AUDIT REPORT
OF THE
NEBRASKA PUBLIC EMPLOYEES
RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN

A PENSION TRUST FUND OF THE
STATE OF NEBRASKA

JANUARY 1, 2005 THROUGH DECEMBER 31, 2005

Issued on September 6, 2006

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN

BACKGROUND

The Nebraska Public Employees Retirement Board (the Board) was created in 1971 to administer Nebraska retirement plans for school employees, State employees, judges, and the State Patrol. The Board assumed administration of the retirement system for Nebraska counties in 1973. In 1976, the Board implemented the State of Nebraska Deferred Compensation Plan. This Plan is an optional supplemental retirement plan.

The Board has eight members appointed by the Governor, with legislative approval, to five-year terms. Members include:

- ♦ Two participants in the school retirement system; one administrator and one teacher;
- ♦ One participant in the Nebraska Judges retirement system;
- ♦ One participant in the retirement system for Nebraska counties;
- ♦ One participant in the State employees retirement system of the State of Nebraska;
- ♦ One participant in the Nebraska State Patrol retirement system;
- ♦ Two public representatives who are not State employees or employees of its subdivisions; with at least ten years of experience in the management of a public or private organization or have at least 5 years experience in the field of actuarial analysis or the administration of an employee benefit plan.
- ♦ The State Investment Officer as a nonvoting, ex-officio member.

All appointed members must be Nebraska citizens.

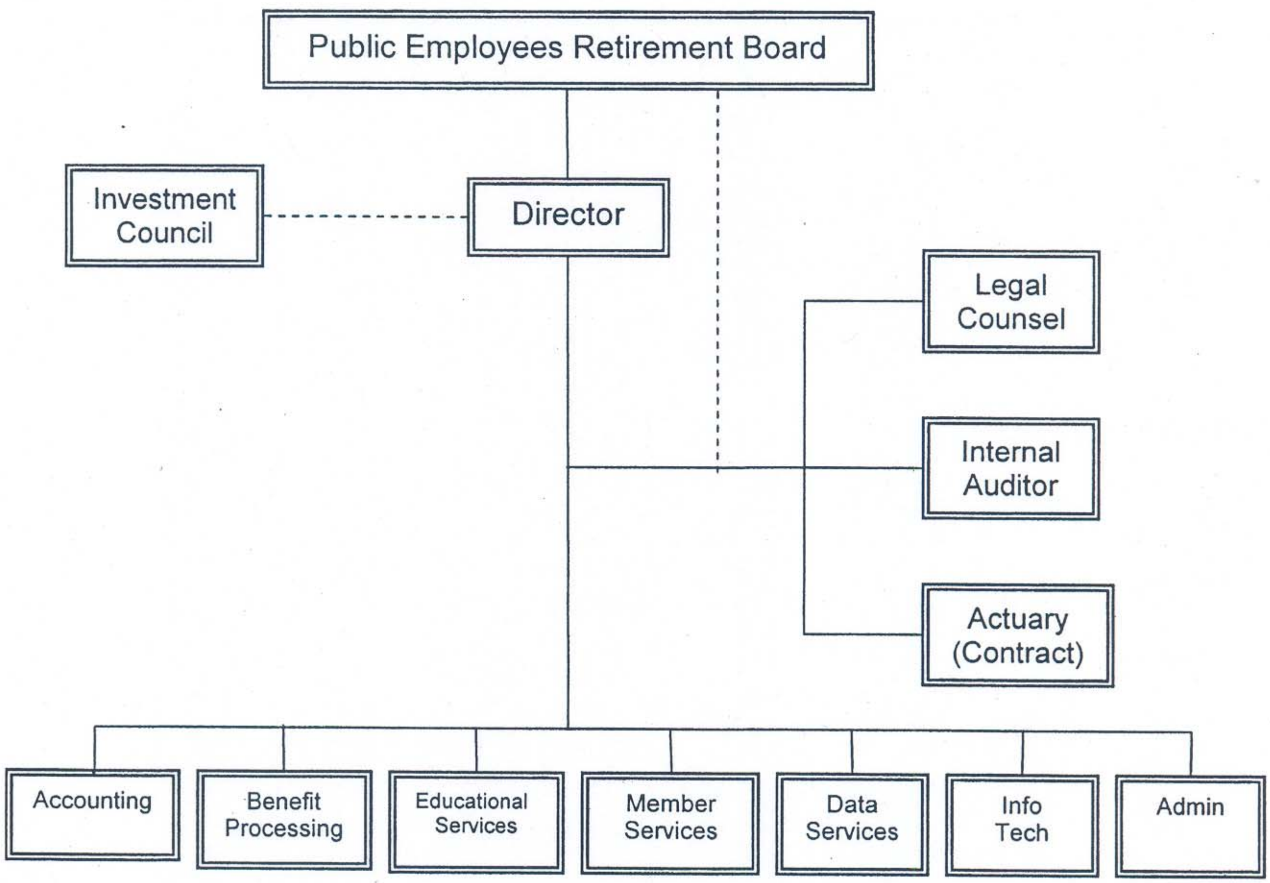
The Board meets monthly. As of July 1, 2005, members of the Board shall be paid fifty dollars per diem, and all members shall be reimbursed for actual and necessary expenses.

The Board hires a director to manage the day-to-day operations. Expenses are to be equitably distributed among the retirement systems. All expenses must be provided from investment income earned by various retirement funds, unless other fund sources to pay expenses are specified by law.

MISSION STATEMENT

The Nebraska Public Employees Retirement Systems recognizes the importance of a successful retirement and is dedicated to providing the highest quality service necessary to assist members in achieving this goal.

