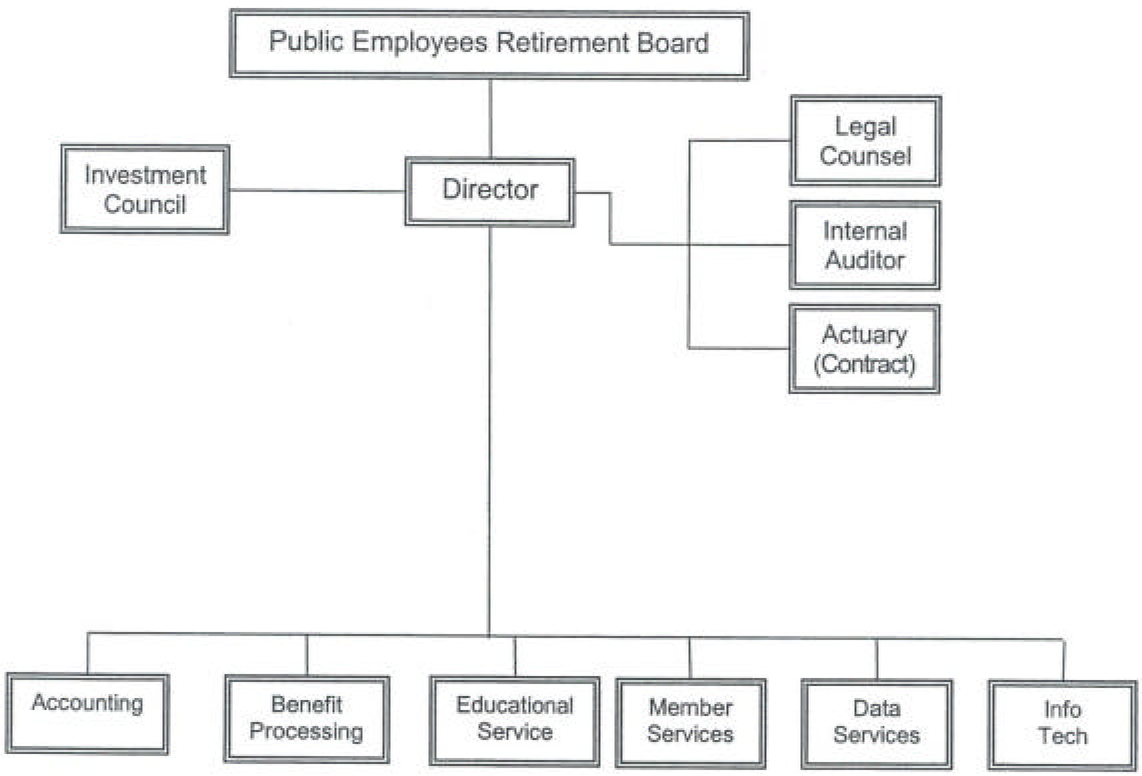
The Board meets monthly. Members are not paid, but are reimbursed for their expenses.

The Board hires a director to equitably distribute expenses among the retirement systems it administers. 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.

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held December 22, 2004, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our audit. Those in attendance for NPERS were:

NAME	TITLE
Anna Sullivan	Director
Joe Schaefer	Legal Counsel
Randy Gerke	Accounting and Finance Manager
Teresa Zulauf	Internal Auditor
Jane Hansen	Member Services Manager
Dennis Cooper	Data Services Manager
Dean Gress	Infrastructure Support Analyst
Tammy Petersen	Business System Analyst

SUMMARY OF COMMENTS

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

1. ***Nebraska Information System and Accounting Procedures:*** Significant areas of concern or areas where improvement to the Nebraska Information System (NIS) is needed to ensure NIS integrity and operational efficiency were identified.

2. ***NPERS Information System:*** Areas of concern or areas where improvement to the NPERS Information System is needed to ensure both system integrity and operational efficiency were identified.

3. ***Purchase of Service Calculations:*** Three of six purchase of service calculations tested were performed by PIONEER and could not be replicated. Five of six purchase of service calculations tested were not accurate. Overpayments from participants ranged from $3,127 to $9,254.

4. ***Incorrect Reported Compensation from School Districts:*** Of the 30 school districts tested, 12 reported compensation that was not in compliance with the definition of compensation in the statutes. Three school districts did not include all the required components in compensation. We also noted seven districts handling a fringe benefit package inconsistently.

5. ***Resolution of Prior Audit Findings:*** NPERS did not adequately address all of the specific findings at school districts tested and identified in prior audit findings.

6. ***Travel Expenses:*** Three of eight travel documents tested contained reimbursements for meal expenses without adequate documentation, or was an unreasonable meal expense. NPERS also continued to provide lodging for certain Board members and staff for their annual retreat when the lodging was less than 60 miles from their home or headquarter city.

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

SUMMARY OF COMMENTS
(Continued)

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. Nebraska Information System and Accounting Procedures

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004 the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003 at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003 reconciliation indicates an unknown variance between the bank records and the accounting records of $3,654,783, with the bank being short compared to the accounting records.

   During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Continued)

and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an unknown variance between the bank records and the accounting records of $5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.

c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem; however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.

d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Continued)

detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State. The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the State Records Administrator schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.

g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Nebraska Information System and Accounting Procedures</u> (Continued)

h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.

j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:

1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.

2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.

3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Nebraska Information System and Accounting Procedures (Concluded)

k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

   DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

NPERS' Response: The Nebraska Public Employees Retirement System (NPERS) is not responsible for the issues the Auditor of Public Accounts (APA) has identified as concerns or the areas for improvement needed for the Nebraska Information System (NIS). The responsibility for resolving these issues lies with the Department of Administrative Services (DAS) and the NIS implementation team. NPERS does not have the authority to address any of these issues.

2. NPERS Information System

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records.

During the fiscal year ended June 30, 2004, NPERS implemented the second phase of a new information system, Pension Information of Nebraska for Efficient and Effective Retirement, or PIONEER. The first phase of PIONEER went live on January 27, 2003 and included virtually all aspects of NPERS' previous mainframe system, with the exception of benefits payments. PIONEER's second phase went live January 12, 2004, and included all aspects needed in order to process benefits.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. NPERS Information System (Continued)

We have identified concerns and areas where improvement to PIONEER is needed. The following are the more significant concerns or areas where improvement is needed to ensure the integrity of member data:

a. There were not adequate procedures to monitor changes made by the NPERS' Project Team in PIONEER. Changes made by the Project Team were observed only by another member of the Project Team and the review was not documented. Additionally, access and changes to databases or table files was not formally reviewed or documented.

b. A records retention policy has not been implemented to ensure an adequate audit trail is maintained for PIONEER information.

c. There are no specific, written security procedures.

d. NPERS did not provide documentation to support the testing of the conversion from the mainframe to PIONEER for benefits processing.

Although NIS is the official accounting system of the State of Nebraska, PIONEER calculates benefits payments to members and also contains critical data used by the actuary to determine actuarial assets and liabilities and to determine whether the plans are adequately funded. Without good internal controls in place, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

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

NPERS' Response:

A. All database transactions (inserts, updates, and deletes) are currently logged in the Microsoft SQL Server database transaction log. NPERS is currently exploring ways to efficiently review transaction logs. We are currently reviewing the feasibility of several "log viewing tools".

We are developing and implementing procedures to formally review and document all changes made to the database outside of the PIONEER GUI (graphical user interface).

