

State of Wisconsin Investment Board

2002 Annual Report

Table of Contents

INTRODUCTION	3
Message From The Chair	4
Executive Director's Message	5
Overview	6
Management Costs	7
Board of Trustees	8
Agency Management	9
Wisconsin Retirement System	10
State Investment Fund	11
Various Funds	12
FINANCIAL STATEMENTS	13
State Investment Fund	14
Retirement Funds	24
Various Funds	40

This document includes a brief overview of the assets under management by the Investment Board and the Financial Statements for the fiscal year ending June 30, 2002. A complete listing of the Board's investments for the fiscal year is available on the Internet at www.swib.state.wi.us or by contacting the State of Wisconsin Investment Board.

State of Wisconsin
Investment Board

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Introduction

Message from the Chair



Jon Hammes
Chair

"It is a challenge to be a long-term investor in volatile markets. Careful planning that considers a broad range of perspectives and strategies will keep us on the path to success."

An important responsibility of the Board of Trustees is to approve the allocation of Wisconsin Retirement System assets among stocks, bonds, real estate and other types of investments. Our goal is to earn an 8% average annual rate of return over the long-term. If we meet this goal, the WRS will meet its obligations to participants and employer contribution rates can remain fairly stable.

In the exceptional markets of the 1980s and 1990s, returns for the Fixed (balanced) Retirement Fund averaged 12.8%. Retiree benefits increased 75% more than the rate of inflation, benefit formulas for active employees were improved and employer contribution rates were reduced. However, over the last two years, the markets have sharply reversed direction and the 8% objective has become a much steeper hurdle.

In this changing market environment, the Board will complete its next annual asset allocation review in early 2003. In preparation, we will draw upon the diverse views of market strategists and investment managers. Our planning will be anchored by several fundamental concepts: (1) Markets downturns are to be expected; (2) Stocks and other equities have outperformed most other assets over the long-term; and (3) Markets tend to get over valued on the way up and to over correct on the way down.

Another important consideration in our planning is the differing perspectives of WRS members. Those who are many years from retirement are more likely to have a longer-term perspective. Retired members are more likely to be concerned about investment results in the near term and the effect on the benefits they already receive. We have a fiduciary obligation to fairly consider and weigh these differing perspectives in our planning.

The result of our work should be a strategy that strives to reach our long-term goal through up and down market cycles. This may not necessarily result in large changes in our current asset allocation. Moving just 1% of Fixed Fund assets from one asset class to another would shift about \$450 million, a considerable sum.

It is a challenge to be a long-term investor in volatile markets. Careful planning that considers a broad range of perspectives and strategies will keep us on the path to success.

A handwritten signature in black ink, appearing to read "Jon Hammes". The signature is fluid and cursive, with a long horizontal stroke at the end.

Jon Hammes
Chairman
June 30, 2002

Executive Director's Message

It is a privilege to present the Annual Financial Report on behalf of the State of Wisconsin Investment Board for the fiscal year ending June 30, 2002. Total assets managed by the Investment Board as of June 30, 2002, were over \$61 billion with 89%, or \$54.7 billion, in the Wisconsin Retirement System (WRS) Trust Funds.

Like other investors, the Trust Funds have been hard hit by declining markets. We continue to focus on the long-term and selecting the right asset mix to help ensure that the WRS is able to pay the benefits due to current as well as future retirees. Even in a time of extremely difficult markets, there is some good news in our performance story.

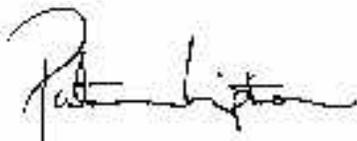
Both the Fixed and Variable Retirement Trust Funds outperformed their one-year benchmarks. The Fixed Fund returned -4.8% versus the benchmark of -5.2% and the Variable Fund -14.7% compared to -15.3% for the benchmark. Both funds also outperformed five- and ten-year benchmarks.

Compared to our peers, our performance was helped by less weighting in domestic stocks as the market continued to decline this fiscal year. Diversification also had a positive impact with three portfolios earning positive returns: Fixed Income, 7.6%; Alternative Investments (such as private equity), 0.7% and Real Estate 7.9%.

