

**ATTESTATION REPORT
OF THE
NEBRASKA INVESTMENT COUNCIL
JULY 1, 2009 THROUGH JUNE 30, 2010**

**This document is an official public record of the State of Nebraska, issued by
the Auditor of Public Accounts.**

**Modification of this document may change the accuracy of the original
document and may be prohibited by law.**

Issued on October 28, 2010

NEBRASKA INVESTMENT COUNCIL

TABLE OF CONTENTS

	<u>Page</u>
Background Information Section	
Background	1
Mission Statement	1
Organizational Chart	2
Comments Section	
Exit Conference	3
Comment and Recommendation	4 - 5
Financial Section	
Independent Accountant's Report	6 - 7
Schedule of Revenues, Expenditures, and Changes in Fund Balances	8
Notes to the Schedule	9 - 13
Government Auditing Standards Section	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Examination of the Schedule of Revenues, Expenditures, and Changes in Fund Balances Performed in Accordance with <i>Government Auditing Standards</i>	14 - 15
Statistical Section	16
Investments Managed as of December 31, 2009	17
Closing Investment Balances as of December 31 st	18
Annual Investment and Custodian Expenses	18

NEBRASKA INVESTMENT COUNCIL

BACKGROUND

The Nebraska Investment Council (Council) was established under 1967 and 1969 laws as a central State investment agency. The Council provides investment management services for the State.

The Council is governed by seven members. Five voting members are appointed by the Governor and confirmed by the Legislature. They serve five-year terms, with one expiring each year. The State Treasurer and the Executive Director of the Nebraska Public Employees Retirement Systems serve as non-voting members.

The Council establishes necessary and proper policies for the investment of funds for which it is responsible. Such policies include appropriate investment strategy decisions, selection of external managers, and allocation of funds among managers. The Council appoints a State Investment Officer, subject to the approval of the Governor and the Legislature. The State Investment Officer, with the assistance of Council staff, directs the investment of these funds in accordance with State statutes and the policies of the Council.