The ProjectTeam will be added to the SQL Server Database. At this point each database transaction will be tracked by the network user ID. This will allow the tracking of all database changes done outside of the GUI.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. NPERS Information System (Concluded)

NPERS' Response, Concluded:

B. The modules in PIONEER that will be affected by a record archival process will need to be identified and documented. A written policy will be developed for the archival of records off the PIONEER system.

C. We do have security procedures and we are in the process of drafting them into a written manual.

D. The Benefit phase of PIONEER was thoroughly tested before being converted to production. Convansys has a statement of work, matching reconciliations and a data map document. Testing in the User Acceptance Testing Environment (UAT) was completed and any problems would have been identified and corrected at that time.

APA's Response: We requested documentation to support the testing of the conversion for the benefit phase during fieldwork of the audit. As noted in the above comment, no documentation was provided to us during the audit.

3. Purchase of Service Calculations

Good internal control requires procedures and records to ensure purchase of service calculations performed by NPERS are accurate and consistent with statutes.

Neb. Rev. Stat. Section 79-921(2) R.R.S 2003 instructs the Board to reinstate to membership, with the same status as when such membership ceased, a school employee who has withdrawn his or her accumulated contributions under the following conditions: If, more than three years after again becoming an employee and rejoining the system but prior to termination of employment, he or she chooses to repay part or all of the amount he or she has withdrawn, plus an amount as determined equal to the total actual annual return that was earned on assets of the system from the time the amounts were withdrawn until the fiscal year in which the employee makes the election to repay.

We tested six purchase of service calculations and noted the following:

- Beginning in January 2004, NPERS relied on PIONEER for the purchase of service calculations. Prior to January, NPERS utilized manual spreadsheets to calculate purchase of service. Three of six purchase of service calculations tested were performed by PIONEER and could not be replicated. We attempted to manually recalculate the amounts paid by the members but were unsuccessful. We also requested NPERS

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Purchase of Service Calculations</u> (Continued)

manually calculate the purchase of service and NPERS was also unable to duplicate the amount determined by PIONEER. The total purchase of service payments received by NPERS for the fiscal year was $2,506,659.

- Five of six purchase of service calculations tested (including those noted above) were not calculated in accordance with Statute 79-921. The differences were due to different rates of return used by NPERS and the problem with replicating PIONEER calculations, as noted above. The rates of return used by NPERS from the fiscal year 1988 through fiscal year 2001 did not agree to the actual annual return earned on assets as provided by the Nebraska Investment Council. Additionally, during fiscal year 2002 and 2003, NPERS used an actuarial assumed rate of return on assets of 8% in the calculation, when the actual rate of return on assets was negative. Overpayments from participants ranged from $3,127 to $9,254. The use of incorrect rates of return was also noted in our prior audit report.

Without adequate procedures to ensure purchase of service calculations are accurate, members may not pay the actual cost of the service purchased. If members pay too little for the service purchased, the rest of the School Plan will pay the cost of the service. If the cost is calculated too high, the member will pay too much into the School Plan, with no additional benefit.

> We recommend NPERS ensure PIONEER is able to accurately calculate the cost to purchase service. Until that time, we recommend NPERS provide a manual calculation as a verification of the cost produced in PIONEER. We also continue to recommend NPERS ensure purchase of service calculations are in accordance with statutes and to resolve all discrepancies due to the issues identified in this finding.

NPERS' Response: On July 1, 2004, the law was changed, per our request, to require the rate used to calculate the cost of repaying a refund using the actuarial assumed rate of return on the assets rather than the actual rate of return.

In April of 2003, we were concerned about having to use two years of negative rates of return on the assets to calculate the refund repay service calculations. In essence this meant that plan members could repay less than the amount initially refunded to them in order to restore their former service credit.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Purchase of Service Calculations</u> (Concluded)

NPERS' Response, Concluded:
An internal legal opinion in the Spring of 2004 questioned the use of the assumed rate of return rather than actual rate of return. Therefore, the agency set about correcting the amounts repaid by those during the period April of 2003 through April of 2004. We also requested that the law be changed to allow us to use the assumed rate of return in the event we faced negative actual returns in the future.

We recognized our error and have now completed the recalculation of over 200 purchase of service calculations and are in the final process of refunding the excess amounts charged these members when they repaid their refunds. The process has taken longer than we had hoped and so was not rectified during the audit period ending June 30, 2004, but will be by the end of the current audit period.

As part of our review of this process, we also reviewed the rate table used within our PIONEER system to be sure it is correct going forward. The difficulty prior to the law change in July of 2004, was that the actual rate of return for the plan year end in June would not be known until the August following. This meant we would carry the previous year's rate until the new rate was known.

Going forward this will no longer be a problem since the assumed rate of return within the plan changes very infrequently.

4. <u>Incorrect Reported Compensation from School Districts</u>

Neb. Rev. Stat. Section 79-902(35)(a) R.R.S. 2003 defines compensation under the School Employees Retirement Act as "Compensation means gross wages or salaries payable to the member for personal services performed during the plan year. Compensation does not include amounts which the retirement board determines were fraudulently obtained, compensation for unused sick leave or unused vacation leave converted to cash payments, insurance premiums converted into cash payments, reimbursement for expenses incurred, fringe benefits, or bonuses for services not actually rendered, including but not limited to, early retirement inducements, cash awards, and severance pay, except for retroactive salary payments paid pursuant to court order, arbitration, or litigation and grievance settlements. Compensation includes overtime pay, member retirement contributions, and amounts contributed by the member to plans under sections 125, 403(b), and 457 of the Internal Revenue Code as defined in section 49-801.01 or any other section of the code which defers or excludes such amounts from income."

Neb. Rev. Stat. Section 84-1503(1)(f) R.S.Supp., 2003 requires the Board "To adopt and implement procedures for reporting information by the employers, as well as sampling and monitoring procedures."

4. Incorrect Reported Compensation from School Districts (Continued)

Good internal control requires procedures and records to ensure contributions remitted under the School Employees Retirement Act are consistent with the statute.

NPERS did not perform adequate sampling and monitoring procedures to determine whether reported compensation was in accordance with the provisions of statutes. We reviewed payroll records at 30 of 539 school districts. The amounts contributed by these 30 school districts, $48,915,302, represented approximately 28% of the total contributions for all school districts for the fiscal year. We noted the following:

- Of the 30 school districts tested, 12 reported compensation that was not in compliance with the definition of compensation in the School Employees Retirement Act. This included 43 of 129 contributing members tested. Incorrect components included cash payments in-lieu-of health insurance, payments for reimbursement of expenses, and fringe benefits. The fringe benefit amounts included long-term disability payments not covered under a Section 125 plan. These errors resulted in overstatements of the members' annual compensation ranging from $24 to $10,100 and excess annual retirement contributions ranging from $4 to $1,471. A similar finding was noted in previous audit reports.

- Three of thirty school districts tested did not include all the required components. This included 3 of 129 contributing members tested. A portion of payment for services for the three members was excluded from retirement. These errors resulted in understatements of the members' annual compensation ranging from $1,268 to $6,052 and understated annual retirement contributions ranging from $185 to $882.

- Seven of thirty school districts tested were not handling a fringe benefit package consistently when determining members' retirement compensation. Five districts were including the fringe benefit package in compensation; two districts were not. The fringe benefit packages could be used for insurance premiums or taken as salary and ranged from $5,800 to $9,715 annually.