For the year ending June 30, the Fixed Fund ranked in the top quartile of 40 public funds with assets greater than \$1 billion and the top 40% for five-year returns.*

During the past fiscal year, the stock markets saw a severe drop through January before recovering in the second half, only to drop again by June 30, 2002. Since September 2000, the market has been experiencing its third largest downturn in 70 years. The negative markets have been fueled by the revelation of questionable or fraudulent financial practices by several large US corporations. SWIB has joined other institutional investors in actively pushing for improvements in corporate governance.

Such events are certainly unwelcome, but SWIB's investment strategy does take into account such difficult market conditions over several economic cycles. When considering our strategy, we review WRS assets and liabilities so that we are aligned with the long-term financial needs of the retirement system. Difficult times test the patience and discipline of investors. Our goal is to continue to outperform in strong and weak markets.



Patricia Lipton
Executive Director
June 30, 2002



Patricia Lipton
Executive Director

"Difficult times test the patience and discipline of investors. Our goal is to continue to outperform in strong and weak markets."

*Trust Universe Comparison Service

Overview

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

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.

Investment Guidelines at a Glance ...

Investments must be within guidelines established for each specific fund.

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

SWIB Seeks to ...

Diversify investments to manage risk and minimize large exposure to unpredictable events.

Invest in organizations that adhere to prevailing laws and generally accepted conduct standards.

Invest in organizations that respect the basic human rights of their employees and clientele.

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

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, 2002

<u>Fund</u>	<u>\$ in Millions</u>	<u>% of Total</u>
Wisconsin Retirement System	\$ 54,738	89%
<i>Fixed Retirement Trust Fund</i>	49,271	80
<i>Variable Retirement Trust Fund</i>	5,467	9
State Investment Fund*	5,181	8
Various Funds		
Tobacco Endowment Fund	595	1
Patients Compensation Fund	588	1
State Life Insurance Fund	73	0
Local Gov't Property Insurance Fund	28	0
Historical Society Trust Fund	10	0
Tuition Trust Fund	15	0
Total	\$ 61,228	100%

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

Management Costs

Total costs of the State of Wisconsin Investment Board include agency operating expenses as well as fees paid to outside suppliers of investment services. In fiscal year 2002, agency operating expenses for staff compensation overhead and equipment were \$18.2 million. Compared to the average value of assets managed, the cost per \$100 of securities managed was 2.85 cents.

Cost of Management - June 30, 2002

	Fiscal Year Ended June 30, 2002	Fiscal Year Ended June 30, 2001
PROGRAM REVENUE AVAILABLE		
Prior Year Balance	\$ 2,739,500	\$ 2,726,800
RECEIPTS FROM:		
State Investment Fund	\$ 811,500	\$ 1,286,900
Fixed Retirement Trust Fund	14,124,000	15,949,800
Variable Retirement Trust Fund	1,609,600	1,840,900
Local Gov't Property Ins. Fund	20,000	48,300
State Life Insurance Fund	41,100	67,500
Historical Society Trust Fund	5,800	25,700
Patients Compensation	53,300	23,700
Tuition Trust Fund	10,800	66,400
Act 11 Retirement Credit	141,200	0
Miscellaneous	15,300	11,400
Total Receipts	\$ 16,832,600	\$ 19,320,600
TOTAL REVENUE AVAILABLE	\$ 19,572,100	\$ 22,047,400
DISBURSEMENTS:		
Salaries	\$ 10,520,100	\$ 12,358,900
Fringe Benefits	2,857,000	3,094,300
Supplies & Equipment	4,839,600	3,854,700
AGENCY OPERATING EXPENSES	\$ 18,216,700	\$ 19,307,900
CLOSING BALANCE	\$ 1,355,400	\$ 2,739,500

Total costs also include external management fees paid to outside advisors to actively manage up to 15% of the Fixed and Variable Fund assets. Costs of other support services include custodial banking services, investment research, passive management fees, legal services and advisory services. These fees are charged directly to the current income accounts of funds managed by SWIB.

Annually, SWIB participates in an independent review of costs compared to other investment managers with similar objectives. An analysis by Cost Effectiveness Measurement, Inc. concluded that SWIB's total cost to manage the Fixed Fund in calendar year 2001 was 22 cents per \$100 managed compared to 27 cents for managers with a similar mix of assets.

