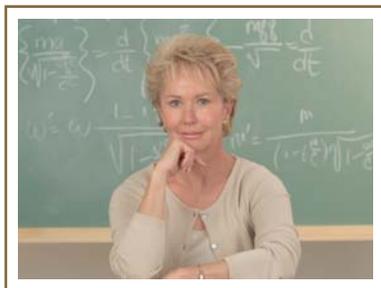


# State of Wisconsin Investment Board



2005 Fiscal Year Annual Report

*"Excellent performance; effective management; efficient service; through educated, ethical employees."*

**State of Wisconsin Investment Board**

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 Madison, WI 53707-7842

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 121 East Wilson Street  
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This document includes a brief overview of the assets under management by the Investment Board and the comparative financial statements and related notes for the fiscal years ending June 30, 2005, and June 30, 2004. A complete listing of the Board’s investments held as of June 30, 2005, is available on the Internet at [www.swib.state.wi.us](http://www.swib.state.wi.us) or by contacting the State of Wisconsin Investment Board.

**Vision**

To be a premier public investment organization, a place where professional excellence and public service thrive. Superior investment returns, the highest ethical and professional standards, teamwork to support the investment process and a rewarding work environment will make SWIB the investment management organization of choice.

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# INTRODUCTION

# Message from the Chair

As part of our responsibilities, SWIB constantly reviews the processes that drive our organization.

This past year, SWIB set out to determine the most desirable mix of management and investment styles for the retirement trust funds. Our aim is to achieve the best investment return after costs, taking appropriate risk and following best practices. This exercise considered portfolio management by SWIB staff (internal managers) and by external managers hired by SWIB. We also examined the use of active, passive and quantitative investment styles.



*James A. Senty*

Active managers seek individual stocks and bonds that will outperform the broader markets. Passive management is a low cost style that seeks the same return as a particular market index, such as the S&P 500. Quantitative management is a specialized active management that uses computer models to pursue somewhat greater returns than an index but with less risk than other forms of active management.

This exercise provided a clearer understanding of how well the different investment strategies performed over the last decade for us and for managers of other large public pension funds. The study showed that SWIB's active and quantitative managers generally outperformed their markets after costs. SWIB's internal managers were strong in some cases and in other cases, strong returns came from external managers. Our current mix of active, passive and quantitative styles appears to be appropriate.

As a result of this intensive study, SWIB is pursuing some changes in our strategies and continues to keep a careful eye on management fees. Performance is carefully monitored to ensure that we are positioned to earn the best long-term, after-cost returns, with appropriate risk.

Perhaps the most significant item that arose from this project was confirmation that SWIB needs the flexibility to select the mix of investment styles that can take advantage of new market opportunities quickly and efficiently. This mix changes over time.

SWIB has had less management flexibility than many of our peers. With the help of the Legislature and Governor, we have pursued several changes to allow us to do our job to the best possible extent. Changes include continuity of funding for internal portfolio management as well as additional flexibility to use external managers when that is the better choice.

We are also mindful that management flexibility must be balanced with accountability. In that spirit, we expanded the reporting we do to policy makers and participants so they have a better understanding of the reasoning behind management decisions.

While the study results did not reveal any need for dramatic changes in the way in which SWIB is investing the retirement trust funds, it did provide some useful insights that will make us a more effective investor now and in the future.

A handwritten signature in cursive script that reads "James A. Senty".

James A. Senty  
Chair  
June 30, 2005

# From the Executive Director

Wisconsin Retirement System members often ask "how do SWIB's investments affect me?" Members who are still working want to know how investment gains in their retirement account could impact their future pension. Retired members are interested in how near-term investment results affect the benefits they already receive. Although active and retired participants may have somewhat different perspectives, both benefit from SWIB's investment strategy, which has a long-term focus.



*David C. Mills*

SWIB works closely with the Department of Employee Trust Funds and its actuary to ensure that our investment strategy is aligned with long-term WRS benefit projections. As a result of careful long-term planning, employee and employer contributions, and solid investment returns, the WRS has avoided the funding problems that now afflict a number of other public pension systems. A recently updated 50-year projection by the actuary affirmed that the WRS should remain in sound financial condition even as the number of retirees increases significantly over the next decade.

By taking a long-term view, SWIB can select investments that may take a number of years to achieve gains. In addition, SWIB can find buying opportunities when short-term investors sell during down markets. Even more importantly, there is evidence that taking a short-term view can lead investors to jump in and out of the market at the wrong times. Being out of the markets for even a few days can make an enormous difference in long-term gains. For example, an investment of \$1,000 in the S&P 500 in 1985 grew to over \$7,200 by 2004. However, missing the ten best days of this 20-year period would have reduced the gain by about \$3,000, or 40% of the total.

While SWIB takes a long-term approach with 50 portfolios, we actively monitor and are active participants in the markets every day. In addition to a long-term outlook, our portfolio managers do consider current market conditions in selecting particular investments to buy or sell. Additionally, a small portion of assets are allocated to a portfolio which makes more opportunistic investments based on market momentum and other factors.

The long-term view that anchors our investment strategy has served active and retired WRS members well. At fiscal year end, the annual return for the Fixed Retirement Fund was 11.1% compared to 10.4% for its benchmark. The five- and ten-returns were 4.0% and 9.2% compared to the benchmark returns of 3.5% and 8.7% for the same periods.

Staying in volatile public markets can test an investor's patience. However, by focusing on a disciplined long-term plan we can weather the daily fluctuations and take full advantage of long-term appreciation of our holdings. That is the path to the best results for all participants of the Wisconsin Retirement System.

A handwritten signature in black ink, appearing to read "David C. Mills".

David C. Mills  
Executive Director  
June 30, 2005

# Overview

The State of Wisconsin Investment Board (SWIB) is a state agency responsible for investing the assets of the Wisconsin Retirement System (WRS), the State Investment Fund and five smaller trust funds established by the State. Investments are made according to the purpose and risk profile of each trust. The WRS includes the Fixed Retirement Investment Trust Fund (Fixed Trust Fund) and the Variable Retirement Investment Trust Fund (Variable Trust Fund).

SWIB is directed by a nine-person, independent Board of Trustees and staffed with professional money managers and support personnel. The Board of Trustees appoints the executive director of the Investment Board. The executive director oversees the staff, develops and recommends agency and investment policies for Board adoption, and ensures adherence to state law and policies.

## Assets Under Management - June 30, 2005

<u>Fund</u>	<u>\$ in Millions</u>	<u>% of Total</u>
<i>Fixed Retirement Investment Trust Fund</i>	\$ 63,996	86%
<i>Variable Retirement Investment Trust Fund</i>	6,018	8
Wisconsin Retirement System	70,014	94
State Investment Fund*	4,020	5
Various Funds		
Injured Patients and Families Compensation Fund	758	1
State Life Insurance Fund	87	0
Local Gov't Property Insurance Fund	43	0
Historical Society Trust Fund	11	0
Tuition Trust Fund	11	0
	<u>\$ 74,944</u>	<u>100%</u>

*\*Excludes deposits from Fixed Retirement Investment Trust Fund, Variable Retirement Investment Trust Fund and Various Funds.*

## Guidelines

Investments must be within guidelines established for each specific fund.

Investments must qualify as prudent under SWIB's standard of fiduciary responsibility.

# Cost of Management

Management costs of the State of Wisconsin Investment Board include external management and advisory fees, investment support services as well as expenses incurred to manage agency operations. The majority of expenses are fees paid to outside advisors, fund managers and index funds. Costs of other support services include custodial banking services, investment research, and legal services.

Agency operating expenses for staff compensation, overhead and equipment were \$16.7 million and represented about 11% of total costs. Expenses are paid from investment earnings of the funds SWIB manages.

SWIB participates in an annual independent review of costs which compares SWIB to other investment managers and public pension fund peers. The 2004 analysis provided by Cost Effectiveness Measurement (CEM), Inc.<sup>1</sup> concluded that SWIB's total cost to manage the Fixed Trust Fund was 24¢ per \$100 managed. The CEM report indicated that this amount is similar to the costs incurred by other funds with a similar mix of assets.

The cost to manage the Fixed Trust Fund was \$146.9 million in 2004. This represents 94% of SWIB's total cost of management.

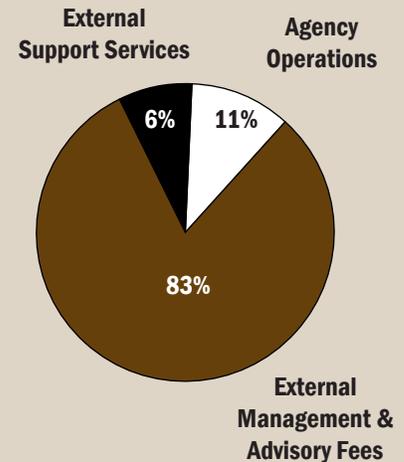
In addition to the Fixed Trust Fund, SWIB manages seven other funds. SWIB's costs to manage all funds were \$157.0 million, or 22¢ per \$100 managed in 2004.

## Total Management Costs

	<b>Calendar Year Ended 12/31/2004</b>
External Management & Advisory	\$ 130,450,300
Agency Operations	16,745,700
Consulting	2,521,900
Custodial Banking	3,782,900
Investment Research	3,398,700
Legal Fees	93,400
	<u>\$ 156,992,900</u>

## Management Costs

As of December 31, 2004



- Costs for managing all funds were 22¢ per \$100 under management.
- All management costs are funded with earnings from the funds.
- Total costs for managing all funds for the calendar year ending December 2004 were \$157.0 million.
- According to CEM<sup>1</sup>, SWIB's costs for the Fixed Trust Fund were considered normal based on the mix of assets managed.

<sup>1</sup> Cost Effectiveness Measurement, Inc. is a Toronto-based international benchmarking firm that provides cost measurement and analysis of corporate and public pension funds.

# Board of Trustees



Front (left to right) Thomas Boldt, James Senty, Eric Stanchfield, Back (left to right) Wayne McCaffery, Laura Engan, Stephen Bablitch, William Levit, Jr., David Geertsen, Deloris Sims

## Public members

**James Senty, Chair,** President, Midwest Gas Companies, La Crosse

**Thomas Boldt, Vice Chair,** President, The Boldt Group, Inc./CEO, The Boldt Co., Appleton

**Stephen Bablitch,** Former Chairman and CEO, Cobalt Corporation, Milwaukee

**David Geertsen,** Local Government, Finance Director, Kenosha County

**Deloris Sims,** President & CEO, Legacy Bank Inc., Milwaukee

**William Levit, Jr.,** Attorney, Godfrey & Kahn S.C., Milwaukee

## WRS Participant Members

**Wayne McCaffery,** Educator, Teacher, Stevens Point

**Eric Stanchfield, Secretary,** Non-educator, Secretary, Department of Employee Trust Funds

## Department of Administration

**Marc Marotta,** Department of Administration, Department Secretary

**Laura Engan,** Designee, Deputy Secretary, Department of Revenue

### Board Membership

- Six public members appointed by the Governor and confirmed by the State Senate including:
  - Four with at least 10 years investment experience.
  - One with at least 10 years financial experience and who works for a local government in the Local Government Investment Pool.
- Educator participant in the Wisconsin Retirement System (WRS) appointed by the Teacher Retirement Board.
- Non educator participant in the WRS appointed by the Wisconsin Retirement Board.
- Secretary of the Department of Administration or designee.  
*(Appointed Board members serve six-year terms.)*

### Board Responsibilities Include:

- To establish long-term investment policies.
- To establish each investment portfolio.
- To monitor investment performance.

# Agency Management

**Executive Director**  
David C. Mills

**Deputy Executive Director**  
Gail L. Hanson

**Chief Operating Officer**  
Kenneth W. Johnson

**Chief Legal Officer**  
Keith L. Johnson

**Director of Human Resources**  
Ledell Zellers

**Director of Quantitative Analytics**  
Ronald A. Mensink

## Public Equities

Directed by Jean C. Ledford

### Domestic

Jackie S. Doeler  
Steven F. Hilmer  
William A. McCorkle  
John F. Nelson  
Chad A. Neumann  
Trisha L. Reopelle

### International

Vacant

## Fixed Income

Directed by J. Alain Hung

### Domestic

Laurel A. Butler  
Todd A. Ludgate

### Global

Chirag J. Gandhi

## Private Markets

Directed by Robert H. Severance  
Charles R. Carpenter, Managing Director

### Real Estate

David Lewandowski  
Steven C. Spiekerman

### Private Equities

Monica A. Jaehnig  
Vacant

## SWIB Staff Quick Facts

- 104.5 authorized positions.
- A majority of the investment staff holds or is pursuing the Chartered Financial Analyst (CFA) designation.
- Top investment staff experience ranges between 5 and 32 years.
- The Board adheres to the industry standards of the CFA Institute.

# Investor Responsibility

SWIB's Investor Responsibility Program began in 1986 to address three main areas: corporate governance, social responsibility, and litigation. Our goal is to enhance long-term investment prospects and potential. SWIB's program staff and investment groups identify program strategies within parameters approved by the Trustees.

SWIB's program has two primary goals:

- (a) to protect and increase SWIB's long-term returns,
- (b) to meet SWIB's fiduciary obligation to manage shareholder rights as an asset of the trust funds.

Each year, we identify key corporate governance issues based on investment staff's recommendations and national trends.