There is a high risk that errors such as those noted above will remain undetected without procedures by NPERS to ensure amounts are accurately reported by school districts in accordance with the statutes. Additionally, since the benefit amount at retirement is calculated based in part on the reported salaries of the members, there is also an increased risk the benefit amount is not in accordance with statutory requirements.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Incorrect Reported Compensation from School Districts (Continued)

We continue to recommend NPERS implement procedures to ensure the compensation reported by school districts is accurate and in accordance with statutes. We also recommend NPERS determine whether the current statutory language needs modification due to the varying interpretations by school districts in defining compensation. We also continue to recommend NPERS follow up with the specific exceptions noted during our testing and communicate to the school districts any corrective action necessary.

NPERS' Response: The Retirement Office has spent several years working with the schools on the subject of "compensation" and what schools should be reporting as compensation for retirement. During the past 18 months nearly 30 schools were directly contacted by us about how they reported compensation to the Retirement Office. In September of 2003, a special meeting was held with nearly 40 school business managers to discuss the compensation definition. Following that meeting a detailed memo was sent in January of 2004 to all 539 schools in the State providing guidance on the subject of reporting compensation.

We noted in the auditor's samples that nearly all of the cases in question dealt with how long term disability (LTD) insurance premiums should be reported. The LTD premiums are never part of the tax-deferred Section 125 plan because the employee must report the amounts as "taxable" in order for the disability benefit to be non-taxable. Therefore, the schools include the premium in gross salary. The cases referred to by the auditors are premium amounts as low as $2 per month and range up to $55. The average premium in the cases cited by the auditors is approximately $20 per month, or $240 per year. The real question is whether the premium is paid by the employer or by the employee. We will follow-up with the schools to clarify this question.

We are seriously concerned about individual school employees who attempt to "spike" salaries immediately prior to retirement in order to artificially increase their ultimate retirement benefits. In two of the cases the auditor's have cited we had already found the problem but are now in a legal dispute with the individuals named over the compensation changes found.

Our work to educate the employers and the business managers has been a great help in improving the accuracy of salaries reported to our office. Each year, in June, we conduct employer training sessions around the state. The feedback we have received from the schools on these sessions has been very positive. It is our opinion that training is usually the issue when schools make errors in reporting to us.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Incorrect Reported Compensation from School Districts (Concluded)

NPERS' Response, Concluded:
Finally, in regard to schools handling fringe benefit packages differently, we have reviewed many of the schools teacher contracts that outline salary and what is classified in salary. We have never found two schools with the same salary agreement. It is our position that if a school and the majority of its employees agree to go to straight salary and to not have a separate benefit package, that is acceptable as long as all employees within the school are treated consistently. The bottom line is, if an employee contributes retirement contributions over his/her career on a higher salary, he/she is entitled to use that salary in the determination of his/her ultimate benefit. On the other hand, if an employee individually wants to add the value of benefits not previously reported as salary and do so only in his/her last three or four years prior to retiring, we will deny that person the use of the higher salary since it has been artificially increased we believe for the purpose of getting a larger retirement benefit.

There is legislation being considered to tighten loop holes some school employees have tried to use to attempt to get larger benefits they have not funded. We will continue to work with the State Legislature and representatives of the Schools to address these problems.

5. Resolution of Prior Audit Findings

Good internal control requires the timely and thorough resolution of prior audit findings. *Government Auditing Standards* paragraph 5.13j and the American Institute of Certified Public Accountants (AICPA) Professional Standards AU 325.21 regard the failure to follow up and correct previously identified internal control deficiencies to be a reportable condition.

NPERS did not adequately address all of the specific findings at school districts tested and identified in prior audit findings.

- Four school districts still were not calculating retirement contributions on the correct compensation as noted in the fiscal year 2003 audit.

- One school district had one employee who was identified in the fiscal year 2003 audit as an employee that should be contributing to the School Plan. The employee was still not contributing to the School Plan during the fiscal year 2004 audit fieldwork.

- Per discussion with the school districts, NPERS contacted one of the five school districts identified in the prior audit. However, that school district continues to calculate retirement compensation incorrectly.

There is an increased risk that errors in the School Plan membership and compensation will remain incorrect without adequate procedures to follow up on prior audit findings.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Resolution of Prior Audit Findings (Concluded)

> We recommend NPERS implement procedures to ensure all audit exceptions are adequately resolved.

NPERS' Response: It is inaccurate to say that the Retirement Office did not follow-up on the cases identified last year. Of the five districts mentioned two schools were contacted by phone and one several times.

Two of the schools have fixed the problems identified going forward for all employees. In the other three cases we will follow-up with the schools, but we are not sure we agree with the auditor's that there is a problem

We had contacted the school district concerning the one employee who was identified in the fiscal year 2003 audit as an employee that should be contributing to the school retirement plan. The school district stated that the employee's title is a mentor which has the same classification as a substitute teacher in the school district. The school district does not consider substitute teachers eligible for retirement, therefore a mentor would not be eligible for retirement. State Statute 79-910.01 states (1) Except for substitute employees, each person employed by a public school who is a school employee shall participate in the retirement system. We will contact the school and try to resolve the issue.

The four remaining cases, two involving car allowances being reported as salary, one with expense reimbursements reported as salary and two with benefits reported as salary will be reviewed by staff and direct contact made with the schools.

The two remaining schools are not in our opinion in violation of the definition of compensation.

APA's Response: Our comment is not inaccurate. We stated NPERS did not "adequately address" the specific findings. NPERS did not provide documentation that they contacted any of the school districts. Therefore, we asked the school districts if they had been contacted by NPERS. As noted, only one district responded that NPERS had contacted them.

6. Travel Expenses

Meal Expenses

The State of Nebraska operated under an accountable plan for travel expenses. An accountable plan, defined by the Internal Revenue Service (IRS) in Publication 463, must meet three rules: 1) The expenses must have a business connection; 2) Employees must adequately account to the

6. Travel Expenses (Continued)

Meal Expenses (Continued)

employer these expenses within a reasonable period of time; and 3) Employees must return any excess reimbursements within a reasonable period of time. Employees can adequately account to employers by providing the employer a statement of expense, account book, a diary, or similar record in which the employee entered each expense at or near the time of occurrence, along with documentary evidence of the travel, mileage, or other expense.

Reimbursements made to employees under an accountable plan are not included in the employees' taxable income. Those expenses that do not meet all three rules of an accountable plan should be treated as having been reimbursed under a nonaccountable plan.

IRS Publication 463 describes the records needed to prove certain travel expenses. This publication generally indicated that documentary evidence, such as receipts, must be maintained to support expenses. Documentary evidence is considered adequate if it shows the amount, place, date, and essential character of the expense. A restaurant receipt is enough to prove an expense for a business meal if it has the name and location of the restaurant, the number of people served, and the date and amount of the expense.

Good internal control requires procedures to ensure requirements of the State's accountable plan are met and that reimbursements are in compliance with guidelines set through the Federal Travel Regulation.

Three of eight travel documents tested contained reimbursements for meal expenses without adequate documentation, or was an unreasonable meal expense, as follows:

- One Board member did not have adequate documentation to support meal expenses in accordance with the State's accountable plan. The member was reimbursed $146 for meals while attending a conference, but did not have a receipt or adequate log for the meals. The member identified the amounts for each meal but did not indicate the restaurant.

- One employee was reimbursed unreasonable amounts for meals. Amendment 109 of the Federal Travel Regulation provided $22 as a reasonable breakdown for dinner at the location of the conference. The employee was reimbursed for dinner only on three different days in the amounts of $45, $44, and $30.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. <u>Travel Expenses</u> (Continued)

<u>Meal Expenses</u> (Concluded)

- The same employee was also reimbursed for meals on a different trip within Nebraska that exceeded the Federal guidelines. The guideline for Nebraska was $31. The breakdown per Amendment 109 of the Federal Travel Regulation was $16 for dinner in Nebraska. The employee was reimbursed a total of $34 which included $25 for dinner. The employee was also reimbursed $16 for a meal and only provided a credit card receipt, which did not indicate the "essential character" of the expense.