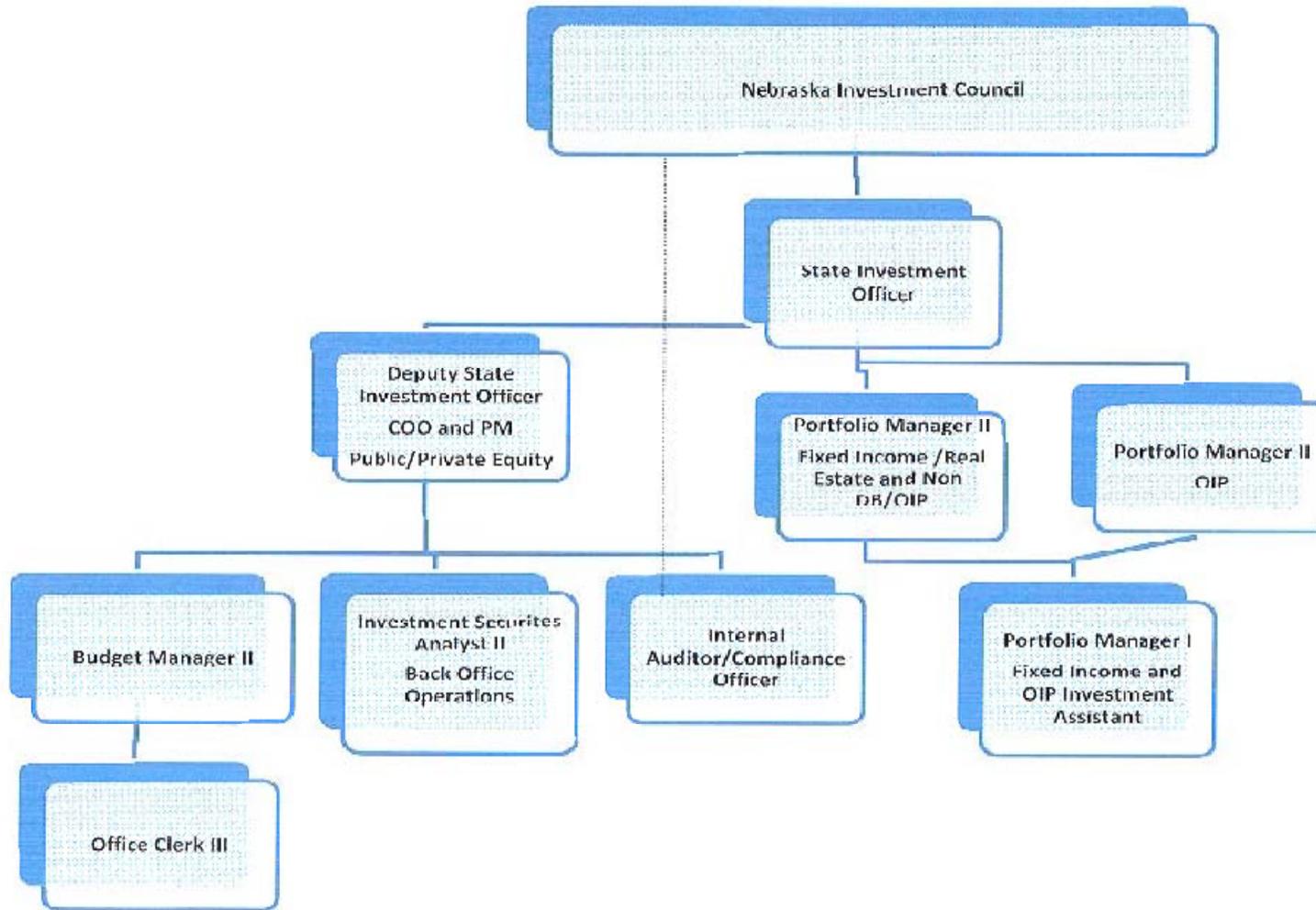
Funds managed include the State's general and cash funds; the State Patrol, Judges, School Employees, State Employees, and County Employees retirement plans and the Deferred Compensation Plan assets; and trust funds such as the Permanent School Fund, the Veterans' Aid Fund, and the Health Care Trust Fund.

MISSION STATEMENT

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

NEBRASKA INVESTMENT COUNCIL

ORGANIZATIONAL CHART



NEBRASKA INVESTMENT COUNCIL

EXIT CONFERENCE

An exit conference was held October 8, 2010, with the Council to discuss the results of our examination. Those in attendance for the Nebraska Investment Council were:

NAME	TITLE
Jeffrey States	State Investment Officer
Joseph P. Jurich	Deputy State Investment Officer
Richard DeFusco (via Teleconference)	Council Member
John L. Maginn (via Teleconference)	Council Member

NEBRASKA INVESTMENT COUNCIL

COMMENT AND RECOMMENDATION

During our examination of the Nebraska Investment Council, we noted a certain matter involving the internal control over financial reporting and other operational matters that is presented here.

Class Action Litigation

Neb. Rev. Stat. §§ 23-2330.02 (Reissue 2007), 24-713.02, 79-977.02, 81-2039, and 84-1329.04 (Reissue 2008) state, “All contributions to the retirement system, all property and rights purchased with the contributions, and all investment income attributable to the contributions, property, or rights shall be held in trust by the State of Nebraska for the exclusive benefit of members...”

Additionally, sound accounting practice and a good internal control plan require procedures to ensure amounts received for class action litigation are deposited with the appropriate plan. The Council manages the investment funds for the Defined Benefit (DB) (School Employees, Judges, and State Patrol) and Cash Balance Benefit (CBB) (State Employees and County Employees) Retirement Plans. The assets of the retirement plans are commingled together at State Street Bank (SSB). Class action litigation receipts may be received by the Council and forwarded to SSB for deposit or received directly by SSB. During testing of class action litigation receipts received directly by SSB, we noted two of ten receipts tested for \$62,708 and \$911 were not deposited exclusively in the DB Plans. The Council did not have procedures to verify SSB deposited the monies in the correct plan.