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held July 25, 2006, with the Nebraska Public Employees Retirement Systems (NPERS) to discuss the results of our examination. Those in attendance for NPERS were:

NAME	TITLE
Anna Sullivan	Director
Jane Bond	Member Services Manager
Joe Schaefer	Legal Counsel
Denis Blank	Public Employees Retirement Board
Cheryl Mueller	Auditor Associate
Randy Gerke	Accounting/Finance Manager
Teresa Zulauf (via teleconference)	Internal Auditor

SUMMARY OF COMMENTS

During our audit of the Nebraska Public Employees Retirement Systems (NPERS) - Deferred Compensation Plan, 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. ***Monitoring of Hartford Assets:*** NPERS did not monitor and review Hartford Life Insurance Company accounts and transactions to ensure proper controls and procedures were in place.

2. ***Required Minimum Distributions:*** One of three required minimum distribution (RMD) payments tested that were calculated by NPERS was incorrectly paid out to the participant.

3. ***Timing of Initial Contributions:*** Two of fourteen initial contributions tested did not meet the requirements of 26 U.S.C. Section 457(b) 2005. Two of fourteen initial contributions tested were not deducted on the date indicated by the participant.

4. ***Asset Charge Allocation:*** NPERS did not have documentation to support the allocation percentages used to allocate the asset charge between the State and County Retirement Plans and the Deferred Compensation Plan.

5. ***Address Changes:*** NPERS did not have adequate procedures in place to review changes made to addresses of members receiving benefit payments.

6. ***No Recent IRS Ruling Letter:*** NPERS has not obtained an IRS ruling letter on the Deferred Compensation Plan since 1985.

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

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

Draft copies of this report were furnished to the 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

SUMMARY OF COMMENTS
(Continued)

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. Monitoring of Hartford Assets

Members who had account balances with Hartford Life Insurance Company (Hartford) prior to September 1, 1997, had the option of maintaining the balances with Hartford or transferring the balances to Ameritas Life Insurance Company (Ameritas). Hartford remained the record-keeper and custodian for member account balances that were not transferred. Hartford performed transactions for benefit payments, transfers, and posting of earnings. Hartford provided various reports to Plan Administrators upon request. At December 31, 2005, Hartford maintained approximately $50 million in assets for the State Deferred Compensation Plan.

26 C.F.R. Section 1.401(a)(9)-5 states, "the minimum amount required to be distributed for each distribution calendar year . . . is equal to the quotient obtained by dividing the account . . . by the applicable distribution period." The applicable distribution period is defined as follows: "The applicable distribution period . . . is determined using the Uniform Lifetime Table . . . for the employees age as of the employees birthday in the relevant distribution calendar year."

Statement on Auditing Standards (SAS) Number 70 provides guidelines for a service center audit to be performed and reviewed to evaluate any third party service centers which are relied upon for transaction processing to ensure controls are operating as intended. Hartford processed $4,606,578 in distributions to Plan members in calendar year 2005. Good internal control requires procedures to ensure transactions are processed according to Plan member instructions and to ensure accounts are properly monitored to ensure compliance with laws and regulations to prevent the loss or misuse of Plan funds.

We noted the following:

- NPERS did not monitor Hartford for compliance with Federal regulations, the Plan document, or contract requirements related to the Hartford participants.

  Hartford prepared an age 70 ½ report each January in order to determine who is required to have the minimum distribution in accordance with Federal regulation. However, NPERS did not request or review this report to ensure participants were paid in compliance with Federal requirements. All three Hartford minimum distribution payments tested were incorrectly calculated by Hartford. Each had an incorrect age factor used to calculate this amount. It is likely all minimum distribution payments were calculated incorrectly, as Hartford indicated they used the incorrect factor for 2005 distributions.

  NPERS also did not monitor annuity payments to Hartford to ensure the payments were in accordance with contract provisions.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Monitoring of Hartford Assets (Continued)

- NPERS did not notify Hartford participants to contact Hartford upon termination or retirement when they received a noncontributing member form from the employer. NPERS also did not notify Hartford when members had retired.

- NPERS did not monitor participant distributions to ensure all distributions were actually processed and processed in the same manner as the participant selected. NPERS signed distribution forms for Hartford participants to verify the termination date. NPERS also received a monthly disbursement report from Hartford which detailed all disbursements made to Hartford participants; however, NPERS did not compare this report to the distribution forms they approved to determine if the correct option selected was paid out.

  It would not be possible for NPERS to verify the correct amounts were paid to the members since NPERS did not maintain or review Hartford account balance information. NPERS subsequently has obtained access to view Hartford participants' quarterly statements online.

- NPERS had not reviewed the Hartford SAS 70 report for the audit period until the report was requested by the auditors. NPERS had to request the report from Hartford.

A similar comment was noted in the prior audit.

Without proper procedures in place to monitor and review transactions processed by Hartford, there is an increased risk members are not properly paid, transactions are not properly processed, and the Plan is not in compliance with Federal regulations. Consequently, without a good understanding of Hartford's controls and procedures, there is an increased risk of possible misstatements and errors to the financial statements, as well as an increased risk of fraud related to Hartford transactions.

> We recommend NPERS implement procedures to ensure compliance with the Plan document and Federal regulation requirements related to minimum distribution payments. We recommend NPERS ensure annuities are calculated in accordance with contract provisions. We recommend NPERS notify members, upon receipt of the noncontributing member form from the employer, to contact Hartford regarding payment of Hartford amounts. We recommend NPERS ensure distributions to Hartford participants are processed accurately in accordance with participant selections. We recommend NPERS obtain and perform a documented review of the SAS 70 report from Hartford on an annual basis to ensure controls at Hartford are operating as intended.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Monitoring of Hartford Assets (Continued)

NPERS' Response: Hartford Life Insurance Company (Hartford) has provided an investment and variable annuity contract for the Nebraska Deferred Compensation Plan to state employees since 1979, and similar retirement plan services to a large number of defined contribution and deferred compensation plans nationwide.