Without an adequate accounting of meal expenses from the employee to the employer, the State could lose its accountable plan status. If the State does not have an accountable plan, the amounts reimbursed to employees for meal expenses would be considered as taxable income.

> We recommend NPERS implement procedures to ensure provisions of the State's accountable plan are met within their travel reimbursement policy.

<u>Lodging Expenses</u>

The State of Nebraska Accounting Manual, Section AM-005, states "It is State Accounting policy that a person generally must be more than 60 miles from his or her workplace in order to be eligible for lodging. We realize there may be reasons to pay for lodging for distances less than 60 miles. Such reasons include, but are not limited to work requirements, medical conditions or weather; in those instances the reason must be clearly stated on the disbursement document."

NPERS continued to have an annual Board retreat at the Lied Conference Center in Nebraska City, Nebraska in August 2003. Three Board members or employees who attended the conference overnight had a headquarter city of Lincoln, which is 50 miles from Nebraska City, and three members were from Omaha, which is 49 miles from Nebraska City. The cost of lodging for these employees was $390. We also noted one Board member from Omaha, one Board member and one staff member from Lincoln did not stay overnight.

Without following the recommended policy of DAS Accounting, NPERS continues to charge all plans for these overnight expenses of this annual retreat.

> We recommend NPERS follow DAS guidelines regarding overnight travel to ensure all plans are charged only reasonable and necessary expenses.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. <u>Travel Expenses</u> (Concluded)

NPERS' Response: We will remind staff of the need to keep receipts and documentation concerning meal expenses. We will also remind all Board Members the documentation that is required when submitting an expense reimbursement. We do not believe, however, that we have the right to deny reimbursement of a legitimate business expense. In one case the log kept by the individual does not list the name of the restaurant, or in another case an employee exceeded the dollar limit allowed for a meal in a particular city. We realize these details are important and so we will continue to remind everyone of the need for details.

The PERB votes each year to have the Annual Board Retreat in Nebraska City, Nebraska. There is a business need for overnight stay as the Board meets into the evening hours. Last year the first half of the meeting on Sunday did not end until after 9:00 pm. The meetings resume at the breakfast hour the following day. The Board has determined it is an unreasonable imposition to expect a Board member to commute in the late evening hours and then again in the morning. Also, the Board agenda is attached to the Board members expense reimbursement to show meeting hours/times.

The Board has adopted a Conference Attendance and Expense Reimbursement Policy. It specifically states "Board members attending the annual Board retreat shall have their actual expenses for official business paid by the agency."

NPERS' Overall Response: Thank you for the time and cooperation provided by your staff during this effort, and in attempting to resolve differences in understandings of the processes required for efficient and effective administration of the Plans. Open lines of communication and a recognition of the time and cost constraints our agency is faced with in maintaining the vast amount of data for which we are responsible have proven to be valuable throughout the audit process.

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INDEPENDENT AUDITORS' REPORT

Nebraska Public Employees Retirement Board
Lincoln, Nebraska

We have audited the accompanying Statements of Plan Net Assets and the related Statements of Changes in Plan Net Assets of the Nebraska Public Employees Retirement Systems (NPERS) – School Employees, Judges, and State Patrol Retirement Plans as of and for the fiscal year ended June 30, 2004, as listed in the Table of Contents. These financial statements are the responsibility of NPERS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements present only the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans and are not intended to present fairly the financial position and results of operations of the Nebraska Public Employees Retirement Systems in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans as of June 30, 2004, and the results of each plan's operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2004 on our consideration of the Nebraska Public Employees Retirement Systems – School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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

Pat Reding, CPA

December 22, 2004 Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
STATEMENTS OF PLAN NET ASSETS
June 30, 2004

	School Employees	Judges	State Patrol
ASSETS			
Cash in State Treasury (Note 1)	$ 5,983,252	$ 81,319	$ 48,253
Deposits with Vendors	9,091	94	94
Receivables:			
Contributions	31,068,953	329,308	771,544
Interest and Dividend Income	14,288,668	257,069	602,417
Receivable for Investments Sold (Note 12)	111,436,401	1,999,103	4,691,011
Due from Other Fund (Note 11)	25,000	-	-
Total Receivables	156,819,022	2,585,480	6,064,972
Pooled Investments, at fair value (Note 3):			
Government Securities	903,470,200	16,207,720	38,032,360
Corporate Bonds	375,742,861	6,740,604	15,817,221
Equity Securities	1,067,891,140	19,157,334	44,953,801
Taxable Municipal Bonds	17,578,229	315,343	739,971
Asset Backed Securities	51,060,697	915,999	2,149,444
Collateralized Mortgage Obligations	79,880,760	1,433,014	3,362,650
Commingled Funds and Cash Equivalents	2,636,765,462	47,302,010	110,996,923
Total Investments	5,132,389,349	92,072,024	216,052,370
Invested Securities Lending Collateral (Note 3)	478,400,112	8,582,007	20,138,785
Capital Assets:			
Equipment	7,483,576	2,036,889	1,992,481
Less: Accumulated Depreciation	(1,658,342)	(444,807)	(436,646)
Total Capital Assets	5,825,234	1,592,082	1,555,835
TOTAL ASSETS	5,779,426,060	104,913,006	243,860,309
LIABILITIES			
Compensated Absences (Note 4)	176,537	7,315	7,846
Accounts Payable and Accrued Liabilities	2,588,748	57,435	115,645
Obligations under Securities Lending (Note 3)	478,400,112	8,582,007	20,138,785
Capital Lease Obligations (Note 7)	6,136,091	1,656,789	1,623,546
Payable for Investments Purchased (Note 12)	373,592,144	6,702,021	15,726,684
Contributions for Omaha Public Schools (Note 5)	2,487,152	-	-
TOTAL LIABILITIES	863,380,784	17,005,567	37,612,506
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (A schedule of funding progress for each plan is presented on page 39.)	$ 4,916,045,276	$ 87,907,439	$ 206,247,803

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, 2004

	School Employees	Judges	State Patrol
ADDITIONS:			
Contributions:			
Employee	$ 89,075,955	$ 735,106	$ 2,572,950
Employer	87,438,804	-	2,572,950
Court Fees	-	2,002,153	-
State	16,642,031	72,244	333,736
Total Contributions	193,156,790	2,809,503	5,479,636
Investment Income:			
Net appreciation (depreciation) in fair value of investments	546,309,043	9,927,082	23,319,710
Interest & Dividends	84,833,703	1,540,092	3,612,043
Securities Lending Income	5,762,021	103,365	242,559
Total Investment Income	636,904,767	11,570,539	27,174,312
Investment Expenses	(9,620,716)	(173,206)	(406,895)
Securities Lending Expenses	(4,565,182)	(81,895)	(192,177)
Net Investment Income	622,718,869	11,315,438	26,575,240
Other Additions	22,463	2	2
Total Additions	815,898,122	14,124,943	32,054,878
DEDUCTIONS:			
Benefits	165,347,079	3,872,082	9,146,637
Refunds of Contributions	10,510,894	98,649	8,935
Administrative Expense	3,786,591	490,116	475,551
Total Deductions	179,644,564	4,460,847	9,631,123
Net Increase	636,253,558	9,664,096	22,423,755
Net assets held in trust for pension benefits			
Beginning of year	4,279,791,718	78,243,343	183,824,048
End of year	$ 4,916,045,276	$ 87,907,439	$ 206,247,803

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

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2004

1. Summary of Significant Accounting Policies

Reporting Entity. The Nebraska Public Employees Retirement Systems (NPERS) was restructured by the Legislature in 1971 to administer the existing Nebraska retirement systems. Currently, NPERS is responsible for the administration of five retirement plans and the Deferred Compensation Plan. The five retirement plans administered are: the School Employees, State Patrol, Judges, State Employees, and County Employees Retirement Plans.