SWIB determines ways to work with company management, corporate boards and other shareholders to make changes that should have a positive impact. Our first approach is to communicate with companies to resolve concerns. When necessary, SWIB will withhold votes from director candidates through its proxy vote when issues are not resolved in the interests of shareholders. SWIB's proxy votes are posted on the website.

Our policies for voting social issue resolutions reinforce our investment goals to enhance returns. Making investments or using proxy votes for the sole purpose of promoting social or political causes or goals is contrary to our fiduciary duties. However, some issues could impact a company's long-term viability.

We believe companies with socially unacceptable products or practices will feel the economic consequences of public disapproval or imposition of liability under laws protecting the public health and welfare. The result: negative aspects of a company's behavior will be felt on the economic bottom line over the long term.

If a governance failure creates a legal claim, SWIB considers legal action - often class action suits with other investors - to uphold shareholder rights. In some cases, we work with other large pension funds to protect shareholders through seeking regulatory changes and other actions.

Governance issues are considered when voting our proxies and evaluating investments. Issues may be brought to the attention of the Trustees if they have a significant financial impact on the companies involved.

## Corporate Governance Issues

**1. Effective corporate boards.** SWIB supports effective boards with a majority of independent directors who are willing to act in the best interest of shareholders. An independent director has no conflicts of interest with shareholders and is one whose only connection to the corporation is as a director and shareholder.

**2. Director Elections.** SWIB supports election of directors with a majority vote of shareholders. Shareholders now act in an advisory role in elections. SWIB would like to see a more democratic method. Although shareholders can currently withhold a vote for a director, the company can decide if the director will remain in office. SWIB supports changes to strengthen the voice of the shareholders when voting for directors.

**3. Executive compensation plans.** SWIB supports compensating executives at reasonable levels but believes compensation should be strongly correlated with performance. Further, all types of compensation including stock options, restricted stock, and other forms of non-cash compensation should be performance-based with a focus toward improving long-term shareholder value. SWIB further supports increased transparency and disclosure of compensation components including the goal setting process and method of attainment.

**4. Anti-takeover devices.** Shareholder rights plans, also known as poison pills, can be used to protect companies from hostile takeovers, but can also insulate ineffective management from being replaced. Shareholders should have the right to vote on all new poison pills and have the opportunity to ratify or reject existing pills at least every three years.

# Wisconsin Retirement System

The Wisconsin Retirement System (WRS) makes up 94% of the assets managed by SWIB. As a fiduciary for the funds, SWIB is dedicated to earning the best possible rate of return within acceptable risk parameters consistent with "prudent expert" standards. As of June 30, 2005, the total assets of the WRS were \$70 billion.

The WRS includes the pension funds available through most public employers in Wisconsin other than the City of Milwaukee and Milwaukee County. Participants include current and former employees of Wisconsin's state agencies and local governments. Contributions made to the WRS by these employees and their employers are invested by the Investment Board to finance retirement benefits.

More than 527,000 people participate in the WRS. Investment earnings account for the majority of the annuities paid, thus lowering the costs paid by taxpayers. Over \$2.8 billion in benefits were paid in 2004 to 126,000 annuitants in the WRS.

The WRS is comprised of two trust funds. The larger of the two is the Fixed Trust Fund, which is a broadly diversified portfolio of stocks, bonds, real estate and other holdings. The second fund is the Variable Trust Fund, which is invested in stocks.

The process for determining the effect of investment returns on employee accounts ("effective rate") and changes in benefits for retirees differs between the Variable and Fixed Trust Funds.

The Department of Employee Trust Funds (ETF) is responsible for administering the benefits of the WRS. Most employees who retire receive a pension annuity initially determined by a formula (calculated by ETF) using years of service, salary, and job type.

ETF computes those amounts based on the December 31 rate of return for each of the two trust funds to determine the impact on participants.

## WRS Quick Facts

- System includes more than 527,000 participants.
- 10th largest public pension fund in the US.
- 25th largest pension fund in the world.
- Comprised of Fixed Trust Fund, a balanced fund, and Variable Trust Fund, a stock fund.
- Fixed Fund gains and losses are spread over five years to smooth the effect on participants' accounts.
- Variable Fund annuities fully reflect prior year gains and losses of the investments.
- About 105,000 people participate in the Variable Fund.

## Annualized Performance Ending 6/30/05

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
<b>Fixed Fund</b>	<b>11.1%</b>	<b>4.0%</b>	<b>9.2%</b>
<i>Benchmark</i>	<i>10.4</i>	<i>3.5</i>	<i>8.7</i>
<b>Variable Fund</b>	<b>8.6%</b>	<b>-0.7%</b>	<b>9.0%</b>
<i>Benchmark</i>	<i>9.4</i>	<i>-1.0</i>	<i>8.4</i>
<i>S&amp;P 500</i>	<i>6.3</i>	<i>-2.4</i>	<i>9.9</i>

# State Investment Fund

The State Investment Fund (SIF) is a pool of cash balances of various state and local governmental units. The objectives of this fund are to provide safety of principal, liquidity and a reasonable rate of return. The Fixed Income Group manages the State Investment Fund.

The State Investment Fund includes retirement trust funds' cash balances pending longer-term investment by SWIB's other investment groups. This fund also functions as the State's cash management fund. By pooling the idle cash balances of all 58 state funds, it provides the State's general fund with the needed liquidity for operating expenses.

Over 1,100 local units of government also deposit revenues in the SIF until they are needed. These funds are commingled in the Local Government Investment Pool (LGIP).

The cash balances available for investment vary daily as cash is accumulated or withdrawn from the agency funds. The SIF is invested primarily in obligations of the US government and its agencies, and high quality commercial bank and corporate debt obligations. Net assets of the State Investment Fund as of June 30, 2005, were \$4.8 billion.

## Portfolio Characteristics as of June 30, 2005:

- 76% of Fund invested in US government securities.
- Average maturity 28 days versus iMoneyNet\* at 36 days.
- Short term liquidity (0 - 3 months) equal to 179% of LGIP and 94% of SIF.
- 53% of portfolio assets change rates overnight, 94% in three months.

To achieve our objectives, the SIF adheres to rigorous quality standards, careful attention to maturity schedules and emphasis on high marketability. Enhanced return is sought through intensive portfolio management, which considers probable changes in the general structure of interest rates.

Earnings for the State Investment Fund are calculated and distributed monthly, based on the participant's average daily balance as a percent of the total pool.

## SIF Quick Facts

- SIF provided a superior rate of return, ranking 1st out of 218 government money market funds.\*
- SIF also ranked 14th out of 1,250 money market funds (top 2%).\*

## State Investment Fund Annualized Time-Weighted Returns

<u>Fiscal Year</u>	<u>Return</u>
1996	5.4
1997	5.3
1998	5.4
1999	5.0
2000	5.5
2001	6.0
2002	2.5
2003	1.5
2004	1.0
2005	2.1

*\*Source: The iMoneyNet financial company money fund statistics.*

\* iMoneyNet All Taxable Money Market Index

# Various Funds

SWIB manages five funds for various state agencies. These funds make up just over 1% of the total assets managed. Each is invested to meet specific objectives.

## **HISTORICAL SOCIETY TRUST FUND**

The State Historical Society of Wisconsin is both a state agency and a private membership organization. SWIB is responsible for investing the endowment funds of the Society to help with its goal to promote a wider appreciation of the American heritage, with an emphasis on the collection, advancement, and dissemination of knowledge of the history of Wisconsin and the region.

## **LOCAL GOVERNMENT PROPERTY INSURANCE FUND**

The purpose of the Fund is to make reasonably priced property insurance available for tax-supported local government property such as government buildings, schools, libraries, and motor vehicles. The Fund provides policy and claim service to the policyholders.

## **STATE LIFE INSURANCE FUND**

The Fund is a state-sponsored life insurance program for the residents of Wisconsin. The applicant must be a state resident at the time of application for coverage through the Fund. The Fund operates on a nonprofit basis and receives no subsidies from the state.

## **INJURED PATIENTS AND FAMILIES COMPENSATION FUND**

The Fund was created by statute in 1975 to provide excess medical malpractice coverage for Wisconsin health care providers. Health care providers obtain primary medical malpractice insurance from private insurance companies in an amount required by law. Coverage in excess of the primary insurance is provided by the Fund. The program is administered by the Office of the Commissioner of Insurance.

## **TUITION TRUST FUND**

The Tuition Trust Fund was created to invest the funds for EdVest Wisconsin, a state-sponsored way to save for the cost of college expenses. It offers an investment opportunity designed to help families keep up with rising college tuition expenses. Participants purchase “tuition units” which can be redeemed and applied toward undergraduate tuition and fees at most public and private schools nationwide. SWIB is responsible for investing assets of the program, which are managed in the Tuition Trust Fund. This Fund is currently closed to new participants. Other options are administered through the Office of the State Treasurer.

### **For More Information:**

#### **State Historical Society**

(608) 264-6400

#### **Local Gov’t Property Insurance**

Office of the Commissioner of Insurance

(608) 266-3585 (Madison) or

(800) 236-8517 (toll-free)

#### **State Life Insurance Fund**

Office of the Commissioner of Insurance

(608) 266-0107 (Madison) or

(800) 562-5558 (toll-free)

#### **Injured Patients and Families Compensation Fund**

Office of the Commissioner of Insurance

(608) 266-6830 (Madison)

#### **EdVest**

Office of the State Treasurer

(608) 264-7899 (Madison) or

(888) 338-3789 (toll-free)

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**STATE INVESTMENT FUND**  
**Statement of Net Assets**  
**As of June 30, 2005 and June 30, 2004**

	June 30, 2005	June 30, 2004
<b>Assets</b>		
Investments (at fair value):		
Repurchase Agreements	\$ 2,071,000,000	\$ 1,268,000,000
Government and Agency	1,890,046,080	3,467,477,867
Commercial Paper	523,325,131	636,893,516
Certificates of Deposit (CDs)	700,000,000	596,996,534
Mortgage Backed Securities	616,012	862,947
Swap(s)	0	(9,126,554)
<b>Total Net Investments (at fair value)</b>	<b>\$ 5,184,987,223</b>	<b>\$ 5,961,104,310</b>
Other Assets:		
Accrued Interest Receivable	7,274,376	6,959,549
<b>Total Assets</b>	<b>\$ 5,192,261,599</b>	<b>\$ 5,968,063,859</b>
<b>Liabilities</b>		
Check Float Invested	\$ 367,426,645	\$ 328,135,862
Earnings Distribution Payable	12,671,151	5,068,647
Accrued Swap Payments	0	516,542
Accrued Expenses	70,000	64,000
<b>Total Liabilities</b>	<b>\$ 380,167,796</b>	<b>\$ 333,785,051</b>
<b>NET ASSETS</b>	<b>\$ 4,812,093,803</b>	<b>\$ 5,634,278,808</b>
Net Assets consist of:		
Participating Shares	\$ 4,812,220,000	\$ 5,641,214,000
Undistributed Unrealized Gains (Losses)	(126,197)	(6,935,192)
<b>NET ASSETS</b>	<b>\$ 4,812,093,803</b>	<b>\$ 5,634,278,808</b>

The accompanying notes, on pages 21 through 25, are an integral part of this statement.

## STATE INVESTMENT FUND

### Statement of Operations and Changes in Net Assets For the Fiscal Years Ended June 30, 2005 and 2004

	June 30, 2005	June 30, 2004
Investment Revenue		
Investment Income	\$ 124,796,956	\$ 82,208,976
Net Swaps Revenue (Expense)	(8,828,797)	(13,694,646)
<b>Total Investment Revenue</b>	<b>\$ 115,968,159</b>	<b>\$ 68,514,330</b>
Expenses		
Management Operating Expense Allocation	\$ 1,325,852	\$ 897,558
Custodial Bank Charges	177,500	195,043
State Treasurer Costs	0	46,461
Electronic Services	159,589	140,189
Legal and Consulting Fees	22,882	41,326
<b>Total Expenses</b>	<b>\$ 1,685,823</b>	<b>\$ 1,320,577</b>
<b>NET INVESTMENT REVENUE</b>	<b>\$ 114,282,336</b>	<b>\$ 67,193,753</b>
State Working Bank Charges Allocation	2,784,478	2,628,605
<b>Net Investment Income</b>	<b>\$ 111,497,858</b>	<b>\$ 64,565,148</b>
Distributions Paid and Payable	104,688,863	63,449,362
<b>Change in Undistributed Unrealized Gains (Losses)</b>	<b>\$ 6,808,995</b>	<b>\$ 1,115,786</b>
Beginning of Period Undistributed Unrealized Gains (Losses)	(6,935,192)	(8,050,978)
<b>End of Period Undistributed Unrealized Gains (Losses)</b>	<b>\$ (126,197)</b>	<b>\$ (6,935,192)</b>
Participant Transactions		
Receipts by Transfer to Fund	\$ 23,909,576,000	\$ 26,525,022,000
Disbursements by Transfer from Fund	(24,738,570,000)	(26,536,806,000)
<b>Net Change in Participating Shares</b>	<b>\$ (828,994,000)</b>	<b>\$ (11,784,000)</b>
Beginning of Period Participating Shares	5,641,214,000	5,652,998,000
<b>End of Period Participating Shares</b>	<b>\$ 4,812,220,000</b>	<b>\$ 5,641,214,000</b>
<b>Net Assets</b>	<b>\$ 4,812,093,803</b>	<b>\$ 5,634,278,808</b>

The accompanying notes, on pages 21 through 25, are an integral part of this document.