In 1997, the decision was made by the Public Employees Retirement Board (PERB) and the Nebraska Investment Council (NIC) to establish a new Deferred Compensation Plan for state employees with investments provided by the NIC and recordkeeping services by Ameritas Life Insurance Corporation. This decision was driven in part by the lack of control the PERB and staff as well as the NIC had over the contract, the investments and expenses.

There was a concern that if the contract were cancelled outright, plan members would be hurt by expensive surrender charges that would be assessed against their accounts. So, once the decision was made to offer the new DCP plan, members were given a choice to transfer their funds to the new DCP plan or to keep their funds with Hartford. It was made clear that all future contributions by members were required to be made to the new plan. Originally, Hartford assessed every member who elected to move his/her funds to the new plan a fee for moving. Those fees have since been waived by Hartford but it continues to be the member's decision whether to keep his/her original funds with Hartford.

Today, all contact with members who have maintained an account with Hartford is between that member and Hartford. The one exception is when a member terminates his/her employment with the State of Nebraska and they are eligible for a distribution. We have begun to remind those members to contact Hartford directly if they wish to receive a distribution of their funds at Hartford. We realize members with funds at Hartford are receiving regular statements from Hartford which includes contact information, phone numbers, etc. for use when additional information is needed from Hartford. However, this notification is provided to members as an extra precaution should they forget they have an account at Hartford.

In addition, we approve the distributions paid by Hartford. They forward all requests for distribution through us and we confirm that a Non-Contributing Member Form has been received from the appropriate state agency. We then inform Hartford that the account is eligible to be paid out.

Each time a participant takes a monthly annuity benefit, we receive a notification from Hartford on that person which is put into the member's file. We receive a report of all total participants receiving benefits each month. It is possible to check this against the distribution request but information is not available for us to verify that the amount of a monthly annuity benefit issued by Hartford is correct. Annuity rates are variable.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Monitoring of Hartford Assets</u> (Concluded)

NPERS' Response, Concluded:
The monitoring, calculating and payment of required minimum distributions is done by Hartford. This is a part of their contractual requirements and is not our responsibility.

Hartford has been reviewed by Ernst & Young LLP, and a Statement on Auditing Standards Number 70 report (SAS 70) has been issued. We will be receiving the SAS 70 report and reviewing the report in a timelier manner.

APA's Response: As previously noted, Hartford maintains approximately $50 million in assets for the State Deferred Compensation Plan. We feel very strongly that NPERS should implement monitoring procedures related to minimum distribution requirements, annuity payments, and distributions made to members by Hartford to ensure the assets of those members are protected. While we understand the calculating and payment of required minimum distributions is the responsibility of Hartford, we strongly disagree with the assertion by NPERS that monitoring is solely Hartford's responsibility.

2. <u>Required Minimum Distributions - NPERS</u>

26 C.F.R. Section 1.401(a)(9)-5 states that "the minimum amount required to be distributed for each distribution calendar year … is equal to the quotient obtained by dividing the account … by the applicable distribution period." The applicable distribution period is defined as follows: "the applicable distribution period … is determined using the Uniform Lifetime Table … for the employees age as of the employees birthday in the relevant distribution calendar year."

For one of three Ameritas required minimum distribution payments tested, the incorrect amount was paid to the participant. These payments tested were calculated by NPERS. Again, an incorrect age factor was used in the calculation. There were 15 required minimum distribution payments calculated by NPERS for calendar year 2005, totaling $37,109.

Without proper procedures in place to ensure minimum distribution payments are calculated correctly, there is an increased risk members are not properly paid and that the Plan is not in compliance with the Federal regulation.

> We recommend NPERS implement procedures to make certain minimum distribution payments are calculated correctly to ensure the Plan is in compliance with Federal requirements.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Required Minimum Distributions – NPERS (Concluded)

NPERS' Response: We are taking action to update our procedures and will provide additional training to staff to ensure the calculation of required minimum distributions are accurate and correct.

3. Timing of Initial Contributions

An eligible State Deferred Compensation Plan means a plan which meets requirements of 26 U.S.C. Section 457(b) (2005). 26 U.S.C. Section 457(b)(4) (2005) states that compensation is to be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month.

NPERS Deferred Compensation's Plan Document states "compensation may be deferred in any calendar month only if an agreement providing for such deferral has been entered into before the first day of such a month." Good internal control requires procedures to ensure the amounts are not deferred in the same calendar month as the participant enters into an agreement with NPERS. Good internal control also requires procedures to ensure initial contributions begin by the paycheck date indicated by the participant.

NPERS did not have adequate procedures to ensure initial contributions were not deducted in the same month the participant entered into an agreement to defer compensation. Two of fourteen initial contributions tested were deducted in the same calendar month the participant entered into an agreement with NPERS. This issue was also noted in the prior audit. The two members contributed $1,500 and $100 for their first contribution.

NPERS also did not have adequate procedures to ensure initial contributions were made on the date indicated by the participant. Two of fourteen initial contributions tested were not deducted on the date indicated by the participant. There were 190 new participants for calendar year 2005 contributing a total of $290,288.

Noncompliance with Federal regulations could disqualify the Nebraska Deferred Compensation Plan as an eligible plan.