NPERS is a part of the State of Nebraska reporting entity. The five retirement plans and the Deferred Compensation Plan are classified as pension trust fund types in the State of Nebraska Comprehensive Annual Financial Report.

Separate reports have been issued for the State Employees and County Employees Retirement Plans for fiscal year ended December 31, 2003, and the Deferred Compensation Plan for fiscal year ended December 31, 2001.

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

Basis of Presentation. The accompanying financial statements of NPERS – School Employees, Judges, and State Patrol Retirement Plans have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

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

Pension funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the Statements of Plan Net Assets.

The School Employees, Judges, and State Patrol Retirement Plans' financial statements were prepared on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

Cash in State Treasury. Cash in State Treasury represents the cash balance of a fund as reflected on the Nebraska Information System (NIS). Investment of all available cash is made by the State Investment Officer, on a daily basis, based on total bank balances. Investment income is distributed based on the average daily book cash balance of funds designated for investment. Determination of whether a fund is considered designated for investment is done on an individual fund basis. The cash funds of the School Employees, Judges, and State Patrol Retirement Plans were designated for investment during fiscal year 2004.

Investments. Investments as reported in the financial statements include long-term investments. All investments are stated at fair value based on quoted market prices. Short-term investments are reported at cost, which approximates fair value.

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

Capital Assets. Capital assets consist of computer software and equipment. All capital assets are valued at cost where historical records are available and at estimated historical cost here no historical records exist.

Generally, equipment that has a cost in excess of $5,000 at the date of acquisition and has an expected useful life of two or more years is capitalized. Purchased software that is financed with long-term debt or capitalized lease financing is also capitalized. The amount capitalized includes the cost of the software and related expenses necessary to put the software into place. The useful life is determined based on the system and will be depreciated over 7 years, the same period as the lease financing arrangement used to purchase the software. Equipment is depreciated using the straight-line method.

2. Plan Descriptions and Contribution Information

Membership of each plan consisted of the following at June 30, 2004, the date of the last actuarial valuation:

	School Employees	Judges	State Patrol
Retirees and beneficiaries receiving benefits	12,730	158	301
Terminated plan members entitled to but not yet receiving benefits	15,245	8	15
Active plan members	36,353	163	489
Total	64,328	329	805

2. Plan Descriptions and Contribution Information (Continued)

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

By State law, there is to be an equitable allocation of expenses among the retirement systems administered by the NPERB, 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. As of June 30, 2004, there were 539 participating school districts. All regular public school employees in Nebraska, other than those who have their own retirement plan (Class V school districts, Nebraska State Colleges, University of Nebraska, Nebraska Community Colleges), are members of the plan. The benefits are based on both service and salary.

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

Contributions. The State's contribution is based on an annual actuarial valuation. In addition, the State contributes an amount equal to 0.7 percent of the compensation of all members. The employees' contribution is equal to 7.25 percent of their compensation. The school district's (employer) contribution is 101 percent of the employees' contribution.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions and Contribution Information (Concluded)

Judges Retirement

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

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

Contributions. The plan is funded by members' contributions, a portion of the court fees and the State's contributions. A five dollar fee for each case was collected from District and County courts plus a ten percent charge on certain fees collected in the County Courts. The State's contribution is based on an annual actuarial valuation. Judges contributed six percent of their salary during their first 20 years of service during the fiscal year.

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

Contributions. Members are required to contribute 11 percent of their annual pay plus, for a State Patrol officer employed on or before January 4, 1979, 11 percent of pay received at termination for unused sick leave and vacation leave. The member contribution is matched by the State Patrol (employer). The State's contribution is based on an annual actuarial valuation.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Investments

Investments. Neb. Rev. Stat. Section 72-1239.01(1)(a) R.S.Supp., 2003 states, "The appointed members of the Nebraska Investment Council shall have the responsibility for the investment management of the assets of the retirement systems administered by the Public Employees Retirements Board as provided in section 84-1503 . . . The appointed members shall be deemed fiduciaries with respect to the investment of the assets of the retirement systems . . . and shall be held to the standard of conduct of a fiduciary specified in subsection (3) of this section." Neb. Rev. Stat. Section 72-1239.01(3) R.S.Supp., 2003 states, "The appointed members of the council shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in 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 retirement systems . . . so as to minimize the risk of large losses, unless in light of such circumstances it is clearly prudent not to do so."

Neb. Rev. Stat. Section 72-1246 R.S.Supp., 2003, authorized the State Investment Officer to invest in investments of the nature which individuals of prudence, discretion, and intelligence acquire or retain in dealing with the property of another, and if the State Investment Officer has special skills or is named on the basis of representations of special skills or expertise, he or she is under a duty to use such skills, subject to the direction of the Nebraska Investment Council.

The Nebraska Investment Council has contracted with outside managers to manage all of the funds of the School Employees, Judges, and State Patrol Retirement Plans, except for the funds in the State Treasury.

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

Governmental Accounting Standards Board (GASB) Statement Number 3 requires government entities to categorize investments for the purpose of giving an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which securities are held by NPERS or its agent in the name of NPERS. Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty trust department or agent in the name of NPERS. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department but not in the NPERS' name.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. **Investments** (Continued)

The Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans each own a portion of pooled investments which are managed by the Nebraska Investment Council. These investments meet the criteria of GASB Statement Number 3, Category 1.

The carrying amount of these pooled investments at June 30, 2004, is at market value as set forth below:

Investments - Category 1		
Government Securities		$ 626,451,805
Corporate Bonds		369,103,204
Equity Securities		
Not on Securities Loan		987,669,700
On Securities Loan		6,556,417
Taxable Municipal Bonds		18,633,543
Asset Back Securities		54,126,140
Collateralized Mortgage Obligations		84,676,424
Subtotal		2,147,217,233
Not Categorized		
Investments held by broker-dealers		
Under Securities Loan With Cash Collateral		
Government Securities		331,258,474
Corporate Bonds		29,197,482
Equity Securities		137,776,159
Securities Lending Short-Term Collateral		
Investment Pool		507,120,904
Commingled Funds and Cash Equivalents		2,795,064,395
Total		$ 5,947,634,647
Carrying Amount at Market Value		
School Employees	$ 5,132,389,349	
Judges	92,072,024	
State Patrol	216,052,370	$ 5,440,513,743
Invested Securities Lending Collateral		
School Employees	478,400,112	
Judges	8,582,007	
State Patrol	20,138,785	507,120,904
Total Investments		$ 5,947,634,647

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. Investments (Concluded)

Securities Lending Transactions. The State Investment Officer participated 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 NPERS custodial bank administers the securities lending program and receives cash, United States Government or government agency obligations, or convertible bonds at least equal in value to the market value of the loaned securities as collateral for securities of the type on loan at year-end. Securities lent at year-end for cash collateral are presented as unclassified in the following schedule of custodial risk; securities lent for securities collateral are classified according to the category for the collateral. At year-end, NPERS had no credit risk exposure to borrowers because the amounts NPERS owes the borrowers exceed the amounts the borrowers owe NPERS. The collateral securities cannot be pledged or sold by NPERS unless the borrower defaults. There are no restrictions on the amount of securities that can be loaned and there were no losses resulting from borrower default during the year.