We calculated the estimated error using the retirement plan accounting statements at month end.

The plan accounting statements break out the assets by plan that are commingled together at the bank. The following is the estimated error by plan:

	Over/(Under) Deposited
School Employees Retirement Plan (including Omaha Schools)	\$ (60,252)
Judges Retirement Plan	\$ (1,037)
State Patrol Retirement Plan	\$ (2,330)
State Employees Retirement Plan	\$ 49,748
County Employees Retirement Plan	\$ 13,871

Without procedures to ensure proceeds from class action litigation are distributed to the appropriate plan there is an increased risk plan assets are under or overstated. A similar finding was also noted in the previous attestation report.

We recommend the Council ensure proceeds from class action litigation are deposited with the appropriate plan. We further recommend the Council determine the actual proceeds that were deposited improperly and make necessary adjustments at SSB.

NEBRASKA INVESTMENT COUNCIL

COMMENT AND RECOMMENDATION

(Continued)

Class Action Litigation (Concluded)

Council's Response: The Council has a set of procedures in place to address all aspects of its class actions process. The procedures address the receipt and deposit of all settlements, but not the verification of the ownership ratios applied by SSB. To better control the class action payment portion of this process, the procedures as updated require, "the internal auditor confirms that ownership ratios and dollar amounts of any and all settlements received have been deposited correctly." The Council has directed SSB to correct the two settlement payments where ownership questions existed. Looking forward, the Council has put in place a standing letter of direction to SSB that addresses this audit finding and several others that would present themselves as issues at some point if not included in this letter. Lastly, the Council will review all DB-only settlements paid in CY 2009 and 2010 and make any necessary adjustments and report its findings at the November 15, 2010 Council meeting.

It should be noted this report is critical in nature as it contains only our comment and recommendation on the area noted for improvement.

Draft copies of this report were furnished to the Council to provide them an opportunity to review the report and to respond to the comment and recommendation included in this report. The formal response received has been incorporated into this report. The response has been objectively evaluated and recognized, as appropriate, in the report. A response that indicates corrective action has been taken was not verified at this time, but will be verified in the next examination.

We appreciate the cooperation and courtesy extended to our staff during the course of the examination.



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
P.O. Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

NEBRASKA INVESTMENT COUNCIL

INDEPENDENT ACCOUNTANT'S REPORT

Nebraska Investment Council
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council (Council) for the fiscal year ended June 30, 2010. The Council's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting the schedule of revenues, expenditures, and changes in fund balances and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Investment Council for the fiscal year ended June 30, 2010, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2010, on our consideration of the Nebraska Investment Council's internal control over financial reporting (internal control) and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the internal control or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

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

Signed Original on File

October 18, 2010

Timothy J. Channer, CPA
Assistant Deputy Auditor

NEBRASKA INVESTMENT COUNCIL
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2010

	Nebraska Investment Council Cash Fund 27510	Operating Pool Distributive Fund 77500	Totals (Memorandum Only)
REVENUES:			
Sales & Charges	\$ 2,270,225	\$ -	\$ 2,270,225
Miscellaneous:			
Investment Interest	23,386	-	23,386
Other Miscellaneous	4	-	4
TOTAL REVENUES	<u>2,293,615</u>	<u>-</u>	<u>2,293,615</u>
EXPENDITURES:			
Personal Services	650,710	-	650,710
Operating	1,372,087	-	1,372,087
Travel	12,729	-	12,729
TOTAL EXPENDITURES	<u>2,035,526</u>	<u>-</u>	<u>2,035,526</u>
Net Change in Fund Balances	258,089	-	258,089
FUND BALANCES, JULY 1, 2009	<u>780,971</u>	<u>-</u>	<u>780,971</u>
FUND BALANCES, JUNE 30, 2010	<u>\$ 1,039,060</u>	<u>\$ -</u>	<u>\$ 1,039,060</u>
FUND BALANCES CONSIST OF:			
General Cash	\$ 1,041,954	\$ (18,461,347)	\$ (17,419,393)
Deposits with Vendors	504	-	504
Due to Vendors	(3,398)	-	(3,398)
Operating Pool Distributions	-	(855)	(855)
OIP Interest Receivable	-	18,462,202	18,462,202
TOTAL FUND BALANCES	<u>\$ 1,039,060</u>	<u>\$ -</u>	<u>\$ 1,039,060</u>