> We recommend NPERS implement procedures to ensure the initial contribution does not take place in the same calendar month the participant entered into an agreement to defer compensation with NPERS. In addition, we recommend NPERS implement procedures to ensure initial contributions are made on the date indicated by the participant.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Timing of Initial Contributions (Concluded)

NPERS' Response: The State Employees' Retirement System Manual for State Agencies provided by our office to all state agencies defines when the effective date of the first contributions should be made. We will further clarify with State Agencies when to begin contributions.

We will also implement additional procedures to monitor initial contributions made by participants.

4. Asset Charge Allocation

Good internal control requires adequate documentation to support the method used to allocate the asset charge between Plans. The asset charge is used by NPERS to pay expenses of the various Plans.

In 2003, NPERS implemented a charge against Plan assets used to pay NPERS expenses. Until March 2005, the asset charge was calculated by the custodian of the Plan assets. The custodian commingled funds of the State and County Retirement Plans and the Deferred Compensation Plan for investment purposes. Therefore, a method was needed to allocate the charges between these three Plans. NPERS did not maintain adequate documentation to support the method used to allocate the asset charge between the State and County Retirement Plans and the Deferred Compensation Plan from the inception of the asset charge in 2003 through March 2005. In April 2005, Ameritas (the record-keeper) began calculating the asset charge based on the total assets held by each Plan. As a result, NPERS was able to allocate the asset charge to the proper Plan based on the actual Plan balances.

From the inception of the asset charge in 2003 through March 2005, an average of $3,779 per month was allocated to the Deferred Compensation Plan. Again, this allocation method was not documented by NPERS. When the record-keeper began calculating the asset charge based on the assets in the Plan, the average asset charge received by the Deferred Compensation Plan increased to $6,646 per month; an increase of $2,867 per month. This indicates that the allocation percentage being used prior to April 2005, did not accurately reflect the assets held by the Deferred Compensation Plan.

Without adequate documentation to support the amount received by each Plan for Plan expenses, there is an increased risk the assets of each Plan are not being used for the exclusive benefit of each Plan.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Asset Charge Allocation (Concluded)

> We recommend NPERS maintain adequate documentation to support allocation methods used to allocate monies coming into the Plans or being disbursed from the Plans to ensure assets of each Plan are only used for the exclusive benefit of each Plan. We also recommend the Board consider whether the Deferred Compensation Plan incurred its fair share of participant expenses in light of the significant increase in the allocation of monies coming into the Deferred Compensation expense fund.

NPERS' Response: We understand the importance of proper and adequate documentation and will make sure the documentation for the asset charge allocation is up-to-date.

5. Address Changes

Good internal control requires procedures to ensure changes made to members' accounts are authorized and correct to reduce the risk of fraudulent transactions.

NPERS does not have adequate procedures in place to review changes made to addresses of members receiving benefit payments.

When NPERS received an address change a retirement specialist made the change in PIONEER, created a printout from OMNI with the old address information, and manually wrote the new address information on the printout. This printout was then sent to the call center where the change was made in OMNI. Once the change was made in both PIONEER and OMNI, a benefits manager confirmed the address change to the printout received by the call center. The original address change documentation was never compared to PIONEER and OMNI to ensure the address was correctly updated.

Without adequate procedures to ensure address changes are correct and authorized, there is an increased risk of fraudulent transactions.

> We recommend NPERS implement procedures to ensure address changes are adequately reviewed and confirmed to signed original supporting documentation.

NPERS' Response: We will review and update our procedures concerning address changes. Staff will be made aware of the importance of the comparison of the address to signed original supporting documentation.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. No Recent IRS Ruling Letter

Good internal control and sound accounting practice requires a ruling from the Internal Revenue Service (IRS) on whether the Nebraska 457 Plan is an eligible Plan. In addition, it was a recommendation by the Groom Law Group, Chartered and The Segal Company in the compliance audit report presented to the Board on January 28, 2002, that they request such a ruling on the Deferred Compensation Plan.

NPERS has not obtained an IRS ruling letter on the Deferred Compensation Plan since 1985. The Plan Document has been updated since the time of the last ruling and there have been significant changes since 1985.

Without an IRS ruling letter stating the Nebraska 457 Plan is an eligible Plan, the Nebraska Deferred Compensation Plan may not be operating as an IRS eligible plan.

> We recommend NPERS submit their Plan Document to the IRS and obtain an IRS ruling letter to determine whether the Nebraska 457 Plan is an eligible plan. We also recommend the Board implement a policy dictating when and how often an IRS ruling letter should be obtained.

NPERS' Response: Since there is a charge incurred for an IRS ruling letter, we will review our budget and determine when we will be able to submit the appropriate documentation to the IRS for a ruling letter. Board discussion will also be generated on this subject concerning the implementation of a policy to determine when and how often the ruling letter will be obtained.

7. Reconciliation of Bank Records to the Nebraska Information System

During the audit of the Comprehensive Annual Financial Report (CAFR) of the State of Nebraska, the Auditor of Public Accounts (APA) noted the absence of reconciliation between the Nebraska State Treasurer's actual bank statements and Nebraska accounting records (in both the Nebraska Information System (NIS) and the Nebraska Accounting System (NAS), system before NIS). This has been an issue for the Department of Administrative Services Accounting Division (State Accounting) for many years. The APA's previous comments noted monthly reconciliations have not been completed in a timely manner and reconciliations performed have shown significant unknown variances between the bank records and the accounting records, with the bank being short compared to the accounting records. Although State Accounting continues to work on correcting the reconciliation of bank records to NIS, the APA continues to note areas where improvement is still needed in the reconciliation process to ensure NIS integrity and operational efficiency. Specifically, the APA noted the status of the reconciliation process as of December 19, 2005, to be as follows:

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Reconciliation of Bank Records to the Nebraska Information System</u> (Concluded)

State Accounting has worked on the reconciliation process, but continued progress is needed. State Accounting's reconciliation process has developed into a very detailed process of analyzing bank activity, compared to activity recorded on NIS, to identify reconciling items. State Accounting has completed their reconciliation process for the months of July of 2004, and May, June, and July of 2005. The APA has reviewed these reconciliations. The months of May, June, and July show variances of $3,425,381, $3,405,702, and $3,405,862, respectively. Again, the reconciliations show the bank being short compared to the accounting records. Per inquiry of management, State Accounting has started the reconciliation process for various months of the fiscal year ended June 30, 2006; however, the reconciliation process has not been a continuous monthly process and no monthly reconciliation has been completed since July of 2005.