Fixed Fund Costs per \$100 Managed

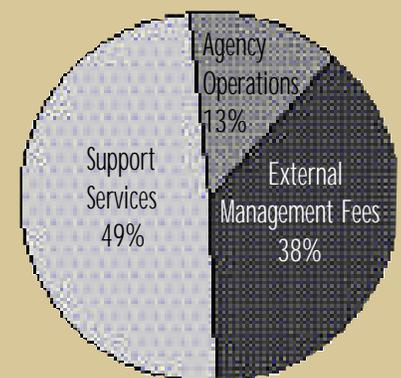
Calendar Year 2001



Management Costs at a Glance ...

- Total costs for all funds were 19¢ per \$100 managed.
- All management costs are funded with earnings of the funds managed.

Calendar Year 2001
Total Costs = \$131.8 million



Board of Trustees

Board Members...

- 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 LGIP.*
- Teacher participant in the WRS appointed by the Teacher Retirement Board.
- Non teacher participant in WRS appointed by the Wisconsin Retirement Board.
- Secretary of the Department of Administration or designee.
(Appointed members of the Board serve six-year terms.)

Board Responsibilities...

- Establish long-term investment policies.
- Set guidelines for each investment portfolio.
- Monitor investment performance.



Left to right, seated front, John Petersen III, Jon Hammes, Eric Stanchfield. Left to right, standing back, George Lightbourn, James Senty, Wayne McCaffery, Andrea Steen Crawford., William Sauey, James Nelsen.

Jon D. Hammes - Chair (*Public Member*)
President, Hammes Company, Brookfield

John Petersen III - Vice-Chair (*Public Member*)
President, Inland Investment Co., Madison

Eric O. Stanchfield - Secretary (*WRS, Wisconsin Retirement Board Appointee*)
Secretary, Department of Employee Trust Funds

Andrea Steen Crawford (*Local Government Public Member*)
Village Manager, Village of Elm Grove

George Lightbourn
Secretary, Department of Administration

Wayne McCaffery (*WRS, Teacher Retirement Board Appointee*)
Teacher, Stevens Point

James R. Nelsen (*Public Member*)
Investment Advisor, Loomis, Sayles & Company, Milwaukee

William R. Sauey (*Public Member*)
Chairman/President, Nordic Group of Companies, Ltd., Baraboo

James A. Senty (*Public Member*)
President, Midwest Gas Companies, La Crosse

Agency Management

Senior Management

Executive Director - Patricia Lipton

Assistant Executive Director - James M. Gannon

Chief Investment Officer - Public Fixed Income - Jon R. Traver

Chief Investment Officer - Public Equities - Jean C. Ledford

Chief Operating Officer - Kenneth W. Johnson

Chief Legal Officer - Keith L. Johnson

Director of Human Resources - Ledell Zellers

Director of Internal Audit - James W. Kaellner

Senior Investment Managers

Domestic Equities

Jackie S. Doeler

Steven F. Hilmer

William A. McCorkle

John F. Nelson

Trisha L. Reopelle

International Equities

Charles D. Saunders

Real Estate

Robert H. Severance

Domestic Public Fixed Income

Laurel A. Butler

Eve A. Hampton

Sally J. Lee

John J. Zwadzich

Global Fixed Income

J. Alain Hung

Alternative Investments

James M. Gannon

Monica A. Jaehnig

Jon R. Vanderploeg

Michael A. Wagner

SWIB Staff at a Glance...

- 104.5 authorized positions.
- A majority of the investment staff holds or is pursuing the Chartered Financial Analyst (CFA) designation.
- The Board adheres to the industry standards of the Association for Investment Management Research.
- Professional standards and continuing education are stressed for staff.

Wisconsin Retirement System

WRS at a Glance...

- The Wisconsin Retirement System includes about 492,000 participants.
- Participants are current and former employees of state agencies and local governments.
- WRS is comprised of the Fixed Trust Fund, a balanced fund, and the Variable Trust Fund, a stock fund.
- The Fixed Trust Fund capital gains and losses are spread over several years to smooth account returns.
- The Variable Fund annuities fully reflect the gains and losses of the investments.
- Nearly 91,000 people participate in the Variable Trust Fund.

The Wisconsin Retirement System (WRS) makes up about 89% of the assets managed by SWIB. As fiduciary for the funds, SWIB is dedicated to earning the best possible rate of return within acceptable risk parameters and “prudent expert” standards in all investment matters. More than 492,000 people participate in the WRS, including current and former employees of Wisconsin’s state agencies and most local governments. The WRS is comprised of the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund. As of June 30, 2002, the total assets of the WRS were \$54.7 billion.