The accompanying notes are an integral part of the schedule.

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2010

1. Criteria

The accounting policies of the Nebraska Investment Council (Council) are on the basis of accounting as prescribed by the State of Nebraska Department of Administrative Services (DAS).

Per Neb. Rev. Stat. § 81-1107(2) (Reissue 2008), the State of Nebraska Director of Administrative Services duties include “The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes.”

In accordance with Neb. Rev. Stat. § 81-1111(1) (Reissue 2008), The State Accounting Administrator has prescribed the system of accounts and accounting to be maintained by the State and its departments and agencies and has developed necessary accounting policies and procedures. The prescribed accounting system currently utilizes EnterpriseOne to maintain the general ledger and all detailed accounting records. Policies and procedures are detailed in the Nebraska State Accounting Manual published by DAS State Accounting Division (State Accounting) and are available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances was obtained directly from the general ledger and fund balance information maintained on EnterpriseOne. As transactions occur, the agencies record the accounts receivables and accounts payable in the general ledger. As such, certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The expenditures and related accounts payables recorded in the general ledger as of June 30, 2010, include only those payables posted in the general ledger before June 30, 2010, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2010, **does not** include amounts for goods and services received before June 30, 2010, which had not been posted to the general ledger as of June 30, 2010.

Liabilities for accrued payroll and compensated absences are not recorded in the general ledger.

The fund types established by the State that are used by the Council are:

20000 – Cash Funds – account for revenues generated by specific activities from sources outside of State government and the expenditures directly related to the generation of the revenues. Cash funds are established by State statutes and must be used in accordance with those statutes.

70000 – Distributive Funds – account for assets held by the State as an agent for individuals, private organizations, other governments, and/or other funds.

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

(Continued)

1. Criteria (Concluded)

The major revenue account classifications established by State Accounting used by the Council are:

Sales & Charges – Monies drawn down by the Council from the funds held at State Street Bank. The monies are used for the expenditures of the Council.

Miscellaneous – Revenue from sources not covered by other major categories, such as investment income.

The major expenditure account classifications established by State Accounting used by the Council are:

Personal Services – Salaries, wages, and related employee benefits provided for all persons employed by the Council.

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

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

Other significant accounting classifications and procedures established by State Accounting and used by the Council include:

Assets – Resources owned or held by a government that have monetary value. Assets include cash accounts and deposits with vendors. Accounts receivable are recorded as an increase to revenues resulting in an increase to fund balance on the schedule. Cash accounts and deposits with vendors are also included in fund balance and are reported as recorded in the general ledger. For significant accounting procedures related to the Operating Pool Distributive Fund 77500 assets see Note 6.

Liabilities – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions are recorded as expenditures resulting in a decrease to fund balance.

2. Reporting Entity

The Nebraska Investment Council is a State agency established under and governed by the laws of the State of Nebraska. As such, the Council is exempt from State and Federal income taxes. The schedule includes all funds of the Council included in the general ledger.

The Nebraska Investment Council is part of the primary government for the State of Nebraska.

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

(Continued)

3. Totals

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

4. General Cash

General cash accounts are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Nebraska Investment Council that maintains an operating investment pool for such investments. Interest earned on those investments is allocated to funds based on their percentage of the investment pool.

