



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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January 30, 2019

Michael Walden-Newman, State Investment Officer
Nebraska Investment Council
1526 K Street, Suite 420
Lincoln, Nebraska 68508

Dear Mr. Walden-Newman:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State) as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have issued our report thereon dated January 4, 2019. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Investment Council (Council) or other operational matters that are presented below for your consideration. The comment and recommendation, which has been discussed with the appropriate members of the Council's management, is intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness.

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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination

of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the comment below (Improper Investment Classifications) to be a material weakness.

That comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We did not identify any deficiencies in internal control that we consider to be significant deficiencies.

Draft copies of this letter were furnished to the Council to provide management with an opportunity to review and to respond to the comment and recommendation contained herein. Any formal response received has been incorporated into this letter. Such response has been objectively evaluated and recognized, as appropriate, in the letter. A response that indicates corrective action has been taken was not verified at this time, but it will be verified in the next audit.

The following is our comment and recommendation for the year ended June 30, 2018.

1. Improper Investment Classification

The Nebraska Investment Council (Council) contracted with State Street Bank (SSB) to perform custodial banking services of the State's investments for the fiscal year ended June 30, 2018. SSB ensured the State's investments were properly recorded, including investment balances, sales and purchases, investment classifications, ratings, etc. The Council was responsible for reviewing the activity to ensure investments held by the custodian were accurate and complete.

The Department of Administrative Services – State Accounting (DAS) utilized the SSB investment holdings report to generate the investment classifications contained in the financial statements, and Deposits and Investments Portfolio note disclosure, for the Comprehensive Annual Financial Report (CAFR). During testing of the SSB investment holdings report, we noted two securities were not properly presented at June 30, 2018, as follows:

- One security, valued at \$1,762,896,802 was correctly classified by SSB with an investment type name of mutual funds. However, SSB incorrectly classified the investment major and minor industry names as cash equivalents when they should have been commingled funds. DAS utilizes all of those classifications to make a determination of how to report for financial statement presentation. The Auditor of Public Accounts (APA) questioned the DAS financial statement presentation of short-term investment, and the Council confirmed with SSB the security should have been presented as commingled funds. DAS made the correction for the CAFR.
- A second security, valued at \$76,854,796, was correctly classified by SSB with an investment type name of limited partnership. However, SSB incorrectly classified the investment major and minor industry names as cash equivalents when they should have been venture capital. The APA questioned the DAS financial statement presentation of private real estate, and the Council determined it should have been classified as a private equity investment. DAS made the correction for the CAFR.

Good business practices include collaboration between DAS and the Council to review the accuracy of investments classifications for CAFR financial statement presentation.

Without such a review process, there is an increased risk for material misstatement of financial reporting.

We recommend the Council work with DAS to review the accuracy of CAFR investment classifications.

Council Response: We agree. The Council does assist when classifications are questioned by other state agencies or state auditors merging the bank classifications into the state's established classifications. This practice is outlined in the most recent APA Cash & Investment Presentation & Disclosure Memo dated 6.30.18, section titled "DAS Procedures for Preparation of Footnote." The Council will continue to assist agencies whenever asked to help ensure they meet GASB investment codification standards. Furthermore, the Council will continue to educate agencies about the State's various investment portfolios as requested.

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Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Council and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Council.

This communication is intended solely for the information and use of the Council, the Governor and State Legislature, others within the Council, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not intended to be, and should not be, used by anyone other than the specified parties. However, this communication is a matter of public record, and its distribution is not limited.



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