The larger of the two trust funds comprising the WRS is the Fixed Trust Fund, which is a balanced fund. It is a broadly diversified portfolio of stocks, bonds, real estate and other holdings.

In 2001, the Variable Fund was reopened to WRS participants who are active employees. It is primarily invested in stocks.

The process for determining the effect of investment returns on employee accounts (the “effective rate”) and change in benefits for retirees differs between the Variable and Fixed Funds. The Department of Employee Trust Funds computes those amounts based on the December 31 rate of return for each of the two trust funds.

Annualized Performance Ending 6/30/02

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
Fixed Fund	-4.8%	5.5%	9.5%
<i>Benchmark</i>	<i>-5.2</i>	<i>4.9</i>	<i>8.8</i>
Variable Fund	-14.7%	3.8%	10.2%
<i>Equity Benchmark</i>	<i>-15.3</i>	<i>2.0</i>	<i>9.3</i>
<i>S&P 500</i>	<i>-18.0</i>	<i>3.7</i>	<i>11.4</i>

State Investment Fund

SIF at a Glance:

- SIF provided a superior rate of return, ranking 1st (tie) out of 219 government money market funds.
- SIF also ranked 40th out of 1,158 money market funds (top 4%).

State Investment Fund Annualized Time-Weighted Returns

<u>Fiscal Year</u>	<u>Return</u>
1993	4.1%
1994	3.9
1995	5.4
1996	5.4
1997	5.3
1998	5.4
1999	5.0
2000	5.5
2001	6.0
2002	2.5

The State Investment Fund (SIF) is a pool of cash balances of various state and local governmental units. It makes up about 8% of the assets managed by SWIB. The objectives of this fund are to provide liquidity, safety of principal, 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 divisions. This fund also functions as the State's cash management fund. By pooling the idle cash balances of all 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). There are total of 58 funds in the State Investment Fund.

The cash balances available for investment vary daily as cash is accumulated or withdrawn from the agency funds. It is invested primarily in obligations of the US government and its agencies, and high quality commercial bank and corporate debt obligations. Total assets of the State Investment Fund as of June 30, 2002, were \$5.9 billion.

To achieve safety of principal and liquidity, 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.

Various Funds

Historical Society Trust Fund

For more information about the State Historical Society, contact the Society at (608) 264-6400 (Madison).

Local Government Property Insurance Fund

For more information about Local Government Property Insurance contact the Office of the Commissioner of Insurance at (608) 266-3585 (Madison) or (800) 236-8517 (toll-free).

State Life Insurance Fund

For more information about the State Life Insurance Fund, contact the Office of the Commissioner of Insurance at (608) 266-0107 (Madison) or (800) 562-5558 (toll-free).

Patients Compensation Fund

For more information about the Patients Compensation Fund, contact the Office of the Commissioner of Insurance at (608) 266-6830 (Madison) or (800) 562-5558 (toll-free).

Tuition Trust Fund (EdVest)

For more information about EDVEST, contact the Office of the State Treasurer at (608) 264-7899 (Madison) or (888) 338-3789 (toll-free).

Tobacco Permanent Endowment Fund

The tobacco settlement funds are distributed for purposes established by state law.

SWIB manages six funds for various state agencies. These funds make up just over 2% 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.

PATIENTS 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 (EDVEST)

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" that 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.

TOBACCO PERMANENT ENDOWMENT FUND

The Tobacco Permanent Endowment Fund was created to invest Wisconsin's tobacco settlement payment under an agreement signed between the state and major tobacco companies.

Financial Statements



INDEPENDENT AUDITOR'S REPORT

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Ms. Patricia Lipton, Executive Director
State of Wisconsin Investment Board

We have audited the accompanying Statement of Net Assets for the State Investment Fund of the State of Wisconsin, as of June 30, 2002 and 2001, and the related Statement of Operations and Changes in Net 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements present only the investment activity of the State Investment Fund and are not intended to 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the State Investment Fund as of June 30, 2002 and 2001, and the results of its investment operations and changes in net assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the financial statements of the State Investment Fund. The Management Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and supplementary information 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 was not audited by us and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we also issued a report dated August 23, 2002, on our consideration of the Investment Board's internal control over financial reporting for the State Investment Fund and on our tests of its compliance with certain provisions of laws and regulations. That report, which was 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 read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