5. Capital Assets

Capital assets include land, buildings, equipment, improvements to buildings, construction in progress and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items). Under State Accounting policies, expenditures for such capital assets are not capitalized as an asset in the funds used to acquire or construct them. Rather, costs of obtaining the capital assets are reflected as expenditures in the general ledger and are reported as such on the Schedule.

However, State Accounting does adjust such expenditures and reports the capital assets as assets for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). In addition, the Council takes an annual inventory and accounts for all equipment that has a cost of \$1,500 or more at the date of acquisition in the State Accounting System as well as all computer equipment.

For the CAFR, the State requires the Council to value all capital assets at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment that has a cost of \$5,000 or more at the date of acquisition and has an expected useful life of two or more years is capitalized. Depreciation expenses are reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend the asset's life is not capitalized.

Equipment is depreciated in the CAFR using the straight-line method with estimated useful lives of three to ten years.

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

(Continued)

5. Capital Assets (Concluded)

Capital asset activity of the Council recorded in the State Accounting System for the fiscal year ended June 30, 2010, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets:				
Equipment	\$ 20,685	\$ -	\$ -	\$ 20,685
Less accumulated depreciation for:				
Equipment				18,945
Total capital assets, net of depreciation				\$ 1,740

6. Operating Pool Distributive Fund 77500

The Operating Pool Distributive Fund 77500 (Fund) is used to record the receipting and distribution of investment income related to the State's Operating Investment Pool (OIP) and Time Deposit Open Account (TDOA). OIP and TDOA investment income transactions are recorded directly to the Fund's accounts receivable and liability accounts, rather than through a revenue or expenditure account.

DAS State Accounting records all interest and dividend income received as a credit to OIP Interest Receivable and a debit to General Cash in the State's general ledger. All other income, realized gains and losses, and management fees are recorded on EnterpriseOne using a liability account. Earned income that has not yet been received increases both the receivable and the liability accounts. Earned income is distributed to funds participating in the OIP by debiting the liability account and crediting cash. At the end of each month, the liability account should have a zero balance and the cash account should have a credit balance which equals the debit balance of the accounts receivable account.

The following table shows the activity of the Fund. The cash balance of the Fund represents dividends, interest, and net amortization receivable from the custodial bank.

Cash Balance July 1, 2009	Net Earned Income Received	Net Earned Income Allocated	Cash Balance June 30, 2010
\$ (21,321,791)	\$ 90,167,963	\$ (87,307,519)	\$ (18,461,347)

NEBRASKA INVESTMENT COUNCIL

NOTES TO THE SCHEDULE

(Continued)

7. Recaptured Commissions

The Council receives recaptured commissions on the purchase and/or sale of securities from certain broker dealers. The amount rebated is based on a certain percentage of the brokerage costs and is negotiated between the Council and individual broker dealers. Recaptured commissions are transferred into a separate account at State Street Bank (SSB) and are only to be used to pay for services that directly or indirectly benefit the participants of the investment plans that generated the recaptured commissions. Recaptured commission revenue is not recorded on the general ledger until the Council disburses money from this SSB account. When the Council records the revenues and expenditures on EnterpriseOne they will also submit a request to DAS Budget Division to increase their appropriations.

The following schedule shows recaptured commission amounts earned and used during fiscal year 2010:

Beginning Balance July 1, 2009	\$	132,673
Recaptured Commissions and Interest Earned		101,454
Recaptured Commissions Used for Expenses		(4)
Ending Balance June 30, 2010	\$	<u>234,123</u>



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
P.O. Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.state.ne.us

NEBRASKA INVESTMENT COUNCIL
**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN EXAMINATION OF
THE SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Nebraska Investment Council
Lincoln, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Investment Council as of and for the year ended June 30, 2010, and have issued our report thereon dated October 18, 2010. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our examination, we considered the Nebraska Investment Council's internal control over financial reporting (internal control) as a basis for designing our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, but not for the purpose of expressing an opinion on the effectiveness of the Nebraska Investment Council's internal control. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Investment Council's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Investment Council's financial schedule is 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 schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our examination, 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 noted a certain additional item that we reported to management of the Nebraska Investment Council in the Comments Section of this report as Class Action Litigation.