Summary Information by Investment Classification

	June 30, 2005				June 30, 2004	
	Interest Rates	Maturity Dates	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)	Fair Value
Repurchase Agreements	2.90-3.35	07/01/05-07/01/05	\$ 2,071,000,000	\$ 2,071,000,000	\$ 1,268,000,000	\$ 1,268,000,000
Government and Agency Commercial Paper	2.60-3.27	07/01/05-08/11/06	1,890,172,277	1,890,046,080	3,465,264,977	3,467,477,867
Certificates of Deposit	3.02-3.23	07/01/05-08/04/05	523,325,131	523,325,131	636,911,578	636,893,516
Asset Backed Securities	4.94	06/16/08	700,000,000	700,000,000	597,000,000	596,996,534
Mortgage Backed Securities	N/A	N/A	0	0	0	0
Yankee/Euro Issues	4.33	07/27/07	616,012	616,012	862,947	862,947
Swap(s)	N/A	N/A	0	0	0	0
		03/16/05	0	0	0	(9,126,554)
<b>Total Investments</b>			<b>\$ 5,185,113,420</b>	<b>\$ 5,184,987,223</b>	<b>\$ 5,968,039,502</b>	<b>\$ 5,961,104,310</b>
<b>Ratio of Fair Value to Book Value</b>				<b>99.9976%</b>		<b>99.8838%</b>



## 1. Description of Fund

The State Investment Fund (SIF) pools the excess cash of the State of Wisconsin and its Agencies, certain retirement funds, and various local government units (Local Government Investment Pool - LGIP) into a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. Only State of Wisconsin Agencies are required to invest their excess cash in the SIF. In the State's Comprehensive Annual Financial Report (CAFR), each State Agency's pro rata portion of the SIF is reported in their Generally Accepted Accounting Principles (GAAP) fund as "Cash and Cash Equivalents" while the funds of various local governments are reported as a separate fiduciary investment trust fund entitled "Local Government Pooled Investment Fund". The staff of the State of Wisconsin Investment Board (SWIB) manages the SIF with oversight by the Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. The SWIB is not registered with the SEC as an investment company.

Wisconsin Statutes 25.17(3)(b), (ba) and (bd) enumerate the various types of securities in which the SIF can be invested, which include direct obligations of the United States and Canada, securities guaranteed by the United States, securities of federally chartered corporations such as the African Development Bank, the unsecured notes of financial and industrial issuers, Yankee/Euro issues, certificates of deposit issued by banks in the United States and solvent financial institutions in Wisconsin and bankers acceptances.

The Board of Trustees may approve other prudent investments and has granted derivatives authority, subject to review and approval of the SWIB Investment Committee, limited to positions in finance futures, options and swaps and only if the purpose is to hedge existing positions, to adjust portfolio duration within statutory guidelines, or otherwise to reduce the interest rate risk to which SWIB is subjected in the normal course of business. Interest only and principal only securities, inverse floaters, and off balance sheet synthetic derivatives are not permitted.

## 2. Significant Accounting Policies

### A. Basis of Presentation

The accompanying financial statements of the investment activity of the SIF are prepared in accordance with Generally Accepted Accounting Principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

### B. Basis of Accounting

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Interest income is accrued as earned and dividend income is recorded on the ex-dividend date.

SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements.

### C. Valuation of Securities

Generally, investments are valued at fair value for financial statement purposes and amortized cost for purposes of calculating income to participants (See Footnote 3). The Bank of New York, as custodial bank, compiles fair value information for applicable securities by utilizing third party pricing services. The fair value of investments is determined at the end of each month.

Government/U.S. Agency securities and Commercial Paper are priced using matrix pricing. This method estimates a security's fair value by using quoted market prices for securities with similar interest rates,

Summary Information by Investment Classification						
	June 30, 2005				June 30, 2004	
	Interest Rates	Maturity Dates	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)	Fair Value
Repurchase Agreements	2.90-3.35	07/01/05-07/01/05	\$ 2,071,000,000	\$ 2,071,000,000	\$ 1,268,000,000	\$ 1,268,000,000
Government and Agency Commercial Paper	2.60-3.27	07/01/05-08/11/06	1,890,172,277	1,890,046,080	3,465,264,977	3,467,477,867
Certificates of Deposit	3.02-3.23	07/01/05-08/04/05	523,325,131	523,325,131	636,911,578	636,893,516
Asset Backed Securities	1.99-4.94	07/15/05-06/16/08	700,000,000	700,000,000	597,000,000	596,996,534
Mortgage Backed Securities	N/A	N/A	0	0	0	0
Yankee/Euro Issues	4.33	07/27/07	616,012	616,012	862,947	862,947
Swap(s)	N/A	N/A	0	0	0	0
		03/16/05	0	0	0	(9,126,554)
<b>Total Investments</b>			<b>\$ 5,185,113,420</b>	<b>\$ 5,184,987,223</b>	<b>\$ 5,968,039,502</b>	<b>\$ 5,961,104,310</b>
<b>Ratio of Fair Value to Book Value</b>				<b>99.9976%</b>		<b>99.8838%</b>

maturities, and credit ratings. Further, beginning with fiscal year 2005, short-term debt investments with remaining maturities of up to ninety days are valued using amortized cost to estimate fair value, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors.

Repurchase Agreements and nonnegotiable Certificates of Deposit are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. In addition, a bond issued by a State of Wisconsin Agency, having a par value at June 30, 2005 of \$0.6 million, is valued at par, which management believes approximates fair value.

Swaps are valued at the net present value of estimated expected future cash flows using discount rates commensurate with the risk involved.

#### D. Management Operating Expenses

Management operating expenses are SWIB's administrative costs that are allocated, in advance, to the SIF participants. Also, in fiscal year 2004, certain related costs of the Office of the State Treasurer have been allocated to the fund.

### 3. Pool Earnings and Pool Shares

For purposes of calculating earnings to each participant, all investments are valued at amortized cost. Specifically, the SIF distributes income to pool participants monthly, based on their average daily share balance. Distributed income includes interest income based on stated rates (both paid and accrued), amortization of discounts and premiums on a straight-line basis, realized investment gains and losses calculated on an amortized cost basis, and investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements, because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values of the pool's investments. The total difference between the fair values of the investments in the pool and the values distributed to the pool participants using the amortized cost method described above is reported in the equity section of the statement of net assets as "Undistributed Unrealized Gains (Losses)".

Pool shares are bought and redeemed at \$1.00 based on the amortized cost of the investments in the fund. The State of Wisconsin does not provide any legally binding guarantees to support the value of pool shares. However, LGIP investments, except for investments in U.S. Government/Agencies, State of Wisconsin Agencies, and Wisconsin Banks, are insured against credit loss by the Financial Security Assurance Corporation. Further, the Federal Deposit Insurance Corporation (FDIC) insures the prorata share of Certificates of Deposit held by the LGIP. Finally, the State of Wisconsin Public Deposit Guarantee Account protects a depositing municipality by up to \$400,000 if the local governing body has designated the LGIP as a public depository.

#### 4. Deposit and Investment Risk

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. For the SIF, evaluations of levels of diversification, nominal risk exposures including sector, maturity, and interest rate exposures, and risk/return plots form the core of the monitoring process. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines. At least quarterly, comprehensive reporting is presented to SWIB's Compliance and Investment Committees and the Board of Trustees.

##### A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the SIF. The SIF's investment guidelines establish numerous, very specific maximum exposure limits based on the minimum credit ratings as issued by nationally recognized statistical rating organizations (NRSROs). As of June 30, 2005, these credit ratings and aggregate exposures by investment type were as follows:

Credit Quality Distribution for Fixed Income Securities			
	Ratings	Fair Value	%
Repurchase Agreements:			
U.S. Government Debt collateral	N/A	\$ 1,609,500,000	31.0%
U.S. Agency collateral	AAA/Aaa	461,500,000	8.9%
Federal Home Loan Board (FHLB)	A-1+/P-1	653,627,019	12.6%
Federal Home Loan Mortgage Corp (FHLMC)	A-1+/P-1	634,968,444	12.3%
Federal National Mortgage Assoc (FNMA)	A-1+/P-1	576,589,867	11.1%
Federal Home Loan Board - Note	AAA/Aaa	24,860,750	0.5%
Commercial Paper	A-1+/P-1	498,325,131	9.6%
Commercial Paper	A-1 /P-1	25,000,000	0.5%
Certificates of Deposit:			
Nonnegotiable (Bankers Bank)	N/A	500,000,000	9.6%
Negotiable	A-1+/P-1	150,000,000	2.9%
Negotiable	A-1 /P-1	50,000,000	1.0%
Mortgage Backed (Wisc Dept of Vets Affairs)	Not Rated	616,012	0.0%
Totals		\$ <u>5,184,987,223</u>	<u>100.0%</u>

##### B. Custodial Credit Risk

Deposits - Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. SWIB does not have a deposit policy specifically for custodial credit risk. As of June 30, 2005, the SIF held certificates of deposit with an estimated fair value of \$500 million invested pursuant to the Wisconsin Certificate of Deposit Program implemented in July 1987. Investment guidelines provide

that banks accepted into this program must accept deposits in Wisconsin and meet credit-screening criteria designed to assure the safety of the deposits. Approximately \$436 million is insured through FDIC insurance and the State of Wisconsin Public Deposit Guarantee Account. The remaining \$64 million is considered uninsured and uncollateralized. The actual coverage of these deposits fluctuates daily based on the allocable share of participants' accounts.

#### C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The SIF's investment guidelines limit concentrations of credit risk by establishing numerous maximum issuer and/or issue exposure limits based on credit rating. These guidelines do not place a limit on maximum exposure for any U.S. Agency. As of June 30, 2005 the SIF has more than five percent of its investments in FHLB (13.1%), FHLMC (12.3%), FNMA (11.1%), and Repurchase Agreement collateral consisting of various securities issued by these same three U.S. Agencies (8.9%). Since the Repurchase Agreements mature each day, new collateral, consisting of a different blend of U. S. Treasury and Agency securities, is assigned each night.

#### D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The SIF uses the weighted average maturity method to analyze interest rate risk and investment guidelines mandate that the weighted average maturity for the entire portfolio will not exceed one year.

<b>Weighted Average Maturities for Fixed Income Securities</b>		
	Fair Value	Weighted Ave Maturity (Days)
Repurchase Agreements:	\$ 2,071,000,000	1
Government and Agency	1,890,046,080	29
Commercial Paper	523,325,131	10
Certificates of Deposit	700,000,000	119
Mortgage Backed Securities	616,012	757
Total Fair Value	<u>\$ 5,184,987,223</u>	
Portfolio Weighted Ave Maturity		28

#### E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SIF guidelines allow the investment in Canadian or Yankee/Euro denominated issues provided they are fully hedged against foreign currency risk. As of June 30, 2005 the SIF did not own any issues denominated in a foreign currency.

### 5. Restructured Investments - March 16, 1995

During fiscal year 1995, SWIB became aware of the existence of market exposure in certain swap agreements and structured bonds which could impair the earnings of the SIF. In one case, a \$10 million notional value swap agreement which contained exposure to Mexican interest rates, included a leverage factor, which caused a very high rate of market volatility. In another case, structured bonds with a par value of \$58 million were found to have a potential loss of principal because the redemption values were linked to foreign currency rates.

In March 1995, SWIB entered into agreements with two counterparties that resulted in the counterparties' assumption of all future market risk associated with ten swap agreements and two structured bonds. At the time of the agreement, the counterparties assigned a market value to these investments of negative \$95,321,000. Within this restructuring, one swap agreement required SWIB to make periodic payments over a period of ten years, while the other agreement required periodic payment of the loss over a period of five years. Interest cost associated with the periodic payment of the loss over time was estimated to be \$24.8 million. Earnings were charged as payments were made.

Various parties, under the direction of the Board of Trustees, evaluated the appropriateness of the original derivatives that were considered high risk, and determined that several of the positions were not in compliance with the Board of Trustees' investment guidelines. SWIB has suspended the use of non risk reducing derivatives in the SIF and on November 2, 1995 the Board of Trustees adopted investment guidelines prohibiting the use of such instruments. The following schedules provide more analysis of the restructured investments.

<b>Restructured Investments Analysis</b>			
	Fair Value		
	June 30, 2005	June 30, 2004	March 16, 1995
<u>Restructured Interest Rate Mirror Swaps</u>			
USD Libor Swap	\$ 0	\$ 0	\$ (1,380,000)
ESP Libor Swap	0	0	(2,960,000)
ITL Libor versus ESP Libor Swap	0	0	(1,537,000)
SWK CMS Swap	0	0	(4,160,000)
CMT Two-Year Spread Swap	0	0	(889,000)
Ten-Year Swap Spread Swap	0	0	(4,720,000)
DEM Libor Swap	0	0	(6,570,000)
FFR Pibor Swap	0	0	(5,710,000)
Subtotal	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ (27,926,000)</u>
<u>Restructured Asset Amortizing Swaps</u>			
SLMA Currency Linked NZ\$ vs. Yen	\$ 0	\$ 0	\$ (4,995,000)
Grantor Trust Crncy Linked C\$ vs. Lira vs. Yen	0	0	(27,400,000)
Subtotal	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ (32,395,000)</u>
<u>Mexican - Spread Restructuring Swap</u>			
10.74% - 1m USD Libor	\$ 0	\$ (9,126,554)	\$ (35,000,000)
US Treas. 7.50% 2/15/05 Hedge-Unreal. Gain	0	4,698,948	0
Subtotal	<u>\$ 0</u>	<u>\$ (4,427,606)</u>	<u>\$ (35,000,000)</u>
Total Fair Value	<u>\$ 0</u>	<u>\$ (4,427,606)</u>	<u>\$ (95,321,000)</u>

For fiscal years 2005 and 2004, the cash outflow for the restructured interest rate swap was (\$9,345,609) and (\$13,698,323) respectively. At June 30, 2005 all restructured investments had matured, and the SIF did not hold any derivative financial instruments.