August 23, 2002

by



Janice Mueller
State Auditor

Management's Discussion and Analysis provides general information on the financial activities of the State Investment Fund (SIF). The SIF invests the excess operating funds of: 1) State of Wisconsin agencies, 2) the State's public retirement funds, and 3) the Wisconsin Local Government Investment Pool (LGIP). At June 30th the ownership of the SIF was as follows:

	<u>2002</u>	<u>2001</u>
1. Various State of Wisconsin agencies	22%	25%
2. Wisconsin public retirement funds	12%	11%
3. Local Government Investment Pool	66%	64%

Following this section are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the SIF. The Statement of Operations and Changes in Net Assets provides information on the investment income of the fund and its 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 SIF financial information for the fiscal years ended June 30, 2002 and 2001 is as follows:

SIF Condensed Financial Information			
Fiscal Year Ended:	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Total Assets	\$ 6,290,330,252	\$ 6,401,237,750	(1.7)
Total Liabilities	354,060,222	360,374,204	(1.8)
Net Assets	<u>\$ 5,936,270,030</u>	<u>\$ 6,040,863,546</u>	(1.7)
Investment Revenue	\$ 165,449,893	\$ 349,745,833	(52.7)
Expenses	1,179,810	1,701,628	(30.7)
State Working Bank	3,944,525	3,692,978	6.8
Net Investment Income	<u>\$ 160,325,558</u>	<u>\$ 344,351,227</u>	(53.4)
Average Daily Cash Balance	\$ 6,695,835,985	\$ 6,003,803,646	11.5
Time Weighted Annual Yield	2.51%	5.96%	(57.9)

Because SIF investment balances are used to fund participants' operating cash flows, it invests in highly-liquid, short-term domestic fixed income securities. At June 30, 2002, SIF Net Assets had decreased slightly, by \$104,593,516 from the prior year, due to participant withdrawals exceeding contributions. However, the Average Daily Cash Balance was significantly higher than the previous year, peaking at \$7.841 billion in February, 2002.

The Net Investment Income decrease of 53.4% was largely due to the Federal Open Markets Committee cutting the Fed Funds Target rate 11 times in calendar year 2001, from 6.50% to 1.75%. This also caused the Time Weighted Annual Yield to drop from 5.96% to 2.51%.

STATE INVESTMENT FUND
Statement of Net Assets
As of June 30, 2002 and June 30, 2001

	<u>June 30, 2002</u>	<u>June 30, 2001</u>
Assets		
Investments (At fair value):		
Repurchase Agreements	\$ 992,000,000	\$ 798,000,000
Government and Agency	4,915,096,950	5,196,239,080
Commercial Paper	0	0
Certificates of Deposit (CDs)	396,820,000	400,000,000
Asset Backed Securities	1,983,870	10,700,341
Mortgage Backed Securities	1,924,166	2,593,857
Yankee/Euro Issues	0	0
Swap(s)	<u>(26,806,525)</u>	<u>(25,889,413)</u>
 Total Net Investments (At fair value)	 \$ 6,281,018,461	 \$ 6,381,643,865
 Other Assets:		
Accrued Interest Receivable	<u>9,311,791</u>	<u>19,593,885</u>
 Total Assets	 <u>\$ 6,290,330,252</u>	 <u>\$ 6,401,237,750</u>
 Liabilities		
Check Float Invested	\$ 344,397,323	\$ 336,941,395
Earnings Distribution Payable	9,151,955	23,045,876
Accrued Swap Payments	449,944	315,933
Accrued Expenses	<u>61,000</u>	<u>71,000</u>
 Total Liabilities	 <u>\$ 354,060,222</u>	 <u>\$ 360,374,204</u>
 Net Assets	 <u>\$ 5,936,270,030</u>	 <u>\$ 6,040,863,546</u>
 Net Assets consist of:		
Participating Shares	\$ 5,948,004,000	\$ 6,052,869,000
Undistributed Unrealized Gains (Losses)	<u>(11,733,970)</u>	<u>(12,005,454)</u>
 Net Assets	 <u><u>\$ 5,936,270,030</u></u>	 <u><u>\$ 6,040,863,546</u></u>

The accompanying notes, on pages 19 through 23, are an integral part of this document.