The Nebraska Investment Council's written response to the finding identified in our examination is described in the Comments Section of the report. We did not examine the Nebraska Investment Council's response and accordingly, we express no opinion on it. Where no response is indicated, the Council declined to respond.

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

Signed Original on File

October 18, 2010

Timothy J. Channer, CPA
Assistant Deputy Auditor

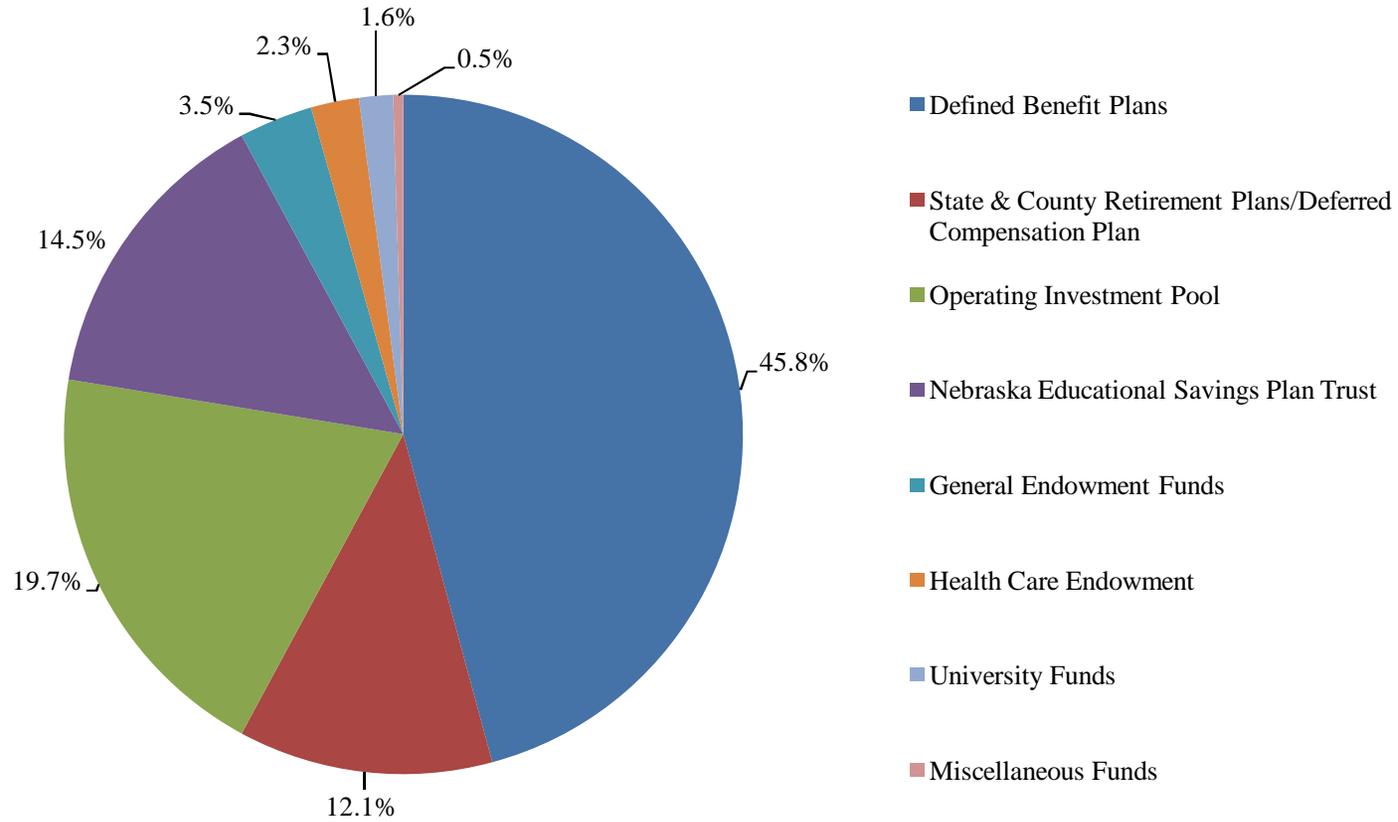
NEBRASKA INVESTMENT COUNCIL

STATISTICAL SECTION