Generally, either NPERS or the borrowers can terminate securities loans on demand. Cash collateral is invested in one of the lending agent's short-term investment pools that had average durations of 51 and 55 days. Because loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. There is no loss indemnification provided to NPERS by the contract with the custodian.

Derivative Financial Instruments. Derivative instruments are financial contracts in which underlying values depend on the values of one or more underlying assets, reference rates, or financial indices. These instruments are used primarily to enhance performance and reduce volatility of the portfolio, in accordance with the Investment Council-approved Derivatives Policy. NPERS invests in collateral mortgage obligations, futures contracts, and U.S. Treasury STRIPS. Collateral mortgage obligations, with a par value of $117,964,003, are traded on exchanges and carried at fair value. Futures represent commitments to purchase or sell securities or money market instruments at a future date and at a specific price. NPERS invests in futures contracts related to securities of the U.S. Government, Government Agency obligations, and equity indices which are traded on organized exchanges, thereby minimizing NPERS' credit risk. The net change in the futures contract value is settled daily in cash with the exchanges. At June 30, 2004, NPERS held futures contracts with a par value of $313,002,800 and a market value of $0. Treasury STRIPS, which are backed by the full faith and credit of the United States, are utilized because NPERS receives a payment at a specific date. Fair value at June 30, 2004 was $20,181,939 and par value was $61,250,000.

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Compensated Absences

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

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

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

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

The liability for the vested portion of compensated absences for each plan at June 30, 2004, is as follows:

	School Employees	Judges	State Patrol
Annual Leave	$ 98,354	$ 4,075	$ 4,371
Sick Leave	77,912	3,229	3,463
Compensatory Leave	271	11	12
	$ 176,537	$ 7,315	$ 7,846

5. Contribution for Omaha Public Schools

Neb. Rev. Stat. Section 79-916, R.R.S. 2003 required an annual payment to be made to Omaha Public Schools as a result of that school system having a separate retirement system. The contribution amount represents the July payment to Omaha Public Schools. This amount is included in State Contributions Additions and recorded as benefits when payment is made.

6. Six-Year Historical Trend Information

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

7. Contingencies and Capital Lease Commitments

Risk Management. NPERS is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. NPERS, as part of the primary government for the State, participates in the State's risk management program. The DAS Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

A. Motor vehicle liability, which is insured for the first $5 million of exposure per accident. 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 Public Employee's Retirement Systems' financial statements.

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Contingencies and Capital Lease Commitments (Continued)

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

The second Master Lease Agreement, dated November 1, 2001, was for $2,166,847 including interest costs of $241,847, a rate of 3.245%. The third Master Lease Agreement, in July 2002, was for $6,029,861 including interest costs of $644,861, a rate of 3.129%. The first Master Lease Agreement was refinanced into the third Master Lease Agreement. As a result, the first Master Lease Agreement no longer exists. The fourth Master Lease Agreement, dated February 26, 2003, was for $5,915,227 including interest costs of $525,227, a rate of 2.757%. The fifth Master Lease Agreement, dated February 12, 2004, was for $4,062,231 including interest costs of $326,708, a rate of 2.530%. The minimum annual lease payments and the present value of future minimum payments for all capital leases as of June 30, 2004 are as follows:

Fiscal Year	School Employees	Judges	State Patrol
2005	$ 1,173,592	$ 343,490	$ 330,479
2006	1,173,593	343,491	330,480
2007	1,173,593	343,491	330,480
2008	1,115,989	326,631	314,258
2009	981,321	287,216	276,337
2010-2011	1,011,373	156,871	180,443
Total Minimum Payments	6,629,461	1,801,190	1,762,477
Less: Interest and Executory costs	493,370	144,401	138,931
Present value of net minimum payments	$ 6,136,091	$ 1,656,789	$ 1,623,546

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

8. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended June 30, 2004 are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
School Employees:					
Compensated Absences	$ 180,355	$ -	$ 3,818	$ 176,537	$ 25,474
Capital Lease Obligations	5,229,345	1,684,721	777,975	6,136,091	1,022,495
Totals	$ 5,409,700	$ 1,684,721	$ 781,793	$ 6,312,628	$ 1,047,969
Judges:					
Compensated Absences	$ 4,590	$ 2,725	$ -	$ 7,315	$ 1,056
Capital Lease Obligations	1,391,400	493,089	227,700	1,656,789	299,267
Totals	$ 1,395,990	$ 495,814	$ 227,700	$ 1,664,104	$ 300,323
State Patrol:					
Compensated Absences	$ 4,944	$ 2,902	$ -	$ 7,846	$ 1,132
Capital Lease Obligations	1,368,210	474,411	219,075	1,623,546	287,931
Totals	$ 1,373,154	$ 477,313	$ 219,075	$ 1,631,392	$ 289,063

9. School Employee Contributions

Employee contributions for the School Plan exceeded employer contributions due to purchase of service payments totaling $2,506,659. Members can purchase service credit for reinstatement of service, out-of-state service, for a leave of absence, or within twelve months of retirement in accordance with Neb. Rev. Stat. Sections 79-921 R.R.S. 2003, 79-933.05 R.R.S. 2003, 79-933.06 R.R.S. 2003, and 79-933.08 R.R.S. 2003.

10. Capital Assets

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
School Employees:				
Equipment	$ 5,798,855	$ 1,684,721	$ -	$ 7,483,576
Less: Accumulated Depreciation	709,597	948,745	-	1,658,342
Total Capital Assets, Net	$ 5,089,258	$ 735,976	$ -	$ 5,825,234
Judges:				
Equipment	$ 1,543,800	$ 493,089	$ -	$ 2,036,889
Less: Accumulated Depreciation	189,043	255,764	-	444,807
Total Capital Assets, Net	$ 1,354,757	$ 237,325	$ -	$ 1,592,082
State Patrol:				
Equipment	$ 1,518,070	$ 474,411	$ -	$ 1,992,481
Less: Accumulated Depreciation	185,892	250,754	-	436,646
Total Capital Assets, Net	$ 1,332,178	$ 223,657	$ -	$ 1,555,835

NOTES TO FINANCIAL STATEMENTS
(Continued)

11. Due From Other Fund

Due From Other Fund represents a transfer of cash between the NPERS administrative cash fund and the County defined contribution cash fund. During 2003 the County defined contribution cash fund did not have enough money to pay expenses and received a transfer of cash in the amount of $25,000 from the NPERS administrative cash fund, which is part of the School Plan. This amount was still owed to the School Plan at June 30, 2004.

12. Receivable/Payable for Investment Sales/Purchases

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.

The receivable and payable for investment sales and purchases represent securities in which the asset has been recorded as of June 30, 2004, but the security has not settled.

13. Subsequent Events

Public Employees Retirement Board
2004 Neb. Laws LB 1097 was signed into law April 15, 2004. The law changed the make up of the Public Employees Retirement Board. Beginning January 1, 2005, the Board shall consist of eight appointed members and the State Investment Officer as a nonvoting, ex officio member. Six of the appointed members shall be participants in the retirement systems administered by the board, and two of the appointed members shall not be an employee of the State of Nebraska or any of its political subdivisions and shall have at least 10 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. On and after January 1, 2005, any person who is appointed to the board and who is not an employee of the State of Nebraska or any of its political subdivisions shall not own any funds which are administered by the Board.