## 6. Related Party Transactions

The SIF held one bond issued by a State of Wisconsin agency, the Department of Veterans Affairs, with a remaining par and carrying value of \$0.6 million at June 30, 2005. Management believes the rate of interest received is comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.



STATE OF WISCONSIN

## Legislative Audit Bureau

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Janice Mueller  
State Auditor

### INDEPENDENT AUDITOR'S REPORT

Senator Carol A. Roessler and  
Representative Suzanne Jeskewitz, Co-chairpersons  
Joint Legislative Audit Committee

Members of the Board of Trustees and  
Mr. David Mills, Executive Director  
State of Wisconsin Investment Board

We have audited the accompanying Statements of Net Investment Assets for the Retirement Investment Trust Funds (Fixed Retirement Investment Trust Fund and Variable Retirement Investment Trust Fund) of the State of Wisconsin as of June 30, 2005 and 2004, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only the investment activity of the Retirement Investment Trust Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Retirement Investment Trust Funds attributable to the Department of Employee Trust Funds. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Retirement Investment Trust Funds as of June 30, 2005 and 2004, and the changes in net investment assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2, the financial statements include investments that do not have readily ascertainable market prices and are valued based on a variety of third-party pricing methods. We have reviewed the procedures used by the Investment Board in arriving at estimates of the values of such investments and have inspected underlying documentation, and, given the circumstances, we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ from the values that would have been used had a ready market for the investments existed.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Retirement Investment Trust Funds of the State of Wisconsin. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated November 23, 2005, on our consideration of the Investment Board's internal control over financial reporting and on 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 over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, 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.

LEGISLATIVE AUDIT BUREAU

November 23, 2005

by



Janice Mueller  
State Auditor

The State of Wisconsin Retirement Funds' narrative discussion and analysis of the financial activities for the fiscal year ended June 30, 2005 is presented by management as an introduction to the financial statements. It is meant to assist the reader in understanding the financial statements by providing an overall review of the financial activities during the year as well as to provide a comparison of the prior year's activity and results.

**Overview of Basic Financial Statements**

Following this section are the financial statements and footnotes which reflect only the investment activity of these funds. Retirement reserves, contribution revenue and benefit expense are excluded from presentation in these statements.

-The **Statement of Net Investment Assets** provides information on the financial position of the Fund at year-end. It indicates the investment assets available for payment of future benefits and any current liabilities related to the investments.

-The **Statement of Changes in Net Investment Assets** presents the results of the investing activities during the year. The changes reflected on this statement support the overall change that has occurred to the prior year's net assets on the Statement of Net Investment Assets.

-The **Notes to the Financial Statements** offer additional discussion that is essential to the full understanding of the data presented in the financial statements. The notes give more detail about accounting policies, significant account balances and activities, material risks, obligations, contingencies and subsequent events, if any.

The financial statements and related notes are prepared in accordance with Governmental Accounting Standards Board Pronouncements.

**Retirement Trust Funds**

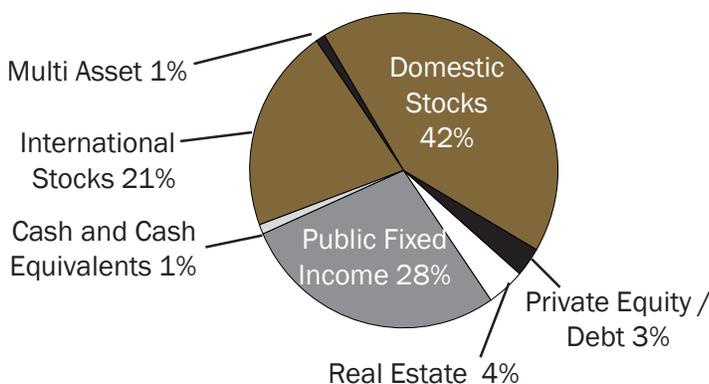
Approximately 527,000 people participate in the Wisconsin Retirement System (WRS), including current and former employees of Wisconsin's state agencies and most local governments. Contributions made to the WRS by these employees and their employers are invested by the State of Wisconsin Investment Board to finance retirement and other benefits. The WRS is comprised of the Fixed Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund whose combined net investment assets total \$70 billion as of June 30, 2005.

**Fixed Retirement Investment Trust Fund**

The larger of the two trust funds comprising the Wisconsin Retirement System is the Fixed Retirement Investment Trust Fund (FRITF) totaling \$64 billion. All WRS members have at least half - if not all - of their pension account in the FRITF. It is a fully diversified, balanced fund invested for the long-term needs of the

WRS. It includes a mixture of holdings, such as stocks, bonds, and real estate. Diversification helps to stabilize the effects of market changes. The basic investment objective of this trust fund is to achieve an average 7.8% annual return over the long-term and a rate of return of 3.7% a year above wage-rate growth. This objective is based on market rate of return and actuarial assumptions needed to meet obligations of the pension system.

**% of Total FRITF Assets as of June 30, 2005**



<b>Fixed Retirement Investment Trust Fund Condensed Financial Information</b>			
Fiscal Year Ended June 30:	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Cash and Cash Equivalents	\$ 1,489,353,668	\$ 1,643,140,381	-9.4%
Other Current Assets	330,647,044	439,888,821	-24.8%
Invested Securities Lending Collateral	6,567,592,482	4,850,012,855	35.4%
Other Assets	2,346,305	2,353,702	-0.3%
Investments	<u>62,472,413,289</u>	<u>57,710,738,435</u>	8.3%
Total Investment Assets	\$ 70,862,352,788	\$ 64,646,134,194	9.6%
Current Liabilities	\$ 298,882,445	\$ 655,479,425	-54.4%
Securities Lending Collateral Liability	6,567,592,482	4,850,012,855	35.4%
Total Investment Liabilities	\$ <u>6,866,474,927</u>	\$ <u>5,505,492,280</u>	24.7%
Net Investment Assets	\$ <u><u>63,995,877,861</u></u>	\$ <u><u>59,140,641,914</u></u>	8.2%
Investment Revenue (Loss)	\$ 6,425,111,524	\$ 8,313,745,557	-22.7%
Investment Expense	<u>(149,630,655)</u>	<u>(139,134,958)</u>	7.5%
Net Investment Income (Loss)	\$ 6,275,480,869	\$ 8,174,610,599	-23.2%
Net Receipt (Disbursements)	<u>(1,420,244,922)</u>	<u>694,261,238</u>	-304.6%
Net Increase (Decrease) in Net Investment Assets	\$ <u><u>4,855,235,947</u></u>	\$ <u><u>8,868,871,837</u></u>	-45.3%

The FRITF net investment assets increased approximately \$4.9 billion or an increase of 8.2%. This was primarily due to investment returns of 11.1%. The various asset classes returned the following amounts over the fiscal year: public equities 10.6%, fixed income 8.8%, real estate 23.4%, private equity 35.4%. Net investment assets were decreased by net disbursements made by the Department of Employee Trust Funds mainly for net benefit payments. The statements presented here reflect the investment activity of these funds, as well as net cash flows from the Department of Employee Trust Funds which include benefit payments, contribution receipts and transfers from the Variable Retirement Investment Trust Fund. Excluded from presentation in the statements are, for example, retirement reserves, contribution revenue, and benefit expense.

The securities lending collateral and the securities lending liability increased 35.4% over the previous year end due to an increase in the market value of the lendable securities. The increase was due, in part, to the overall growth in the investments of the Fund, as well as the transfer of assets from commingled funds, for which securities lending activity is not reported, to separately managed funds, for which securities lending activity is reported. While commingled funds partake in securities lending activities, the collateral assets and liabilities on the lending transactions are considered assets and liabilities of the commingled fund, not the FRITF.

Expenses increased 7.5% when comparing fiscal year 2004 to fiscal year 2005. Nearly all of this increase can be attributed to higher management fees. Equity and fixed income assets under management that are subject to management fees, have increased \$4.7 billion over the past year. This increase translated to \$12.6 million more in base management fees being incurred in fiscal year 2005. On the other hand, management fees incurred on private market assets have decreased \$4.3 million over the past fiscal year. As the limited partnerships age, the method of calculating management fees is often based on fair value rather than total commitments, reducing the amount subject to management fees. The fair value of the assets, on which fees are calculated, is reduced as distributions are made. Other shifts in management

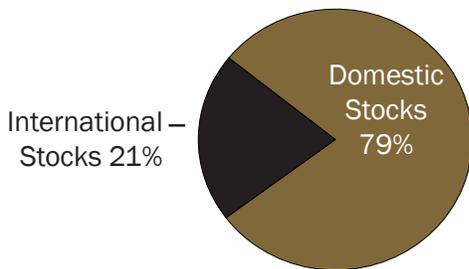
fee expenses have occurred over the year. Performance based fees have declined \$7.6 million primarily due to lower excess returns and \$3 billion fewer assets being subject to performance fees.

Net receipts (disbursements) decreased significantly when compared to fiscal year 2004. This line item represents the net cash flows of non-investment related activity such as net benefit payments/receipts, and expenses related to administering the benefit programs. The large fluctuation occurred during fiscal year 2004, when the system received over \$1.5 billion from the State and various municipalities for the payment of unfunded pension and other benefit liabilities.

**Variable Retirement Investment Trust Fund**

The Wisconsin Legislature passed, and the Governor signed into law, 1999 Wisconsin Act 11 which reopened the Variable Retirement Investment Trust Fund (VRITF) for new contributions, effective January 1, 2001. Act 11 allows active employees participating in the WRS to put half of their pension fund contributions into this stock fund. Approximately 20% of WRS members participate in the Fund, which totaled \$6 billion at the end of fiscal year 2005. It is 99.7% invested in equities with the remaining assets held in money market investments. Employees who choose this fund accept a higher degree of risk for the potential of greater long-run returns. The investment objective of the VRITF is to exceed similar equity-oriented portfolios over a full market cycle.

**% of Total VRITF Assets as of June 30, 2005**



Act 11 allows active employees participating in the WRS to put half of their pension fund contributions into this stock fund. Approximately 20% of WRS members participate in the Fund, which totaled \$6 billion at the end of fiscal year 2005. It is 99.7% invested in equities with the remaining assets held in money market investments. Employees who choose this fund accept a higher degree of risk for the potential of greater long-run returns. The investment objective of the VRITF is to exceed similar equity-oriented portfolios over a full market cycle.

The VRITF net investment assets increased \$209 million over the fiscal year. The increase stemmed from the equity portfolios returning 8.6% for the fiscal year ended June 30, 2005. Investment returns and employee and employer contributions were offset by disbursements out of the Fund. These disbursements include annuity payments to retirees and active participants opting out of the VRITF. At the end of each calendar year, individual participants in the VRITF may elect to terminate their variable participation and transfer their account to the FRITF.

At the end of the fiscal year ended June 30, 2004 the VRITF was undergoing a shift in asset allocation. As a result, other current assets and other current liabilities balances, which reflect assets being bought and sold, were considerably higher than the balances at the current fiscal year end.

Expenses decreased 3.6% over fiscal year 2005. Although assets under management increased, overall management fee expense incurred decreased. This can be attributed to a reduction in performance based fees. The reason performance based fees decreased is twofold. First, management fee agreements were renegotiated from performance based fees to flat fees in a large international equity portfolio. This effectively eliminated performance based fees in this portfolio for the fiscal year 2005. And secondly, excess returns were lower in fiscal year 2005, decreasing the amount upon which performance fees are calculated.

<b>Variable Retirement Investment Trust Fund Condensed Financial Information</b>			
Fiscal Year Ended June 30:	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Cash and Cash Equivalents	\$ 91,041,623	\$63,212,332	44.0%
Other Current Assets	18,453,145	114,422,212	-83.9%
Invested Securities Lending Collateral	263,784,057	203,046,268	29.9%
Investments	<u>5,948,991,680</u>	<u>5,747,730,369</u>	3.5%
Total Investment Assets	<u>\$6,322,270,505</u>	<u>\$ 6,128,411,181</u>	3.2%
Current Liabilities	\$ 40,174,553	\$116,092,331	-65.4%
Securities Lending Collateral Liability	<u>263,784,057</u>	<u>203,046,268</u>	29.9%
Total Investment Liabilities	<u>\$ 303,958,610</u>	<u>\$319,138,599</u>	-4.8%
Net Investment Assets	<u><u>\$6,018,311,895</u></u>	<u><u>\$ 5,809,272,582</u></u>	3.6%
Investment Revenue (Loss)	\$ 491,090,691	\$ 1,144,303,042	-57.1%
Investment Expense	<u>(7,149,605)</u>	<u>(7,416,493)</u>	-3.6%
Net Investment Income (Loss)	<u>\$483,941,086</u>	<u>\$ 1,136,886,549</u>	-57.4%
Net Receipt (Disbursements)	<u>(274,901,773)</u>	<u>(378,122,935)</u>	-27.3%
Net Increase (Decrease) in Net Investment Assets	<u><u>\$ 209,039,313</u></u>	<u><u>\$758,763,614</u></u>	-72.5%

### Total Rate of Return

Total rate of return (time-weighted) is widely accepted for comparing investment results. It combines current yield plus changes in current market value.