Our examination was conducted for the purpose of forming an opinion on the schedule of revenues, expenditures, and changes in fund balances. Statistical Section information is presented for purposes of additional analysis. Such information has not been subjected to the procedures applied in the examination of the schedule of revenues, expenditures, and changes in fund balances, and, accordingly, we express no opinion on it.

NEBRASKA INVESTMENT COUNCIL

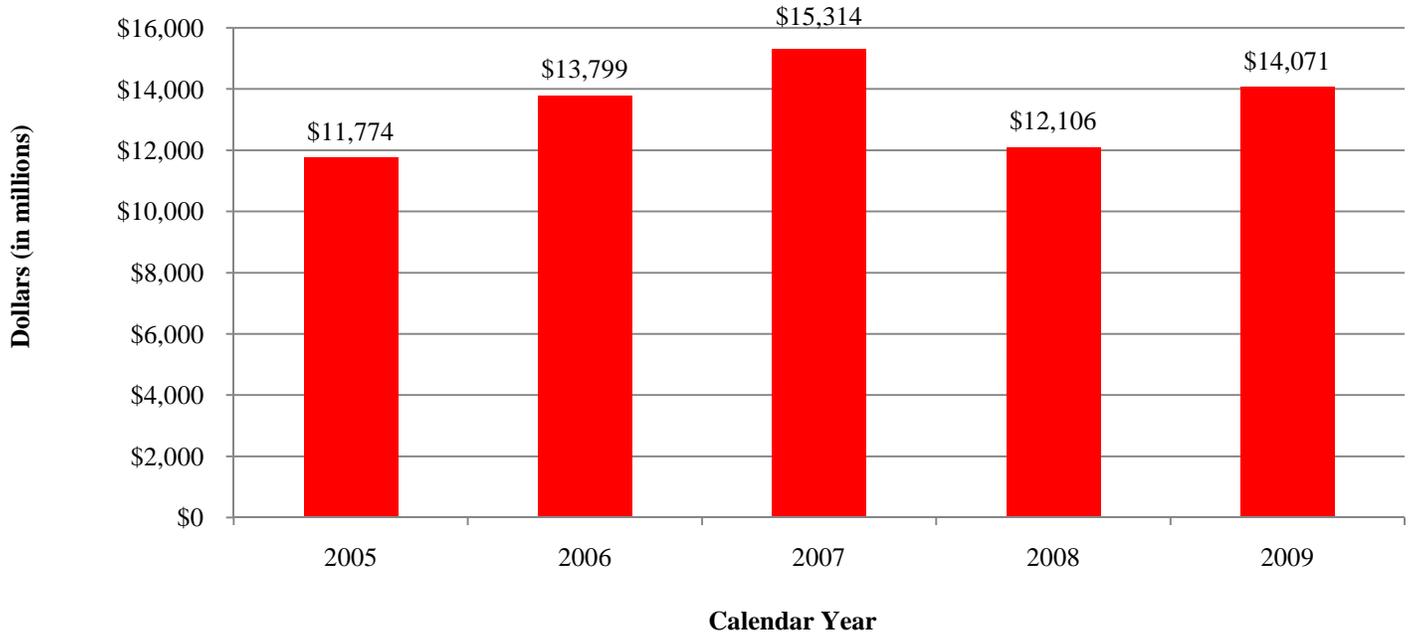
Investments Managed as of December 31, 2009