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial information. Without a timely and complete reconciliation of bank records to the NIS, there is a greater risk for fraud and errors to occur and to remain undetected.

Although State Accounting has worked on the reconciliation process, the process is still not done in a timely manner. The reconciliation continues to reflect unknown variances and shortages. Complete and timely reconciliation procedures between bank records and accounting records are required to provide control over cash and accurate financial information.

> We recommend State Accounting continue their reconciliation process, in a more timely manner, and on at least a monthly basis, to ensure all financial information is correct on NIS. We also recommend, when a consistent cash variance between the bank records and the accounting records is obtained (based on at least six months of reconciliations), DAS submit their plan for adjusting NIS to the Governor and the Legislature so they may take appropriate action to correct NIS and resolve the variances noted.

This issue is the responsibility of State Accounting; however, as the variances have not been identified by fund or agency, this issue directly affects all Nebraska State agencies' financial information and must be disclosed in this report.

NPERS' Response: The responsibility for resolving this issue lies with the State of Nebraska Department of Administrative Services (DAS) and the Nebraska Information System implementation team. NPERS does not have the authority to address this issue.

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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) - Deferred Compensation Plan as of and for the calendar year ended December 31, 2005, as listed in the Table of Contents. These financial statements are the responsibility of the 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 - Deferred Compensation Plan 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 - Deferred Compensation Plan as of December 31, 2005, 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 July 25, 2006, on our consideration of the Nebraska Public Employees Retirement Systems - Deferred Compensation Plan's internal control over financial reporting and on 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.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Nebraska Public Employees Retirement Systems - Deferred Compensation Plan taken as a whole. The accompanying supplementary schedule of Contributions and Distributions and schedules of Hartford and Ameritas Funds Investment Returns are presented for purposes of additional analysis and are not a required part of the financial statements of the Nebraska Public Employees Retirement Systems – Deferred Compensation Plan. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the 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

July 25, 2006 — Assistant Deputy Auditor

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN
STATEMENT OF PLAN NET ASSETS
AS OF DECEMBER 31, 2005

ASSETS	DEFERRED COMPENSATION
Cash in State Treasury	$ 55,447
Receivables:	
Interest Receivable	12,285
Investments (Note 4):	
Pooled Funds	106,069,157
Money Market Funds	3,369,542
Mutual Funds	9,890,216
Guaranteed Investment Contracts	15,677,326
Total Investments	135,006,241
Invested Securities Lending Collateral (Note 4)	457,039
Capital Assets (Note 8):	
Equipment	17,381
Less: Accumulated Depreciation	(8,741)
Total Capital Assets	8,640
Total Assets	135,539,652
LIABILITIES	
Accrued Compensated Absences (Note 6)	4,414
Other Payables (Note 9)	17,021
Obligations Under Securities Lending (Note 4)	457,039
Capital Lease Obligations (Note 5)	10,190
Total Liabilities	488,664
Net assets held in trust for pension benefits	$ 135,050,988

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

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2005

	DEFERRED COMPENSATION
ADDITIONS:	
Contributions:	
Plan member	$ 8,254,966
Investment income:	
Net income (loss) from investing activities	8,743,685
Securities lending income	13,880
Securities lending expense	(13,354)
Net investment income (loss)	8,744,211
Total Additions	16,999,177
DEDUCTIONS:	
Benefits	9,447,053
Administrative expenses	110,301
Total Deductions	9,557,354
Net Increase (Decrease)	7,441,823
Net assets held in trust for pension benefits:	
Beginning of year	127,609,165
End of year	$ 135,050,988

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

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2005

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 (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 School Employees, Judges, and State Patrol Retirement Plans and the State and County Employees Retirement Plans.

The financial statements reflect only the Deferred Compensation Plan and do not reflect all activity of the Nebraska Public Employees Retirement Systems.

Basis of Presentation. The accompanying financial statements of NPERS - Deferred Compensation Plan, 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 liabilities associated with the operation of these funds are included on the Statements of Plan Net Assets.

The Deferred Compensation Plan’s 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 contributions are recognized in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the 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 Deferred Compensation Plan were designated for investment during 2005.

Investments. Investments as reported in the financial statements include long-term investments. Law or legal instruments may restrict these investments. All investments are stated at fair value based on quoted market prices. Guaranteed investment contracts are carried at contract value as reported to the Nebraska Investment Council by the investment fund manager. The State Treasurer and Hartford are the custodians of the funds. The Nebraska Investment Council and Harford have the responsibility for the investments.