<b>Time Weighted Total Rate of Return</b>		
<u>Fiscal Year Ended (June 30)</u>	<u>Fixed Trust Fund</u>	<u>Variable Trust Fund</u>
1996	14.8	20.1
1997	18.9	25.0
1998	17.6	20.6
1999	9.8	15.1
2000	12.5	17.8
2001	-5.4	-13.5
2002	-4.8	-14.7
2003	4.6	-1.9
2004	16.6	23.0
2005	11.1	8.6
<u>10 yr Avg.</u>	<u>9.2%</u>	<u>9.0%</u>

**RETIREMENT FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2005**

	<b>Fixed Retirement Investment Trust Fund</b>	<b>Variable Retirement Investment Trust Fund</b>
<b>Assets</b>		
Cash and Cash Equivalents	\$ 1,489,353,668	\$ 91,041,623
Due from Other Funds	20,468,848	-
Receivable:		
Interest & Dividends	171,926,032	4,161,654
Securities Lending Income	2,739,135	197,573
Sales	135,185,986	14,093,918
Invested Securities Lending Collateral	6,567,592,482	263,784,057
Financial Futures Contracts	327,043	-
Other Assets	2,346,305	-
Investments (at fair value):		
Fixed Income	17,749,033,906	-
Preferred Securities	309,930,639	6,523,215
Convertible Securities	37,295,767	-
Stocks	40,387,136,556	5,942,468,465
Limited Partnerships	2,553,144,446	-
Mortgages	369,286,488	-
Real Estate Owned	420,395,968	-
Debt on Real Estate	(43,188,073)	-
Multi Asset	689,377,592	-
Total Investment Assets	<u>\$ 70,862,352,788</u>	<u>\$ 6,322,270,505</u>
<b>Liabilities</b>		
Purchases Payable	266,281,790	38,216,482
Foreign Currency Contracts	4,049,021	9,135
Vouchers Payable	28,551,634	1,948,936
Securities Lending Collateral Liability	6,567,592,482	263,784,057
Total Investment Liabilities	<u>\$ 6,866,474,927</u>	<u>\$ 303,958,610</u>
<b>Net Investment Assets Held in Trust</b>	<u><u>\$ 63,995,877,861</u></u>	<u><u>\$ 6,018,311,895</u></u>

The accompanying notes, on pages 36 through 46, are an integral part of this statement.

**RETIREMENT FUNDS**  
**Statement of Changes in Net Investment Assets**  
**For the Fiscal Year Ended June 30, 2005**

	<u>Fixed Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ 5,236,233,322	\$ 436,091,322
Interest	573,737,649	983,028
Dividends	515,205,324	53,101,161
Securities Lending Commissions	125,760,438	4,349,996
Other Income	87,366,047	-
Less:		
Investment Expense	(149,630,655)	(7,149,605)
Securities Lending Rebates	(110,013,581)	(3,206,057)
Securities Lending Fees	(3,177,675)	(228,759)
Total Investment Income (Loss)	\$ 6,275,480,869	\$ 483,941,086
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	(1,420,244,922)	(274,901,773)
<b>Net Increase (Decrease)</b>	<b>\$ 4,855,235,947</b>	<b>\$ 209,039,313</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<b>59,140,641,914</b>	<b>5,809,272,582</b>
<b>End of Year</b>	<b>\$ 63,995,877,861</b>	<b>\$ 6,018,311,895</b>

The accompanying notes, on pages 36 through 46, are an integral part of this statement.

**RETIREMENT FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2004**

	<b>Fixed Retirement Investment Trust Fund</b>	<b>Variable Retirement Investment Trust Fund</b>
<b>Assets</b>		
Cash and Cash Equivalents	\$ 1,643,140,381	\$ 63,212,332
Receivable:		
Interest & Dividends Receivables	180,432,744	3,324,073
Securities Lending Income	1,876,837	152,275
Sales Receivables	257,490,868	110,945,800
Invested Securities Lending Collateral	4,850,012,855	203,046,268
Financial Futures Contracts	88,372	-
Other Assets	2,353,702	64
Investments (at fair value):		
Fixed Income	16,495,072,768	-
Preferred Securities	287,854,732	3,966,983
Convertible Securities	43,477,076	1,454,970
Stocks	37,007,385,623	5,742,308,416
Limited Partnerships	2,529,989,393	-
Mortgages	593,064,485	-
Real Estate Owned	417,080,474	-
Multi Asset	336,813,884	-
Total Investment Assets	\$ 64,646,134,194	\$ 6,128,411,181
<b>Liabilities</b>		
Purchases Payable	629,819,946	114,660,101
Foreign Currency Contracts	5,355,871	1,205
Vouchers Payable	20,303,608	1,431,025
Securities Lending Collateral Liability	4,850,012,855	203,046,268
Total Investment Liabilities	\$ 5,505,492,280	\$ 319,138,599
<b>Net Investment Assets Held in Trust</b>	<b>\$ 59,140,641,914</b>	<b>\$ 5,809,272,582</b>

The accompanying notes, on pages 36 through 46, are an integral part of this statement.

**RETIREMENT FUNDS**  
**Statement of Changes in Net Investment Assets**  
**For the Fiscal Year Ended June 30, 2004**

	<u>Fixed Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in Fair Value of Investments	\$ 7,396,288,642	\$ 1,102,491,081
Interest	547,506,062	785,540
Dividends	263,790,230	40,447,153
Securities Lending Commissions	44,421,835	1,652,290
Other Income	97,994,765	-
Less:		
Investment Expense	(139,134,958)	(7,416,493)
Securities Lending Rebates	(34,214,324)	(943,898)
Securities Lending Fees	(2,041,653)	(129,124)
<b>Total Investment Income (Loss)</b>	<b>\$ 8,174,610,599</b>	<b>\$ 1,136,886,549</b>
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	694,261,238	(378,122,935)
<b>Net Increase (Decrease)</b>	<b>\$ 8,868,871,837</b>	<b>\$ 758,763,614</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<b>50,271,770,077</b>	<b>5,050,508,968</b>
<b>End of Year</b>	<b>\$ 59,140,641,914</b>	<b>\$ 5,809,272,582</b>

The accompanying notes, on pages 36 through 46, are an integral part of this statement.

## 1. Description of Funds

The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Fixed Retirement Investment Trust Fund (FRITF) and the Variable Retirement Investment Trust Fund (VRITF). The statements presented here reflect only the investment activity of these funds. Excluded from presentation in the statements are, for example, retirement reserves, contribution revenue, and benefit expense. The investment expenses account on the retirement fund financial statements represents the expenses that are allowed to be charged directly to the trust funds per Wisconsin Statutes s. 25.18(1)(a) and (m) and SWIB's administrative receipts and disbursements. The directly charged expenses include external management fees, legal fees, custodial bank fees, bond insurance fees, and investment consulting fees. SWIB's administrative receipts and disbursements related to the investment function are appropriated under the state's General Fund. The administrative receipts and disbursements allocated to each of the Funds is then billed back to the respective Fund and included in the Statement of Changes in Net Investment Assets as "Investment Expense".

### A. Fixed Retirement Investment Trust Fund

The Fixed Retirement Investment Trust Fund consists mainly of retirement contributions for the participants in the Wisconsin Retirement System (WRS). The WRS is administered by the Department of Employee Trust Funds (DETF) in accordance with Chapter 40 of the Wisconsin Statutes. All retirement fund contributions are invested in this trust fund unless participants have elected to have part of the contributions invested in the VRITF. In addition to the retirement contributions, the assets of various other benefit programs are invested as part of the FRITF at June 30, 2005 as listed in the table below.

#### Other Benefit Programs Within the Fixed Retirement Investment Trust Fund

Accumulated Sick Leave	\$ 1,788,220,276
Long Term Disability Insurance	271,843,477
Duty Disability	201,058,793
Police and Firefighters	119,934,156
Income Continuation Insurance	85,403,583
Milwaukee Retirement System	<u>76,933,254</u>
 Total	 <u><u>\$ 2,543,393,539</u></u>

The FRITF is managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statutes s. 25.14 and 25.17. The FRITF is not registered with the Securities and Exchange Commission as an investment company. The investments of the FRITF consist of a highly diversified portfolio of securities. Wisconsin Statutes 25.17(3) (a) allow investments in loans, securities and any other investments as authorized by s. 620.22. Permitted classes of investments include bonds of governmental units or of private corporations, loans secured by mortgages, preferred or common stock, real property and other investments not specifically prohibited by statute.

### *B. Variable Retirement Investment Trust Fund*

The Variable Retirement Investment Trust Fund also consists mainly of retirement contributions for the participants in the WRS. In addition, the Milwaukee Retirement System had \$25.1 million invested in the VRITF at June 30, 2005.

Participation in the VRITF is at the option of the employee. Participants have elected to credit one half of their retirement contributions and matching amounts of employer contributions to this fund, and have the remainder credited to the FRITF. Individual participants in the variable program may elect to terminate their variable participation and transfer their account to the FRITF.

The VRITF is managed by SWIB with oversight by a Board of Trustees as authorized by Wisconsin Statutes s. 25.14 and 25.17. The VRITF is not registered with the Securities and Exchange Commission as an investment company. Wisconsin Statute 25.17(5) states assets of the VRITF shall be invested primarily in equity securities which shall include common stocks, real estate or other recognized forms of equities whether or not subject to indebtedness, including securities convertible into common stocks and securities of corporations in the venture capital stage. The VRITF consists primarily of common stock and bonds convertible into common stock, although, because of existing conditions in the securities market, there may temporarily be other types of investments.

## **2. Significant Accounting Policies**

### *A. Basis of Presentation*

The accompanying financial statements were prepared in conformity with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

### *B. Basis of Accounting*

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Dividend income is recorded on the ex-dividend date, and interest income is accrued as earned.

SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 which do not conflict with or contradict GASB pronouncements.

### *C. Valuation of Securities*

The investments of the FRITF and the VRITF are valued at fair value, per Wisconsin Statutes s. 25.17(14). Monthly, the investments are adjusted to fair value, with unrealized gains and losses reflected in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments".

Generally, fair value information represents actual bid prices or the quoted yield equivalent at the end of the fiscal year for securities of comparable maturity, quality and type as obtained from one or more major investment brokers. If quoted market prices are not available, a variety of third party pricing methods are used, including appraisals, certifications, pricing models and other methods deemed acceptable by industry standards.

Mortgages are priced via a matrix pricing system. The traditional discounted cash flow methodology is employed, where discounted rates, based on current yields in the base Treasury, consider factors such as coupon rates, term to maturity, Moody's and S&P ratings, and sector/industry information.

Private placements are priced using a multi-tiered approach that prices each holding based on the best available information using the following hierarchy of pricing sources:

1. Custodian supplied prices for assets that are in the Lehman Aggregate Bond Index
2. Prices provided by a contracted third party with expertise in the bond market
3. Modeled prices utilizing CMS BondEdge where spreads are supplied by the same contracted third party

In a few instances private placements cannot be priced by any of the above three sources. In these circumstances the investment is priced using an alternative bond index price or if no independent quotation exists, the investment is priced by SWIB management, usually at cost.

Limited partnerships' fair value is estimated based on periodic reports from the limited partnerships' management. Annually, the reports are audited by independent auditors.

The basis for valuing real estate is independent appraisals, which are prepared once every three years. In years when appraisals are not performed the asset managers are responsible for providing market valuations.

A limited number of securities are carried at cost. Certain non-public or closely held stock are not reported at fair value, but are carried at cost since no independent quotation is available to price these securities.

All derivative financial instruments are reported at fair value in the Statement of Net Investment Assets. The instruments are marked to fair value monthly, with valuation changes recognized in income. Gains and losses are recorded in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments" during the period the instruments are held and when the instrument is sold or expires. The nature and use of derivative instruments is discussed in Note 5.

#### *D. Use of Estimates*

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect amounts reported herein. Due to the inherent uncertainty involved, actual results could differ from those estimates.

### **3. Deposit and Investment Risk**

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. Inspection of levels of diversification, nominal risk exposures, risk/return plots, value at risk, tracking error, and worst case scenario modeling forms the core of the monitoring process. Comprehensive reporting is presented to SWIB's Investment Committee and the Board of Trustees at least quarterly. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines.

*A. Credit Risk*

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SWIB. With the exception of derivative instrument credit risk, there are no fund wide investment guidelines related to credit risk exposures within the FRITF and VRITF. Information regarding SWIB's credit risk related to derivatives is found in Note 5. Other fixed income credit risk investment guidelines spell out the minimum ratings at the time of purchase by individual portfolios or groups of portfolios based on the portfolios' investment objectives. In addition, some fixed income portfolios are required to carry a minimum weighted average rating at all times.

The following schedule displays the lowest credit rating assigned by several nationally recognized statistical rating organizations, on debt securities held by the FRITF and the VRITF as of June 30, 2005. Included in this schedule are fixed income securities including certain short term securities classified as cash equivalents on the Statement of Net Investment Assets. Obligations of the United States and obligations explicitly guaranteed by the US government have been included in the AAA rating below although they are considered to be without credit risk.