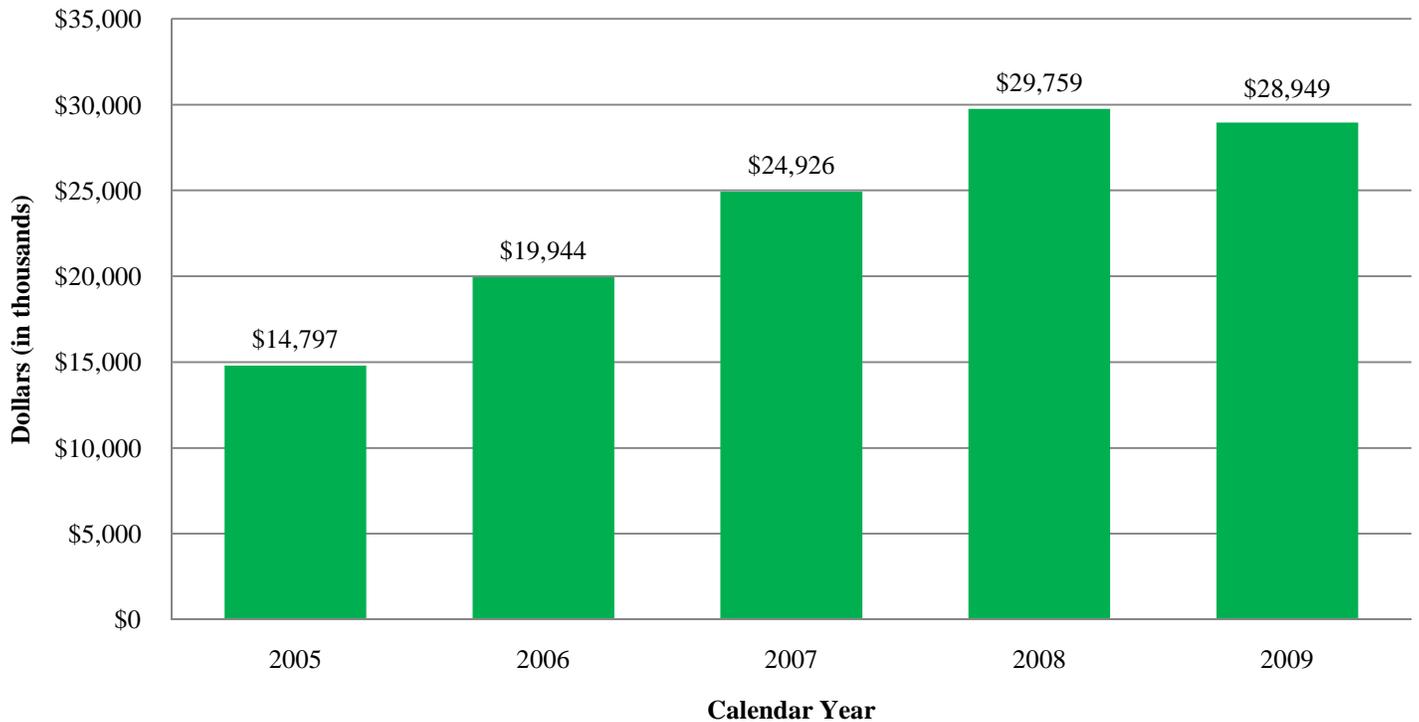
The Nebraska Investment Council (Council) manages the investments of 31 different entities. Numerous organizations may be included in a single entity (ie. the Operating Investment Pool is made up of many separate departments of State government). These 31 entities fall into eight major categories which are displayed above. For all these entities, the Council's responsibilities are primarily related to asset management. The Council does not determine the amount of funds contributed to nor disbursed from the funds it manages. The closing balances as of December 31st for the investments managed by the Council as well as expenses for the past five years are displayed on the following page. For a complete breakdown of investment holdings and expenses for each year see appropriate annual report published by the Council.

Source: Nebraska Investment Council Calendar Year 2009 Annual Report

Closing Investment Balances as of December 31st



Annual Investment and Custodian Expenses



Source: Nebraska Investment Council Calendar Year 2009 Annual Report