State Patrol Contributions
2004 Neb. Laws LB 514 was signed into law April 13, 2004. The bill increased the contribution rate for patrol officers, effective July 1, 2004, from eleven percent to twelve percent. The contribution rate increase is effective for the fiscal year ending June 30, 2005 only.

Judges Contributions
2004 Neb. Laws LB 1097 was signed into law April 15, 2004. The bill increased the contribution rate for judges, effective July 2004, from six percent to eight percent until the maximum benefit has been earned. Prior to July 2004, there was no contribution

NOTES TO FINANCIAL STATEMENTS
(Continued)

13. Subsequent Events (Concluded)

required from members who had earned the maximum benefit. Effective July 2004, the members were required to contribute four percent of his or her monthly compensation to the fund after the maximum benefit has been earned. The bill also allowed for an additional benefit option. Current members had a one-time election to increase their rate of contribution in order to receive the additional benefit option.

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, 2004
UNAUDITED

SCHEDULE 1

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
SCHOOL EMPLOYEES						
6/30/2004	$5,118,011,165	$5,868,266,970	$750,255,805	87.2%	$1,170,601,127	64.1%
6/30/2003	4,952,902,870	5,464,572,876	511,670,006	90.6%	1,138,776,241	44.9%
6/30/2002	4,799,789,893	5,055,867,993	256,078,100	94.9%	1,065,515,857	24.0%
6/30/2001	1,486,008,665	1,704,201,512	218,192,847	87.2%	995,348,331	21.9%
6/30/2000	1,348,542,467	1,526,061,507	177,519,040	88.4%	933,339,432	19.0%
6/30/1999	1,129,546,860	1,345,494,742	215,947,882	84.0%	893,801,152	24.2%

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

Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Accrued Liability (AAL)	(b-a) Unfunded AAL (UAAL)	(a/b) Funded Ratio	(c) Covered Payroll	((b-a)/c) UAAL as a Percentage of Covered Payroll
JUDGES						
6/30/2004	$ 92,810,699	$ 95,671,391	$ 2,860,692	97%	$ 16,655,342	17.2%
6/30/2003	91,863,620	85,387,839	(6,475,781)	108%	16,402,342	(39.5%)
6/30/2002	92,596,279	81,191,724	(11,404,555)	114%	16,062,274	(71.0%)
6/30/2001	90,685,851	90,685,851	-	100%	15,188,085	0.0%
6/30/2000	84,483,073	84,483,073	-	100%	13,913,264	0.0%
6/30/1999	75,521,517	75,521,517	-	100%	13,462,643	0.0%
STATE PATROL						
6/30/2004	$ 216,422,556	$ 222,161,512	$ 5,738,956	97.4%	$ 22,640,907	25.4%
6/30/2003	214,657,454	210,930,784	(3,726,670)	101.8%	21,929,399	(17.0%)
6/30/2002	214,527,994	197,615,091	(16,912,903)	108.6%	18,846,776	(89.7%)
6/30/2001	208,372,640	187,284,490	(21,088,150)	111.3%	16,727,477	(126.1%)
6/30/2000	193,019,673	169,545,801	(23,473,872)	113.8%	15,789,104	(148.7%)
6/30/1999	171,124,224	162,222,559	(8,901,665)	105.5%	14,986,973	(59.4%)

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, 2004
UNAUDITED

SCHEDULE 2

SCHOOL EMPLOYEES

Year Ended	Annual Required Contribution (1)		Percentage
June 30	State (2)	School	Contributed
2004	$ 14,154,879	$ 87,438,804 (3)	100%
2003	13,119,888	84,467,330	100%
2002	12,659,281	80,288,662	100%
2001	12,225,219	77,062,544	100%
2000	11,948,451	69,990,565	100%
1999	11,853,757	65,672,654	100%

JUDGES

Year Ended	Annual Required Contribution		Percentage
June 30	State	Court Fees	Contributed
2004	$ 72,244	$ 2,002,153 (3)	100%
2003	712,518	579,145	50%
2002	72,244	492,613	100%
2001	72,244	487,012	100%
2000	72,244	473,838	100%
1999	72,244	442,802	100%

STATE PATROL

Year Ended June 30	Annual Required Contribution	Percentage Contributed
2004	$ 3,018,366 (3)	96.3%
2003	2,652,857	100%
2002	2,428,025	100%
2001	2,257,609	100%
2000	2,203,735	100%
1999	2,294,332	100%

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

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

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

(3) Additional State funding is required for the School Employees, Judges and State Patrol plans in the amounts of $15,415,949; $644,562; and $948,654, respectively.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
UNAUDITED

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

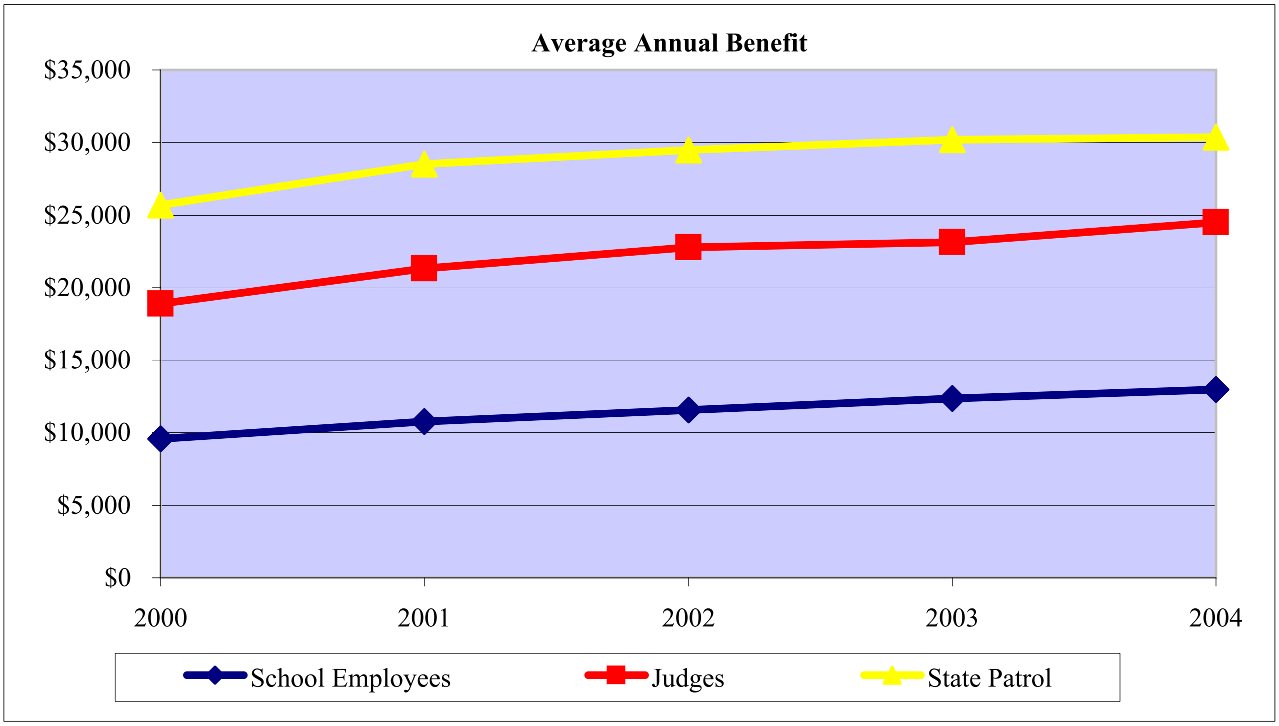
	School Employees	Judges	State Patrol
Valuation Date	June 30, 2004	June 30, 2004	June 30, 2004
Actuarial Cost Method	Entry Age	Entry Age	Entry Age
Amortization Method	Level Dollar Closed	Level Dollar Closed	Level Dollar Closed
Remaining Amortization Period (2)	24 Years	25 Years	25 Years
Mortality	1994 Group Annuity Table Set Back 2 Years	1994 Group Annuity Table Set Back 2 Years	1994 Group Annuity Table
Asset Valuation Method	5 year smoothing	5 year smoothing	5 year smoothing
Actuarial Assumptions:			
Investment Rate of Return (1)	8.0%	8.0%	8.0%
Projected Salary Increases (1)	Graded 10.5% to 4.5%	5.0%	Graded 12% to 4.5%
Cost-Of-Living Adjustments (COLA)	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 75% purchasing power of original benefit	2.5% with a floor benefit equal to 60% purchasing power of original benefit