<b>Credit Quality Distribution</b>		
<b>Ratings</b>	<b>Fair Value</b>	<b>% of Total</b>
P-1	\$ 4,959,314,132	19%
AAA	9,474,999,720	36%
AA	2,942,875,869	11%
A	5,078,926,663	19%
BBB	680,522,936	3%
BB	1,042,198,825	4%
B	599,622,288	2%
CCC	96,276,751	0%
CC	6,680,438	0%
C	380,625	0%
D	1,051,100	0%
Not Rated	1,518,788,367	6%
<b>Total</b>	<b>\$26,401,637,714</b>	<b>100%</b>

*B. Custodial Credit Risk*

The Retirement Funds do not have a deposit or investment policy specifically related to custodial credit risk.

*Deposits* - Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. Bank deposits as of June 30, 2005 were \$141,464,027. A portion of the deposits, totaling \$29,337,727 are covered by federal depository insurance. The remaining uninsured and uncollateralized deposits, totaling \$112,126,300, were held in foreign currencies in SWIB's custodian's nominee name. In addition, SWIB held a number of time deposits with foreign financial institutions with a fair value of \$55,750,433, all of which were uncollateralized and uninsured.

*Investments* - Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, SWIB will not be able to recover the value of investments that are in the possession of an outside party. As of June 30, 2005 the Retirement Funds did not have any investment securities exposed to custodial credit risk.

#### *C. Concentration of Credit Risk*

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. SWIB limits concentrations of credit risk by establishing investment guidelines for individual portfolios or groups of portfolios that generally restrict issuer concentrations in any one company or Rule 144A securities below 5% of assets.

#### *D. Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SWIB uses a number of different methods to analyze interest rate risk. Generally, long or intermediate term portfolios' interest rate risk is determined using the duration method. Duration, which is stated in years, is the measure of price sensitivity of a fixed income security to an interest rate change of 100 basis points. The calculation is based on the weighted average of the present values for all cash flows. On the other hand, short-term portfolios use the weighted average maturity to analyze interest rate risk. Weighted average maturity is the maturity of each position in a portfolio weighted by the dollar value of the position to compute an average maturity for the portfolio as a whole. This measure indicates a portfolio's sensitivity to interest rate changes: a longer average weighted maturity implies greater volatility in response to interest rate changes. SWIB's investment guidelines related to interest rate risk vary by portfolio. Some fixed income portfolios are required to be managed within a range of a targeted duration, while others are required to maintain a weighted average maturity at or below a specified number of days or years.

As of June 30, 2005 SWIB had interest rate risk exposure stated in terms of weighted average maturities, related to the following assets in its FRITF and VRITF (see chart on page 41):

<b>Weighted Average Maturities</b>		
<b><u>Investment Type</u></b>	<b><u>Fair Value</u></b>	<b><u>Weighted Average Maturity (Years)</u></b>
Asset Backed Securities	\$ 115,031,254	4.04
Certificates of Deposit	1,400,466,300	0.56
Commercial Mortgage Backed Securities	2,788,014	7.54
Commercial Paper	2,061,536,976	0.11
Convertible Securities	22,394,098	6.22
Corporate Bonds	2,656,938,141	6.45
Funds	9,846,899,162	6.11
Government Agency	559,425,710	3.64
Mortgages	369,286,488	4.13
Private Placements	663,793,048	6.55
Repurchase Agreements	1,770,385,583	0.01
Sovereign Debt	3,038,226,513	7.73
United States Treasury Securities	3,559,275,157	9.37
Yankee Bonds	335,191,270	5.51
Total	<u>\$26,401,637,714</u>	
Combined Weighted Average Maturity		5.51

#### *E. Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. Currency risk includes both the risk that currencies in which a portfolio's investments are denominated or currencies in which a portfolio has taken on an active position will decline in value relative to the US dollar.

Foreign currency exchange rates may fluctuate significantly for a number of reasons, including the forces of supply and demand in the foreign exchange markets, actual or perceived changes in interest rates, and intervention by US or foreign governments or central banks, or by currency controls or political developments in the US or abroad. The Retirement Funds hold foreign currency denominated cash and securities directly in designated actively managed portfolios and indirectly through their investment in certain commingled investment funds.

As of June 30, 2005 the FRITF and the VRITF assets were denominated in the following currencies (see chart pages 42 and 43):

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**Currency Exposures by Investment Type**


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<u>Currency</u>	Cash and Cash <u>Equivalents</u>	Convertible Securities	<u>Equity</u>	Fixed Income	Preferred Securities
Argentina Peso	\$ 418,822	\$ -	\$ -	\$ 11,471,101	\$ -
Australian Dollar	2,474,370	-	166,027,612	108,045,314	-
Brazil Real	654,879	-	2,915,860	3,605,500	29,580,337
British Pound Sterling	9,399,414	-	1,266,904,053	166,015,924	-
Canadian Dollar	45,112,663	-	328,529,509	83,608,959	-
Columbian Peso	-	-	-	1,868,290	-
Danish Krone	558,393	-	37,659,333	80,799,497	-
Euro Currency Unit	97,234,129	-	1,731,074,678	1,444,557,732	36,495,829
Hong Kong Dollar	4,574,972	-	83,840,218	-	-
Hungarian Forint	54,358	-	6,954,305	-	-
Indian Rupee	4,338,321	-	5,900,796	-	-
Indonesian Rupian	-	-	4,989,113	-	-
Israeli Shekel	378,653	-	7,314,920	-	-
Japanese Yen	13,346,648	-	1,172,230,573	611,125,387	-
Malaysian Ringgit	100,092	-	9,201,134	2,962,792	-
Mexican New Peso	830,970	-	2,923,944	46,875,758	-
Taiwan Dollar	4,689,244	-	72,412,557	-	-
Turkish Lira	840,833	-	20,507,115	4,821,140	-
New Zealand Dollar	20,121	-	17,341,132	36,100,529	-
Norwegian Krone	463,402	-	32,849,058	6,176,865	-
Pakistan Rupee	-	-	234,283	-	-
Philippines Peso	30,392	-	8,640,921	-	-
Polish Zloty	450,984	-	7,977,504	40,155,691	-
South African Rand	1,700,880	-	22,459,142	-	-
Singapore Dollar	1,692,537	-	60,690,324	34,154,048	-
South Korean Won	(190,167)	-	75,243,440	-	-
Swedish Krona	12,292,830	-	125,502,253	46,047,912	-
Swiss Franc	2,319,744	-	318,453,329	-	-
Thailand Baht	276,644	-	4,059,942	4,952,795	-
Uruguayan Peso	-	-	-	1,680,691	-
Total Foreign Currency Exposure	\$ 204,064,128	\$ -	\$ 5,592,837,048	\$ 2,735,025,925	\$ 66,076,166
United States Dollar	1,376,331,163	37,295,767	40,736,767,973	15,014,007,981	250,377,688
Total Investments by Currency Exposure	\$ 1,580,395,291	\$ 37,295,767	\$ 46,329,605,021	\$ 17,749,033,906	\$ 316,453,854

	Private <u>Equity</u>	<u>Mortgages</u>	Real <u>Estate</u>	<u>Multi Asset</u>	Total Exposure <u>by Currency</u>
\$	-	\$ -	\$ -	\$ -	\$ 11,889,923
	-	-	-	-	276,547,296
	-	-	-	-	36,756,576
	88,108,474	-	-	-	1,530,427,865
	31,453,152	-	-	-	488,704,283
	-	-	-	-	1,868,290
	-	-	-	-	119,017,223
	117,019,748	-	-	-	3,426,382,116
	-	-	-	-	88,415,190
	-	-	-	-	7,008,663
	-	-	-	-	10,239,117
	-	-	-	-	4,989,113
	-	-	-	-	7,693,573
	1,592,326	-	-	-	1,798,294,934
	-	-	-	-	12,264,018
	-	-	-	-	50,630,672
	-	-	-	-	77,101,801
	-	-	-	-	26,169,088
	-	-	-	-	53,461,782
	-	-	-	-	39,489,325
	-	-	-	-	234,283
	-	-	-	-	8,671,313
	-	-	-	-	48,584,179
	-	-	-	-	24,160,022
	-	-	-	-	96,536,909
	-	-	-	-	75,053,273
	-	-	-	-	183,842,995
	-	-	-	-	320,773,073
	-	-	-	-	9,289,381
	-	-	-	-	1,680,691
\$	238,173,700	\$ -	\$ -	\$ -	\$ 8,836,176,967
	2,314,970,746	369,286,488	420,395,968	689,377,592	61,208,811,366
\$	<u>2,553,144,446</u>	<u>\$ 369,286,488</u>	<u>\$ 420,395,968</u>	<u>\$ 689,377,592</u>	<u>\$ 70,044,988,333</u>

#### 4. Securities Lending Transactions

State statutes and Board policies permit SWIB to use investments of the two funds to enter into securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities for collateral, in the form of cash or securities, with the simultaneous agreement to return the collateral for the same securities in the future. SWIB's securities custodian is an agent in lending the funds' domestic and international securities. When the Retirement Funds' domestic securities are delivered to a borrower as part of a securities lending agreement, the borrower is required to place collateral equal to 102 percent of the loaned securities' fair value, including interest accrued, as of the delivery date with the lending agent. In the event that foreign securities are loaned, the borrower is required to place collateral totaling 105 percent of the loaned securities' fair value, including interest accrued, as of the delivery date with the lending agent except when the collateral is denominated in the same currency as the loaned security. In this case, collateral is required to total 102 percent of the loaned securities' fair value, including interest accrued, as of the delivery date. Cash collateral is reinvested by the lending agent or its affiliate in accordance with contractual investment guidelines which are designed to insure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers and fees paid to agents, results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

At year end, the Retirement Funds had no credit risk exposure to borrowers because the amounts the Retirement Funds owed the borrowers exceeded the amounts the borrowers owed the Retirement Funds. The contract with the lending agent requires it to indemnify the Retirement Funds if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

The majority of securities loans can be terminated on demand by the Retirement Funds or the borrower. The average term of the loans is approximately one week, which is shorter than the weighted average maturity of 27 days for investments made with the US dollar cash collateral and the weighted average maturity of 36 days for investments made with Euro cash collateral.

Pledging or selling collateral securities cannot be done without a borrower default. The quantity or dollar value of securities lending contracts that the Retirement Funds enter into is not restricted.

The Retirement Funds also earn securities lending income as part of total net earnings from the investment in several commingled funds. These earnings are automatically reinvested in the commingled fund, and as a result the earnings are combined with all other earnings and gains and losses for these funds, and reported in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in the Fair Value of Investments".

#### 5. Derivative Financial Instruments

Investment guidelines prohibit the use of derivatives for speculative purposes or leveraging of the assets. Any derivative issuer or counterparty used must be a recognized exchange or a bank or broker dealer with an actual credit rating of at least: (1) 'B/C' or better from Fitch; (2) 'A1/P1' or better on short term debt from S&P or Moody's; or (3) 'A' or better on long term debt from S&P or Moody's.

Below are the types of derivatives that SWIB uses in its dedicated account portfolios. SWIB also invests in derivative instruments indirectly through several commingled funds. These derivatives have not been included in the following totals.

### A. Foreign Currency Forwards and Options

Currency exposure management is permitted through the use of exchange traded currency instruments, and through the use of spot and forward contracts in foreign currencies. Direct currency hedging is permitted to hedge currency exposure back to the US dollar when consistent with the strategy of the portfolio. Cross-currency exposure management to transfer out of an exposed currency and into a benchmark currency is permitted. Losses may arise from future changes in the value of the underlying currency, or if the counterparties do not perform under the terms of the contract.

During the fiscal years presented in these financial statements SWIB's currency exposure management involved foreign currency spot and forward contracts only. Generally, SWIB enters these contracts to hedge foreign exchange risk. At June 30, 2005 the fair value of foreign currency forward contract assets totaled \$1.802 billion, while the liabilities totaled \$1.806 billion. The net \$4 million is reflected in the Statement of Net Assets as "Foreign Currency Contracts".

### B. Futures Contracts

A financial futures contract is an exchange traded agreement to buy or sell a financial instrument at an agreed upon price and time in the future. Upon entering into a futures contract, collateral is deposited with the broker, in SWIB's name, in accordance with the initial margin requirements of the broker. Futures contracts are marked to market daily by the board of trade or exchange on which they are traded. The resulting gain/loss is received/paid the following day until the contract expires. Futures contracts involve, to varying degrees, risk of loss in excess of the variation margin disclosed in the Statement of Net Investment Assets. Losses may arise from future changes in the value of the underlying instrument, or if the counterparties do not perform under the terms of the contract.

Investment guidelines allow external fixed income portfolio managers to manage interest rate exposure only through the use of exchange-traded interest rate instruments. As of June 30, 2005, the FRITF was invested in exchange-traded interest rate futures contracts with a net exposure totaling \$1.087 billion.

Certain internally managed domestic fixed income portfolios are allowed to invest in financial futures, options, and swaps for the purposes of adjusting duration and to invest anticipated cash flows, subject to review by the SWIB Investment Committee. During the periods presented these portfolios held no futures, options or swaps.

One externally managed equity portfolio is permitted by the investment guidelines to use exchange-traded S&P Equity Index futures contracts to manage its exposure to the stock market during the fiscal years presented. This manager is authorized to utilize futures up to 5% of the fair value of the portfolio although it held no futures during the fiscal years presented. Other external international equity managers are allowed to invest in equity futures and options provided the equity equivalent value of the equity futures and optioned equities does not exceed 20% of assets in the portfolio. During the fiscal years presented equity futures contracts were not in use.