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

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

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

The following summary description of the Nebraska Deferred Compensation Plan is provided for general information purposes. Participants should refer to Neb. Rev. Stat. Sections 84-1504 through 84-1513 for more complete information. The financial statements reflect only the Deferred Compensation Plan and do not reflect all the activity of the Nebraska Public Employees Retirement Systems.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Description (Continued)

The Deferred Compensation Plan (the Plan) is a voluntary defined contribution pension plan. The Plan was implemented in 1976 and is in accordance with 26 U.S.C. Section 457 (2005) under the administrative responsibility of the Nebraska Public Employees' Retirement Board (the Board). The Plan, available to all State employees, School employees, and County employees whose employer does not offer a similar plan providing services to the State, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

Per Neb. Rev. Stat. Section 84-1505(1) R.R.S. 1999, "All compensation deferred under the plan, all property and rights purchased with the deferred compensation, and all investment income attributable to the deferred compensation, property, or rights shall be held in trust for the exclusive benefit of participants and their beneficiaries by the State of Nebraska until such time as payments shall be paid under the terms of the deferred compensation plan."

A. Contributions

Participants of the Plan are required to defer a minimum amount of $25 per month. Additionally, deferrals must not exceed the lesser of 100% of includible compensation or the annual dollar limit established by the IRS. During the 2005 calendar year the annual dollar limit per the IRS was $14,000. Exceptions to the maximum deferral rule include the Age 50 Catch-Up and the Special Section 457 Catch-Up. Members over the age of 50 who elect the Age 50 Catch-Up are allowed to defer the Plan ceiling amount of $14,000 plus an additional set amount of $4,000 for the 2005 calendar year. Members within 3 years of retirement are allowed to elect the Special Section 457 Catch-Up. Under this election, the member is allowed to defer the lesser of twice the current year's Plan ceiling or the Plan ceiling plus the underutilized limitation from prior year contributions. The underutilized limitation is the sum of the current year's Plan ceiling and the Plan ceiling for any prior years less any compensation deferred during those prior years. The Age 50 Catch-Up and the Special Section 457 Catch-Up cannot be combined.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Plan Descriptions (Concluded)

B. Participant's Account

Each participant's account is credited with the participant's contributions and an allocation of the investment earnings or losses. Allocations are based on participant account balances as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

C. Distributions to Participants

Distributions of benefits to participants can be made upon termination, retirement, death, or unforeseeable emergency. Distributions are in the form of a lump sum payment in cash equal to the value of the funds allocated to their account, an annuity option, a systematic withdrawal option, or a deferral option.

3. Private Sector Administrative Agreements

Ameritas Life Insurance Company of Lincoln, Nebraska (Ameritas) is a private sector administrator of the Plan, with the exception of the assets at Hartford. Under the terms of the agreement and automatic extensions, Ameritas provided various accounting and reporting services and received compensation through maintenance fees charged against each participant account.

The State Treasurer has contracted with State Street Bank of Boston, Massachusetts to be the custodian of the Deferred Compensation Plan's funds, with the exception of the assets at Hartford. The Nebraska Investment Council has also contracted with several investment managers, who manage each of Ameritas' funds. Each investment manager charges a unique management fee, which is deducted from the returns on the investment funds.

Hartford Life is also a private sector administrator of the Plan. Participants were able to maintain their accounts at Hartford Life or transfer the accounts to Ameritas' funds. No additional contributions are allowed in the Hartford funds. Hartford maintains approximately $50 million in Plan assets, is the custodian of these funds, and also charges fees to member accounts.

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Investments

Investments. Listed below is a summary of the investment portfolio that comprises the Investments on the Statement of Plan Net Assets. All securities purchased or held must be in the custody of the State or deposited with an agent in the State's name. Neb. Rev. Stat. Section 72-1239.01 R.R.S. 2003 authorizes the appointed members of the council to "act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims by diversifying the investments of the assets of the retirement systems."

NPERS' investments for the Deferred Compensation Plan at December 31, 2005, are presented below. All investments are presented by investment type and debt securities are presented with effective duration presented in years.

Deferred Compensation Plan Investments
at December 31, 2005

	Fair Value	Effective Duration
Debt Securities		
Money Market Funds	$ 3,369,542	0.07
Other Investments		
Investment Contracts	15,677,326	
Mutual Funds	9,890,216	
Pooled Funds	106,069,157	
Total Investments	135,006,241	
Securities Lending Short-Term Collateral Investment Pool	457,039	
Total	$ 135,463,280	

The Pooled Funds above consist of Ameritas funds of $56,242,103 and Hartford funds of $49,827,054. Hartford is considered a pooled fund since the variable annuity contract with NPERS is an unregistered product. However, individual funds offered by Hartford are registered.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses

4. Investments (Continued)

the present value of cash flows, weighted for those cash flows as a percentage of the investments full price. The State has contracts with investment managers that limit the effective duration to within one year of the effective duration of the benchmark.

Credit Risk of Debt Securities. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The State has contracts with investment managers that set minimum quality ratings for securities. NPERS' rated debt investments as of December 31, 2005, were rated by Standards and Poor's and/or an equivalent national rating organization and the ratings are presented below using the Standard and Poor's rating scale.

Deferred Compensation Investments at December 31, 2005

		Quality Ratings
	Fair Value	**Unrated**
Money Market Funds	$ 3,369,542	$ 3,369,542

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The State has contracts with investment managers that limit the maximum amount for an issuer, excluding U.S. Treasury, U.S. Agency, mortgages and non-U.S. sovereign issuers, to 5 percent of the total account. At December 31, 2005, NPERS had no investments that exceeded 5 percent or more of total investments.

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The State has contracts with investment managers that limit foreign currency risk. At December 31, 2005, the deferred compensation plan did not have exposure to foreign currency risk.

Securities Lending Transactions. The State participates in securities lending transactions, where securities are loaned to broker-dealers and banks with a simultaneous agreement to return the collateral for the same securities in the future. The State's primary custodial bank administers the securities lending program and receives cash, United States government or government agency obligations, or convertible bonds at least equal in value to the market value of the loaned securities as collateral for securities of the type of loan at year end. At year end, the State had no credit risk exposure to borrowers because the amounts the State owes the borrowers exceed the amounts the borrowers owe the State. The collateral securities can not be pledged or sold by the State unless the borrower defaults. There are no restrictions on the amount of securities that can be loaned, and there were no losses from borrower default during the year.