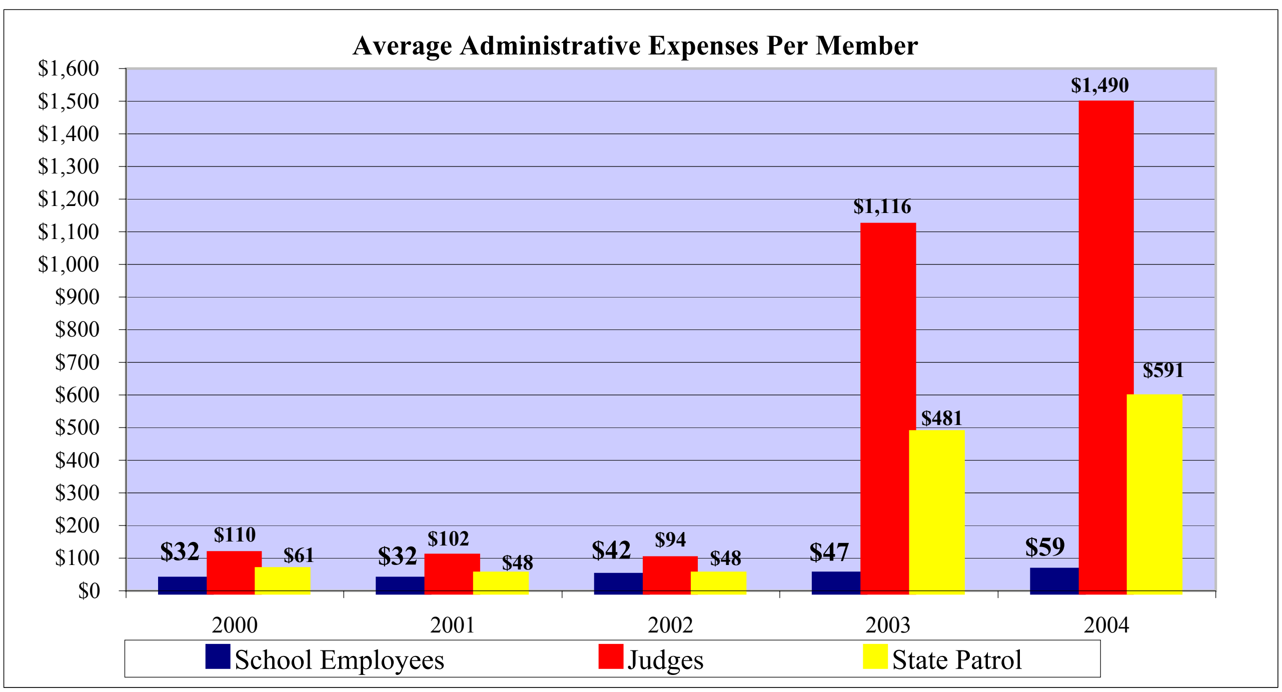
(1) Includes assumed inflation of 3.5% per year.
(2) The total unfunded actuarial liability may be amortized as one amount, or components of the total may be separately amortized. The equivalent single amortization period is the weighted average for all components. The weighted average was calculated as 24 years for the School Employees plan.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
SCHOOL EMPLOYEES, JUDGES, AND STATE PATROL RETIREMENT PLANS
SCHEDULE OF SERVICE EFFORTS AND ACCOMPLISHMENTS
Fiscal Years Ended June 30, 2000 through 2004

	2000	2001	2002	2003	2004
SCHOOL EMPLOYEES					
Active Members	34,718	35,589	35,974	36,779	36,353
Inactive Members	13,918	15,158	14,302	14,531	15,245
Retirees	10,371	10,925	11,360	11,837	12,730
Total Benefits Paid (3)	$ 99,501,638	$ 117,809,712	$131,499,136	$ 146,337,041	$ 165,347,079
Average Annual Benefit (1)	$ 9,594	$ 10,783	$ 11,576	$ 12,363	$ 12,989
Average Monthly Benefit (4)	$ 800	$ 899	$ 965	$ 1,030	$ 1,082
Administrative Expenses	$ 1,891,100	$ 1,983,883	$ 2,601,071	$ 2,995,158	$ 3,786,591
Average Admin. Expense Per Member (2)	$ 32.05	$ 32.17	$ 42.20	$ 47.43	$ 58.86
JUDGES					
Active Members	159	164	166	162	163
Inactive Members	22	13	12	13	8
Retirees	163	165	163	160	158
Total Benefits Paid (3)	$ 3,080,021	$ 3,515,798	$ 3,709,728	$ 3,700,867	$ 3,872,082
Average Annual Benefit (1)	$ 18,896	$ 21,308	$ 22,759	$ 23,130	$ 24,507
Average Monthly Benefit (4)	$ 1,575	$ 1,776	$ 1,897	$ 1,928	$ 2,042
Administrative Expenses	$ 37,783	$ 34,935	$ 31,934	$ 373,723	$ 490,116
Average Admin. Expense Per Member (2)	$ 109.83	$ 102.15	$ 93.65	$ 1,115.59	$ 1,489.71
STATE PATROL					
Active Members	386	403	415	486	489
Inactive Members	16	6	11	13	15
Retirees	269	274	280	288	301
Total Benefits Paid (3)	$ 6,908,835	$ 7,806,983	$ 8,254,431	$ 8,697,575	$ 9,146,637
Average Annual Benefit (1)	$ 25,683	$ 28,493	$ 29,480	$ 30,200	$ 30,387
Average Monthly Benefit (4)	$ 2,140	$ 2,374	$ 2,457	$ 2,517	$ 2,532
Administrative Expenses	$ 40,845	$ 32,763	$ 33,578	$ 378,697	$ 475,551
Average Admin. Expense Per Member (2)	$ 60.87	$ 47.97	$ 47.56	$ 481.19	$ 590.75

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





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

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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, 2004, and have issued our report thereon dated December 22, 2004. The Independent Auditors' Report was modified to disclose that the Required Supplementary Information was unaudited and to emphasize the financial statements present only the School Employees, Judges, and State Patrol Retirement Plans. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described

in the Comments Section of the report as Comment Number 1 (Nebraska Information System and Accounting Procedures), Comment Number 2 (NPERS Information System), Comment Number 3 (Purchase of Service Calculations), Comment Number 4 (Incorrect Reported Compensation from School Districts), and Comment Number 5 (Resolution of Prior Audit Findings).

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

Compliance and Other Matters

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

We also noted an additional item that we have reported to management of the Nebraska Public Employees Retirement Systems - School Employees, Judges, and State Patrol Retirement Plans in the Comments Section of the report as Comment Number 6 (Travel Expenses).

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

Pat Reding, CPA

December 22, 2004 Assistant Deputy Auditor