### C. Asset Backed Securities

The FRITF holds asset backed securities, which are reported at fair market value in the Statement of Net Investment Assets. Asset backed securities are held to maximize yields and in part to hedge against changes in interest rates.

Asset backed securities are debt securities whose value is derived from payments and prepayments of principal and interest generated from whole loan mortgages, mortgage pass-through securities, credit

card receivables, car loan and leases receivables, insurance proceeds receivable, as well as, airline and railroad car loans receivable. In some cases, cash flows are distributed to different investment classes or tranches in accordance with the security's established payment order. Some tranches have more stable cash flows relative to changes in interest rates while others are significantly more sensitive to interest rate fluctuations. In a declining interest rate environment, some asset backed securities may be subject to a reduction in interest payments as a result of prepayments of underlying mortgages, leases, or loans which make up the collateral pool. A reduction in interest payments causes a decline in cash flows and thus a decline in the fair value of the security. Rising interest rates may cause an increase in anticipated interest payments, thus an increase in fair value of the security. The FRITF holds only high quality, senior tranches, resulting in minimal risks of default and prepayment. The degree of prepayment risk also varies with the type of underlying assets.

Mortgage backed securities tend to have a higher degree of prepayment risk due to the long term nature of the security. At June 30, 2005, the FRITF held mortgage backed securities with a fair value totaling \$10 million.

#### *D. Credit-Linked Trust Certificates*

FRITF investment guidelines have allowed certain fixed income managers to manage credit exposure through the use of credit-linked trust certificates. Credit-linked trust certificates are exchange-traded securities, created through a Special Purpose Company, or trust. Proceeds from the sale of the certificates are invested in AAA rated securities, then lent out under a securities lending agreement. The trust also enters into a credit default swap that references 100 high yield corporate bonds. The trust pays a variable coupon and receives a fixed coupon on the notional value during the life of the note. If the issuer of one or more of the 100 high yield corporate bonds defaults, the trust will receive the current market value of the defaulted asset and the notional value will be reduced, lessening future interest earnings.

By investing in credit-linked trust certificates, the FRITF gains immediate, diversified exposure to the high yield fixed income market. For taking on the risk associated with the 100 high yield corporate bonds, the FRITF earns a premium rate of return. Investment in these certificates involves risk of loss from credit downgrades, illiquidity, and counterparty risk. Valuation of this security is calculated by the party marketing the security. Credit-linked trust certificates were purchased during December 2003 as part of an initial allocation to a new manager. They were sold off over the next seven months as the manager assembled the portfolio.

#### *E. Options*

Option contracts give the purchaser of the contract the right to buy (call) or sell (put) the security or index underlying the contract at an agreed upon price on or before the expiration of the option contract. The seller of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk to the extent of the premium paid to enter into the contract. SWIB investment guidelines allow internal US equity portfolios to buy put options and sell call options in connection with existing portfolio positions. Generally, external international equity managers are allowed to invest in futures and options as long as the equity equivalent value of the equity futures and optioned equities does not exceed 20% of assets. In addition, most fixed income portfolios are permitted to enter into option contracts to manage interest rate exposure. The Retirement Funds held no options at June 30, 2005.

## **6. Summary of Investments**

The following schedules provide summary information by investment classification for the FRITF and VRITF at June 30, 2005.

<b>Fixed Retirement Investment Trust Fund - June 30, 2005</b>				
<b>Classification</b>	<b>Coupon Rate (%)</b>	<b>Maturity Dates</b>	<b>Cost</b>	<b>Fair Value</b>
	Variable and .2 to			
Fixed Income	24.00	July 2005 to Oct. 2049	\$ 16,443,342,204	\$ 17,749,033,906
Preferred Securities	N/A	N/A	220,255,071	309,930,639
Convertible Securities	N/A	N/A	35,011,099	37,295,767
Common Stock	N/A	N/A	32,972,869,919	40,387,136,556
Limited Partnerships	N/A	N/A	2,669,597,651	2,553,144,446
Mortgages	6.77 to 7.88	Nov. 2006 to Dec. 2014	341,977,893	369,286,488
Real Estate	N/A	N/A	307,276,450	420,395,968
Debt on Real Estate	Variable and 5.15	June 2015 to May 2027	(51,065,000)	(43,188,073)
Multi Asset	N/A	N/A	549,000,000	689,377,592
Total			<u>\$ 53,488,265,287</u>	<u>\$ 62,472,413,289</u>

<b>Variable Retirement Investment Trust Fund - June 30, 2005</b>				
<b>Classification</b>	<b>Coupon Rate</b>	<b>Maturity Date</b>	<b>Cost</b>	<b>Fair Value</b>
Preferred Securities	N/A	N/A	\$ 5,463,454	\$ 6,523,215
Stocks	N/A	N/A	5,024,198,642	5,942,468,465
Total			<u>\$ 5,029,662,096</u>	<u>\$ 5,948,991,680</u>

## 7. Milwaukee Retirement System

The Milwaukee Retirement System (MRS), consisting of several funds within the Milwaukee Public School Retirement System, invests in the FRITF and VRITF through the WRS. Since the MRS is a separate legal entity from the WRS, both the FRITF and the VRITF qualify as external investment trust funds. Participation by the MRS in the FRITF and VRITF is described in the DETF Administrative Code, Chapter 10.12. MRS provides assets to DETF for investment in the FRITF and VRITF which are managed by SWIB. Each month the DETF distributes the pro-rata share of the total FRITF's earnings less administrative expenses as well as, the VRITF's earnings less administrative expenses. The MRS accounts are adjusted to fair value and gains/losses are recorded directly in the accounts per DETF Administrative Code 10.12(2). No State statute, legal provision, or legally binding guarantee exists to support the value of MRS's portion of the FRITF or the VRITF.

## 8. Unfunded Capital Commitments

The FRITF has committed to fund various limited partnerships and side-by-side agreements related to its private equity and real estate holdings. Commitments that have not been funded as of June 30, 2005 totaled \$1.6 billion. Unfunded commitments are not included in the financial statements since the timing of the funding is not certain.

## 9. Debt on Real Estate

Several real estate investments are leveraged whereby partnerships have been formed to purchase properties through contributions from the FRITF and through the acquisition of debt. At June 30, 2005, two real estate properties with a fair value of \$107.8 million had been financed in part with \$51.1 million (\$43.2 million fair value) in mortgage debt. Interest only payments are made on the debt until June 2015 when \$28 million becomes due and principal reserve fund payments will commence on the remaining \$23.1 million in debt and continue through May 2027.



STATE OF WISCONSIN

## Legislative Audit Bureau

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Janice Mueller  
State Auditor

### INDEPENDENT AUDITOR'S REPORT

Senator Carol A. Roessler and  
Representative Suzanne Jeskewitz, Co-chairpersons  
Joint Legislative Audit Committee

Members of the Board of Trustees and  
Mr. David Mills, Executive Director  
State of Wisconsin Investment Board

We have audited the accompanying Statements of Net Investment Assets for the Various Funds (Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, and EdVest Tuition Trust Fund) of the State of Wisconsin as of June 30, 2005 and 2004, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only the investment activity of the Various Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Various Funds attributable to other state agencies. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Various Funds as of June 30, 2005 and 2004, and the changes in net investment assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2, the financial statements include investments that do not have readily ascertainable market prices and are valued based on a variety of third-party pricing methods. We have reviewed the procedures used by the Investment Board in arriving at estimates of the values of such investments and have inspected underlying documentation, and, given the circumstances, we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ from the values that would have been used had a ready market for the investments existed.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Various Funds of the State of Wisconsin. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated November 23, 2005, on our consideration of the Investment Board's internal control over financial reporting and on 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 over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, 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.

LEGISLATIVE AUDIT BUREAU



November 23, 2005

by

Janice Mueller  
State Auditor

Management Discussion and Analysis provides general information on the investment financial activities of the Various Funds. The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund (LGPIF), State Life Insurance Fund (SLIF), Injured Patients and Families Compensation Fund (IPFCF), Historical Society Trust Fund (HSTF), and EdVest Tuition Trust Fund (EdVest).

Following this section are the financial statements and notes. The Statement of Net Investment Assets provides information on the types of investments and the liabilities of the Various Funds. The Statement of Changes in Net Investment Assets provides information on the investment income of the Various Funds and their net assets at year-end. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the fund financial statements. Condensed Various Funds financial information for the fiscal years ended June 30, 2005 and 2004 is as follows:

Various Funds Condensed Financial Information				
Fiscal Year Ended	2005	2004	Change	Change
	(\$)	(\$)	(\$)	(%)
<b>Net Investment Assets:</b>				
Local Govt Property Ins Fund	43,436,557	32,401,356	11,035,201	34.1%
State Life Insurance Fund	86,770,246	77,501,384	9,268,862	12.0%
Inj Patients & Families Comp Fd	757,837,949	695,628,368	62,209,581	8.9%
Historical Society Trust Fund	11,129,168	10,807,768	321,400	3.0%
EdVest Tuition Trust Fund	11,496,037	11,758,127	(262,090)	(2.2%)
<b>Net Investment Income:</b>				
Local Govt Property Ins Fund	836,237	260,187	576,050	221.4%
State Life Insurance Fund	12,226,681	(2,019,445)	14,246,126	N/A
Inj Patients & Families Comp Fd	58,154,145	20,617,861	37,536,284	182.1%
Historical Society Trust Fund	818,365	1,253,115	(434,750)	(34.7%)
EdVest Tuition Trust Fund	952,971	(300,995)	1,253,966	N/A

Percentage changes in the Net Investment Assets of the Various Funds were relatively small, except for Local Government Property Insurance Fund which was due to program activities within the fund that were not investment related. Net Investment Income was significantly higher in all Various Funds, except Historical Society, primarily due to current year increases in the fair value of bonds as a result of falling long-term interest rates, as compared to the prior year when the fair value of the bonds was decreasing due to rising interest rates. The Local Government Property Insurance Fund was less impacted by this trend because it held shorter maturity bonds and a higher percentage of cash equivalents over the prior year. The Historical Society Trust Fund held an indexed stock fund, representing 71.2% of net investment assets, which experienced a \$0.4 million increase in fair value during the current year as compared to a \$1.1 million increase in fair value during the prior year.

**VARIOUS FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2005**

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
<b>Investment Assets</b>					
Cash and Cash Equivalents	\$ 36,253,795	\$ 2,913,943	\$ 21,344,913	\$ 180,342	\$ 20,703
Receivables					
Investment Income Receivable	182,148	1,175,726	8,638,652	1,322	52,462
Investment Sales Receivable	0	0	3,622,682	0	0
Investments					
Fixed Income	7,000,614	82,680,577	597,736,679	3,027,605	11,422,872
Stocks	0	0	126,502,879	7,920,347	0
<b>Total Investment Assets</b>	<b>\$ 43,436,557</b>	<b>\$ 86,770,246</b>	<b>\$ 757,845,805</b>	<b>\$ 11,129,616</b>	<b>\$ 11,496,037</b>
<b>Liabilities</b>					
Investment Purchases Payable	0	0	1,974	0	0
Accounts Payable	0	0	5,882	448	0
<b>Total Liabilities</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 7,856</b>	<b>\$ 448</b>	<b>\$ 0</b>
<b>Net Investment Assets</b>	<b>\$ 43,436,557</b>	<b>\$ 86,770,246</b>	<b>\$ 757,837,949</b>	<b>\$ 11,129,168</b>	<b>\$ 11,496,037</b>

The accompanying notes, on pages 53 through 56, are an integral part of this document.

**VARIOUS FUNDS**  
**Statement of Changes in Net Investment Assets**  
**For the Fiscal Year Ended June 30, 2005**

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
<b>From Investment Activities:</b>					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ (255,320)	\$ 7,927,991	\$ 27,227,646	\$ 825,314	\$ 274,291
Interest	1,095,270	4,306,559	30,978,993	4,735	678,680
Investment Expenses	(3,713)	(7,869)	(52,494)	(11,684)	0
Increase (Decrease) in Net Investments					
Derived from Investment Activities	\$ 836,237	\$ 12,226,681	\$ 58,154,145	\$ 818,365	\$ 952,971
<b>From Participant Transactions:</b>					
Net Receipts (Disbursements) - Non-Investment Activity	10,198,964	(2,957,819)	4,055,436	(496,965)	(1,215,061)
Net Increase (Decrease) in Net Investment Assets	\$ 11,035,201	\$ 9,268,862	\$ 62,209,581	\$ 321,400	\$ (262,090)
<b>Net Investment Assets</b>					
Beginning of Period	32,401,356	77,501,384	695,628,368	10,807,768	11,758,127
End of Period	<b>\$ 43,436,557</b>	<b>\$ 86,770,246</b>	<b>\$ 757,837,949</b>	<b>\$ 11,129,168</b>	<b>\$ 11,496,037</b>

The accompanying notes, on pages 53 through 56, are an integral part of this document.