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. Investments (Concluded)

Either the State or the borrowers can terminate all securities loans on demand. Cash collateral is invested in one of the lending agent's short-term investment pools that had average durations of 25 and 32 days (at the June 30, 2005 year end.) Because loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. There is no loss indemnification provided to the State by the contract with the custodian.

5. Contingencies and Capital Lease Commitments

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

A. Motor vehicle liability, which is insured for the first $5 million of exposure per accident with a self-insured retention of $300,000 per accident, except for accidents involving vehicular pursuit which have a $1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.

B. Health care and life insurance for eligible employees.

C. Crime coverage, with a limit of $1 million for each loss, and a $25,000 self-insured retention per incident was in effect from July 1, 2005 through October 18, 2005. Starting October 19, 2005 the limit for each loss was increased to $21 million.

D. Real and personal property on a blanket basis for losses up to $250,000,000, with a self-insured retention of $200,000 per loss occurrence. Newly acquired properties are covered up to $5,000,000 for 90 days or until the value of the property is reported to the insurance company. The perils of flood, earthquake, and acts of terrorism have various coverages, sublimits, and self insurance. Details of these coverages are available from the Department of Administrative Services Risk Management Division. State agencies have the option to purchase building contents and inland marine coverage.

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. Contingencies and Capital Lease Commitments (Continued)

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

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

The second Master Lease Agreement, dated November 1, 2001, was for $2,166,847 including interest costs of $241,847, a rate of 3.245%. The third Master Lease Agreement, dated July 15, 2002, was for $6,029,861 including interest costs of $644,861, a rate of 3.129%. The first Master Lease Agreement was integrated 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 lease agreements are made with NPERS, not any of the individual plans. The payments are allocated according to the expense allocation policy of NPERS. The minimum annual lease payments and the present value of future minimum payments for all capital leases as of December 31, 2005, are as follows:

Year	Deferred Compensation Plan
2006	$ 2,602
2007	2,584
2008	2,331
2009	2,019
2010	652
2011	2
Total Minimum Payments	10,190
Less: Interest and Executory costs	608
Present value of net minimum payments	$ 9,582

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. Contingencies and Capital Lease Commitments (Concluded)

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

6. Compensated Absences

All permanent employees working for NPERS 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.

NPERS 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.

The Plan recognizes 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 the Deferred Compensation Plan at December 31, 2005, is as follows:

	DCP
Annual Leave	$ 2,352
Sick Leave	2,057
Compensatory Leave	5
	$ 4,414

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2005, are summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Compensated Absences	$ 2,850	$ 1,564	$ -	$ 4,414	$ 637
Capital Lease Obligations	12,472	-	2,282	10,190	2,602
Totals	$ 15,322	$ 1,564	$ 2,282	$ 14,604	$ 3,239

8. Capital Assets

Capital asset activity for the year ended December 31, 2005, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Equipment	$ 17,381	$ -	$ -	$ 17,381
Less: Accumulated Depreciation	6,258	2,483	-	8,741
Capital Assets, Net	$ 11,123	$ (2,483)	$ -	$ 8,640

9. Other Payables

Other payables consisted of payables for investment purchases, other investments payable recorded by the custodial bank, and investment fees payable.

Securities are recorded on a trade date basis. On the trade date, the Plan owns the asset; however, if the security has not settled, payment has not been received or made. Payables for investment sales and purchases represent securities in which the asset has been recorded as of December 31, 2005, but the security has not settled.

10. Subsequent Events

Effective July 1, 2006, Union Bank and Trust replaced Ameritas as the record keeper for the State, County, and Deferred Compensation Plan assets.

Effective September 30, 2006, the Director of NPERS has submitted her resignation.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION EMPLOYEES RETIREMENT PLANS
SCHEDULE OF CONTRIBUTIONS AND DISTRIBUTIONS

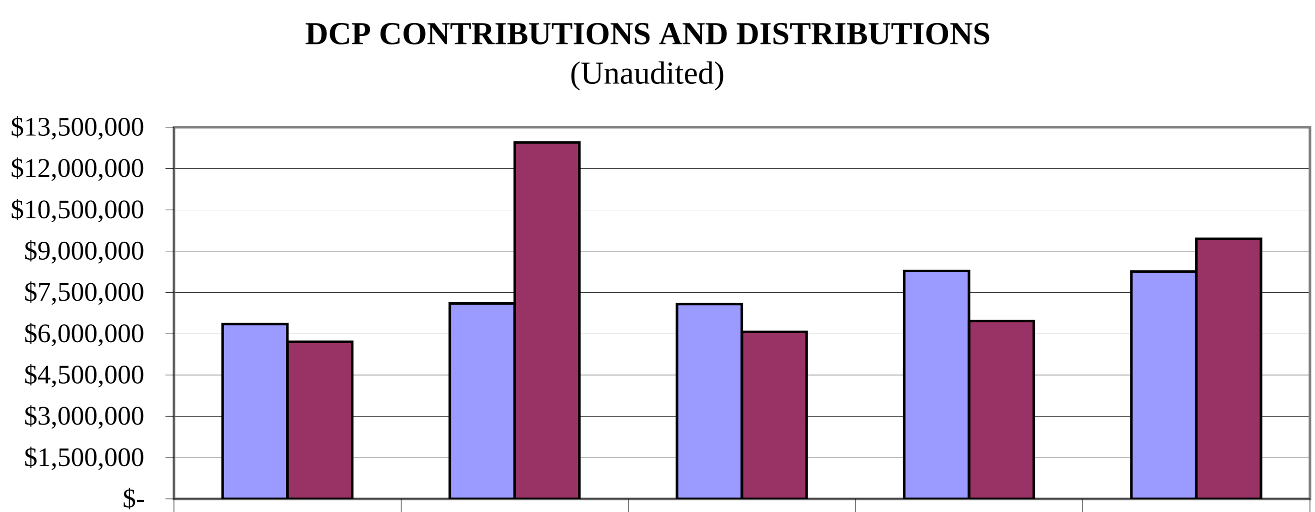
	2001	(Unaudited) 2002	(Unaudited) 2003	(Unaudited) 2004	2005
CONTRIBUTIONS					
Ameritas Contributions	$ 6,353,091	$ 7,079,297	$ 7,080,745	$ 8,268,085	$ 8,254,966
Hartford Contributions	-	23,866	-	12,314	-
Total Contributions	$ 6,353,091	$ 7,103,163	$ 7,080,745	$ 8,280,399	$ 8,254,966
DISTRIBUTIONS					
Ameritas Distributions	$ 2,440,737	$ 5,788,329	$ 2,711,444	$ 3,587,811	$ 4,840,475
Hartford Distributions	3,268,119	7,159,519	3,354,775	2,873,534	4,606,578
Total Distributions	$ 5,708,856	$ 12,947,848	$ 6,066,219	$ 6,461,345	$ 9,447,053

Note: Participants were no longer allowed to contribute to Harford after 1997; however, participants are allowed to transfer their Ameritas account balances to Hartford at the date of termination or at retirement if participants currently have funds with Hartford. Participants in Hartford are allowed to maintain balances at hartford or transfer their balances to Ameritas.

Note: The amounts used are cash basis.

Note: Rollovers from Hartford funds to Ameritas have been adjusted. Hartford considers these rollovers distributions; however, they have not left the Plan. Ameritas recorded the rollovers as contributions.

Note: Hartford contributions represent rollovers into Hartford from IRA's as allowed by the Plan document.



	2001	2002	2003	2004	2005
Contributions	$6,353,091	$7,103,163	$7,080,745	$8,280,399	$8,254,966
Distributions	$5,708,856	$12,947,848	$6,066,219	$6,461,345	$9,447,053

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN
SCHEDULE OF HARTFORD FUNDS INVESTMENT RETURNS
(UNAUDITED)

Fund Name	Investment Returns Year Ending 12/31/05
American Century Balanced	3.9%
American Century Income & Growth	3.9%
American Century Select	0.0%
American Century Ultra	1.3%
American Century Value	4.1%
Calvert Social Balanced	4.9%
EUROPACIFIC Growth	19.7%
Fidelity Balanced	4.2%
Fidelity Growth Opportunities	7.6%
Fidelity Growth & Income	6.2%
Fidelity Overseas	13.3%
Fidelity Value	1.4%
General[①]	4.0%
Growth Fund of America	12.9%
Hartford Advisors	6.4%
Hartford Capital Appreciation	14.7%
Hartford Dividend & Growth	5.2%
Hartford Index	3.7%
Hartford International Opportunities	13.8%
Hartford Money Market	2.1%
Hartford Mortgage	1.6%
Hartford Stock	8.8%
Hartford Bond	1.7%
New Perspective	10.0%
Putnam High Yield Advantage	2.4%
Putnam Vista	11.3%
Scudder Growth & Income	5.0%
Skyline Special Equities	10.0%

Source: Nebraska Investment Council Performance Report (Fourth Quarter 2005)

① Rate of return for the General fund is not included in the Nebraska Investment Council Performance Report as the rate of return is guaranteed. The rate of return for the General fund is obtained from the quarterly plan summaries.

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN
SCHEDULE OF AMERITAS FUNDS INVESTMENT RETURNS
(UNAUDITED)

Fund Name	Investment Returns Year Ending 12/31/05
Aggressive Premixed Fund	6.0%
Bond Market Index	2.4%
Conservative Premixed Fund	4.1%
International Stock Fund	-
Investor Select Fund	-
Lg. Co. Growth Stock Index	5.1%
Lg. Co. Value Stock Index	7.2%
Moderate Premixed Fund	5.0%
Money Market Fund	3.0%
S & P 500 Stock Index	5.0%
Small Co. Stock Fund	6.1%
T. Rowe Stable Value	4.3%

Source: Nebraska Investment Council Performance Report (Fourth Quarter 2005)

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NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS
DEFERRED COMPENSATION PLAN

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 - Deferred Compensation Plan as of and for the year ended December 31, 2005, and have issued our report thereon dated July 25, 2006. We conducted our audit in accordance with generally accepted auditing standards 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 - Deferred Compensation Plan's internal control over financial reporting in order to determine our 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 - Deferred Compensation Plan's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the Comments Section of the report as Comment Number 1 (Monitoring of Hartford Assets).

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 consider the reportable condition noted above to be a material weakness.

Compliance and Other Matters

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

We also noted certain additional items that we reported to management of the Nebraska Public Employees Retirement Systems - Deferred Compensation Plan in the Comments Section of this report as Comment Number 2 (Required Minimum Distributions), Comment Number 3 (Timing of Initial Contributions), Comment Number 4 (Asset Charge Allocation), Comment Number 5 (Address Changes), Comment Number 6 (No Recent IRS Ruling Letter), and Comment Number 7 (Reconciliation of Bank Records to the Nebraska Information System).

This report is intended for the information and use of the Board 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

July 25, 2006 Assistant Deputy Auditor