**VARIOUS FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2004**

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
<b>Investment Assets</b>					
Cash and Cash Equivalents	\$ 24,074,260	\$ 3,690,386	\$ 24,097,100	\$ 160,347	\$ 333,342
Receivables					
Investment Income Receivable	221,645	1,147,951	8,574,351	898	59,820
Investment Sales Receivable	0	0	34,999,078	0	0
Investments					
Fixed Income	8,105,451	72,663,047	567,523,140	3,161,223	11,364,965
Stocks	0	0	105,542,828	7,489,038	0
<b>Total Investment Assets</b>	<b>\$ 32,401,356</b>	<b>\$ 77,501,384</b>	<b>\$ 740,736,497</b>	<b>\$ 10,811,506</b>	<b>\$ 11,758,127</b>
<b>Liabilities</b>					
Investment Purchases Payable	0	0	45,099,762	0	0
Accounts Payable	0	0	8,367	3,738	0
<b>Total Liabilities</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 45,108,129</b>	<b>\$ 3,738</b>	<b>\$ 0</b>
<b>Net Investment Assets</b>	<b>\$ 32,401,356</b>	<b>\$ 77,501,384</b>	<b>\$ 695,628,368</b>	<b>\$ 10,807,768</b>	<b>\$ 11,758,127</b>

The accompanying notes, on pages 53 through 56, are an integral part of this document.

**VARIOUS FUNDS**  
**Statement of Changes in Net Investment Assets**  
**For the Fiscal Year Ended June 30, 2004**

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
<b>From Investment Activities:</b>					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ (570,625)	\$ (6,321,387)	\$ (9,219,882)	\$ 1,268,683	\$ (1,044,672)
Interest	834,641	4,316,314	29,896,834	2,166	743,677
Investment Expenses	(3,829)	(14,372)	(59,091)	(17,734)	0
Increase (Decrease) in Net Investments Derived from Investment Activities	\$ 260,187	\$ (2,019,445)	\$ 20,617,861	\$ 1,253,115	\$ (300,995)
<b>From Participant Transactions:</b>					
Net Receipts (Disbursements) - Non-Investment Activity	8,025,907	(2,692,117)	9,046,896	(351,256)	(1,333,058)
Net Increase (Decrease) in Net Investment Assets	\$ 8,286,094	\$ (4,711,562)	\$ 29,664,757	\$ 901,859	\$ (1,634,053)
<b>Net Investment Assets</b>					
Beginning of Period	24,115,262	82,212,946	665,963,611	9,905,909	13,392,180
End of Period	<b>\$ 32,401,356</b>	<b>\$ 77,501,384</b>	<b>\$ 695,628,368</b>	<b>\$ 10,807,768</b>	<b>\$ 11,758,127</b>

The accompanying notes, on pages 53 through 56, are an integral part of this document.

## 1. Description of Funds

The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, and EdVest Tuition Trust Fund (collectively known as the "Various Funds"). The statements presented here reflect only the investment activity of the Various Funds. Excluded from the presentation in the statements are, for example, claim reserves, reserves for life policies and contracts, contribution revenue, premiums earned, benefit expense, and expenditures from endowment income. Also excluded from the statements are SWIB's administrative receipts and disbursements related to the investment function.

The State Investment Fund (SIF) is used to invest idle cash of the Various Funds. SWIB manages the SIF with oversight by a Board of Trustees, as authorized in Wisconsin Statutes 25.14 and 25.17. SWIB is not registered with the Securities and Exchange Commission (SEC) as an investment company.

### *A. Local Government Property Insurance Fund*

The Local Government Property Insurance Fund (LGPIF) provides property insurance protection to local government units on an optional basis. The Office of the Commissioner of Insurance (OCI) is responsible for administering the operations of the LGPIF, while SWIB performs the investment activities for the fund. SWIB's investment objective is to maintain a high quality portfolio that provides for a high degree of liquidity, a relatively moderate degree of risk, and a high rate of return consistent with the priorities of liquidity and protection of principal. Wisconsin Statute 25.17(3)(b) allows investments in direct obligations of the United States and Canada, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, Yankee/Euro dollar issues, certificates of deposit issued by banks in the United States, and solvent financial institutions in this state.

### *B. State Life Insurance Fund*

The State Life Insurance Fund (SLIF) offers low cost life insurance protection to Wisconsin residents in amounts up to \$10,000 per person. The Office of the Commissioner of Insurance is responsible for administering the operations of the SLIF. SWIB's investment objective is to maintain a diversified portfolio of high quality income obligations that will preserve principal, maximize income while minimizing costs to policyholders, and approximate the expected life of the Fund's insurance contracts. Wisconsin Statute 25.17(3)(a) allows investments in loans, securities and any other investments as authorized by s. 620.22, Wis. Stats. Permitted classes of investments include bonds of government units or of private corporations, loans secured by mortgages, preferred or common stocks, real property and other investments not specifically prohibited by statute.

### *C. Injured Patients and Families Compensation Fund*

The Injured Patients and Families Compensation Fund (IPFCF) provides medical malpractice insurance protection to health care providers permanently practicing or operating in Wisconsin. Management of the IPFCF is vested with a Board of Governors and administration of the operations of the fund is the responsibility of the Office of the Commissioner of Insurance. Since September 1990, SWIB has been responsible for investing the securities held by this Fund. SWIB's investment objective is to maintain a portfolio of investments with maturities and liquidity levels that are appropriate for the needs of the IPFCF. Wisconsin Statute 25.17(3)(a) allows investments in loans, securities and any other investments as authorized by s. 620.22, Wis. Stats. Permitted classes of investments include bonds of governmental units or of private corporations, loans secured by mortgages, preferred or common stock, real property and other investments not specifically prohibited by statute.

### *D. Historical Society Trust Fund*

The State Historical Society of Wisconsin collects and preserves historical and cultural resources relating to the history of Wisconsin and the western United States, conducts historical research, facilitates and encourages education in Wisconsin history, and serves as the Trustee of the State for the preservation and care of government

records. In addition to state and federal funds, the Historical Society receives gifts, grants, and bequests to assist it in carrying out its mission. The gifts, grants and bequests are deposited into the Historical Society Trust Fund (HSTF). SWIB is responsible for managing and supervising the fund's investments. Any income earned, except where reinvestment is required by the terms of the gift or bequest, may be expended by the Historical Society in accordance with provisions of the gift, grant or bequest. The Historical Society funds available for investment are authorized to be invested in "every kind of property, real, personal or mixed, and every kind of investment, specifically including but not by the way of limitation, bonds, debentures, and other corporate obligations, stocks, preferred or common, and shares of investment companies and investment trusts, which persons of prudence, discretion, and intelligence acquire or retain for their own account."

#### *E. EdVest Tuition Trust Fund*

The EdVest Wisconsin program offers families a way to prepare for future higher education costs through the purchase of tuition units. These units, plus investment earnings, are expected to equal one percent of the projected average annual cost of tuition at University of Wisconsin campuses in the year of their use. The Office of State Treasurer is responsible for the administration of the EdVest Wisconsin program. Wisconsin Statute 14.63(10)(b) directs SWIB to invest moneys held in the Tuition Trust Fund in investments with maturities and liquidity that are appropriate for the needs of the fund as reported by the State Treasurer in his or her quarterly reports. All income derived from such investments shall be credited to the fund.

## **2. Significant Accounting Policies**

#### *A. Basis of Presentation*

The accompanying financial statements of the investment activity of the Various Funds are prepared in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The Local Government Property Insurance Fund, the State Life Insurance Fund, and the Injured Patients and Families Compensation Fund operate similar to insurance enterprises and are reported by the State as proprietary funds. In reporting the investment activity of proprietary funds, SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements. The Historical Society Trust Fund is reported by the State as a governmental fund and the EdVest Tuition Trust Fund is reported by the State as a fiduciary fund.

#### *B. Basis of Accounting*

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Dividend income is recorded on the ex-dividend date, and interest income is accrued as earned.

#### *C. Valuation of Securities*

As required by Governmental Accounting Standards Board Statement No. 31, the investments of the Various Funds are valued at fair value, with unrealized and realized gains and losses reflected in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments".

Generally, fair value is based on quoted market prices. Private placements are priced via a multi-tiered method. This method prices each holding based on the best available information using a hierarchy of pricing sources.

#### *D. Use of Estimates*

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect amounts reported herein. Due to the inherent uncertainty involved, actual results could differ from those estimates.

#### E. Cash and Cash Equivalents

Cash and Cash Equivalents reported on the Statement of Net Investment Assets include bank deposits and the individual funds' shares in the State Investment Fund.

### 3. Deposits and Investments

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. Inspection of levels of diversification, nominal risk exposures, risk/return plots, and matching liabilities with assets forms the core of the monitoring process. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines. On a monthly basis, guideline exceptions, if any, are reported to SWIB's Compliance Committee.

#### A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Various Funds. The Various Funds' (except for EdVest) investment guidelines provide that issues be rated "A-" or better at the time of purchase based on the minimum credit ratings as issued by nationally recognized statistical rating organizations (NRSROs). EdVest guidelines do not specifically list a minimum credit quality. As of June 30, 2005, these credit ratings were as follows:

Credit Quality Distribution for Fixed Income Securities										
	LGPIF		State Life		IPFCF		Historical Society		EdVest	
	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%
US Treasury	\$1,976,610	4.6%	\$35,695,406	41.7%	\$192,837,507	31.1%	\$0	0.0%	\$470,097	4.1%
AAA	5,024,004	11.6%	5,019,677	5.9%	77,585,847	12.5%	0	0.0%	8,975,146	78.4%
AA	0	0.0%	7,203,254	8.4%	60,444,901	9.8%	3,027,605	94.4%	330,530	2.9%
A	0	0.0%	22,983,818	26.9%	173,305,454	28.0%	0	0.0%	962,597	8.4%
BBB	0	0.0%	7,557,967	8.8%	72,951,270	11.8%	0	0.0%	496,502	4.3%
BB	0	0.0%	1,223,945	1.4%	16,174,200	2.6%	0	0.0%	85,500	0.8%
B	0	0.0%	895,000	1.0%	4,437,500	0.7%	0	0.0%	102,500	0.9%
Not Rated	0	0.0%	2,101,510	2.5%	0	0.0%	0	0.0%	0	0.0%
Subtotal	\$7,000,614	16.2%	\$82,680,577	96.6%	\$597,736,679	96.5%	\$3,027,605	94.4%	\$11,422,872	99.8%
SIF (unrated)	36,253,000	83.8%	2,913,000	3.4%	21,344,000	3.5%	178,000	5.6%	20,000	0.2%
Totals	\$43,253,614	100.0%	\$85,593,577	100.0%	\$619,080,679	100.0%	\$3,205,605	100.0%	\$11,442,872	100.0%

Note: SIF shares are reported on the Statement of Net Investment Assets as Cash and Cash Equivalents.

#### B. Custodial Credit Risk

Deposits - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Various Funds will not be able to recover deposits that are in possession of an outside party. The Various Funds do not have a deposit policy specifically for custodial credit risk. As of June 30, 2005 the Various Funds had \$5,696 deposited in a bank account covered by federal depository insurance.

Investments - Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Various Funds will not be able to recover the value of investments that are in the possession of an outside party. The Various Funds do not have an investment policy specifically for custodial credit risk. As of June 30, 2005 the Various Funds did not have any investment securities exposed to custodial credit risk.

### C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. With the exception of EdVest, the Various Funds investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or sector exposure limits. Generally, the guidelines provide that no single issuer may exceed 5% of the fund investments, with the exception of U.S. Government and its Agencies, which may be unlimited. The LGPIF further limits mortgage-backed, asset-backed, and individual corporate issuers to 3% of the market value of the fund investments.

As of June 30, 2005 no Various Fund had more than five percent of their total investments (including the SIF) in a single issuer.

### D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Various Funds use the duration method to identify and manage interest rate risk. Three of the Various Funds have investment guidelines relating to interest rate risk. The LGPIF guidelines provide that a bond's maturity must not exceed ten years. The State Life guidelines provide the portfolio weighted average maturity, including cash, shall be a minimum of ten years. The IPFCF guidelines provide that the average duration of the aggregate bond portfolio shall be less than ten years.

<b>Duration for Fixed Income Securities (in years)</b>										
	LGPIF		State Life		IPFCF		Historical Society		EdVest	
	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration
Govt/Agcy	\$7,000,614	0.99	\$36,789,956	11.41	\$231,640,424	5.37	\$0	0.00	\$9,298,671	5.60
Corporate	0	0.00	45,890,621	10.21	366,096,255	5.82	0	0.00	2,124,201	4.11
Bond Funds	0	0.00	0	0.00	0	0.00	3,027,605	5.21	0	0.00
Subtotal/Ave	\$7,000,614	0.99	\$82,680,577	10.75	\$597,736,679	5.65	\$3,027,605	5.21	\$11,422,872	5.33
SIF	36,253,000	0.08	2,913,000	0.08	21,344,000	0.08	178,000	0.08	20,000	0.08
Total/Ave	<u>\$43,253,614</u>	0.23	<u>\$85,593,577</u>	10.38	<u>\$619,080,679</u>	5.45	<u>\$3,205,605</u>	4.93	<u>\$11,442,872</u>	5.32

### E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The Various Fund investment guidelines do not specifically address foreign currency risk with the exception that State Life only allows investments in US dollar denominated instruments. As of June 30, 2005 the Various Funds did not own any issues denominated in a foreign currency.

## 4. Derivative Financial Instruments

*Interest Only Strips* - Interest only strips are securities that derive cash flow from the payment of interest on underlying debt securities. EdVest held several interest only strips for yield enhancing purposes. Because the underlying securities are United States Treasury obligations, the credit risk is low. On the other hand, interest only strips are more volatile in terms of pricing, and thus the market risk is higher than traditional United States Treasury obligations.

As of June 30, 2005 and 2004, the EdVest Tuition Trust Fund held interest only strips valued at \$8.8 and \$8.5 million, representing approximately 77.3% and 74.4% of portfolio investments, respectively.

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