STATE INVESTMENT FUND
Statement of Operations and Changes in Net Assets
For the Fiscal Years Ended June 30, 2002 and 2001

	<u>June 30, 2002</u>	<u>June 30, 2001</u>
Investment Revenue		
Investment Income	\$ 177,186,177	\$ 356,589,287
Net Swaps Revenue (Expense)	<u>(11,736,284)</u>	<u>(6,843,454)</u>
Total Investment Revenue	\$ 165,449,893	\$ 349,745,833
Expenses		
Management Operating Expense Allocation	\$ 811,515	\$ 1,286,852
Custodial Bank Charges	203,236	205,795
State Treasurer Costs	39,572	35,609
Electronic Services	75,349	129,032
Legal and Consulting Fees	<u>50,138</u>	<u>44,340</u>
Total Expenses	<u>\$ 1,179,810</u>	<u>\$ 1,701,628</u>
Net Investment Revenue	\$ 164,270,083	\$ 348,044,205
State Working Bank Charges Allocation	<u>3,944,525</u>	<u>3,692,978</u>
Net Investment Income	\$ 160,325,558	\$ 344,351,227
Distributions Paid and Payable	<u>160,054,074</u>	<u>339,552,422</u>
Change in Undistributed Unrealized Gains (Losses)	\$ 271,484	\$ 4,798,805
Beginning of Period Undistributed Unrealized Gains (Losses)	<u>(12,005,454)</u>	<u>(16,804,259)</u>
End of Period Undistributed Unrealized Gains (Losses)	<u>\$ (11,733,970)</u>	<u>\$ (12,005,454)</u>
Participant Transactions		
Receipts by Transfer to Fund	\$ 24,678,495,000	\$ 23,224,238,000
Disbursements by Transfer from Fund	<u>(24,783,360,000)</u>	<u>(21,969,668,000)</u>
Net Change in Participating Shares	\$ (104,865,000)	\$ 1,254,570,000
Beginning of Period Participating Shares	<u>6,052,869,000</u>	<u>4,798,299,000</u>
End of Period Participating Shares	<u>\$ 5,948,004,000</u>	<u>\$ 6,052,869,000</u>
Net Assets	<u>\$ 5,936,270,030</u>	<u>\$ 6,040,863,546</u>

The accompanying notes, on pages 19 through 23, are an integral part of this document.

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 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, each State Agency’s share of the SIF is reported in their 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 SIF is managed by the staff of the State of Wisconsin Investment Board (SWIB) 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 that can be invested in, 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 this state and bankers acceptances. The Board of Trustees may approve other prudent investments. The Board of Trustees has given standing authority to SWIB staff to invest in resale agreements, financial futures contracts, options and interest rate swaps on behalf of the SIF.

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. 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

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, has compiled fair value information for all securities by utilizing third party pricing services. Government and 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, maturities, and credit ratings. Repurchase agreements and certificates of deposit are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. Swaps are valued at the net present value of estimated expected future cash flows using discount rates commensurate with the risk involved. In addition, a bond issued by a State of Wisconsin agency, having a par value at June 30, 2002 of \$1.9 million, is valued at par, which management believes approximates fair value. The fair value of investments is determined at the end of each month.

Summary Information by Investment Classifications

	June 30, 2002				June 30, 2001	
	Interest Rates	Maturity Dates	Fair Value	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)
Repurchase Agreements	1.90-1.97	07/01/02-				
Government and Agency	1.72-7.02	07/01/02-02/15/05	\$ 992,000,000	\$ 992,000,000	\$ 798,000,000	\$ 798,000,000
Commercial Paper	N/A	N/A	0	0	0	0
Certificates of Deposit	1.80-7.42	07/15/02-06/17/04	396,820,000	396,820,000	400,000,000	400,000,000
Asset Backed Securities	2.25	10/25/02	1,983,870	1,977,316	10,700,341	10,696,167
Mortgage Backed Securities	2.84	04/27/05	1,924,166	1,924,166	2,593,857	2,593,857
Yankee/Euro Issues	N/A	N/A	0	0	0	0
Swap(s)	N/A	03/16/05	(26,806,525)	0	(25,889,413)	0
Total Investments			<u>\$6,281,018,461</u>	<u>\$6,292,752,431</u>	<u>\$6,381,643,865</u>	<u>\$6,393,649,319</u>
Ratio of Fair Value to Book Value				<u>99.8135%</u>		<u>99.8122%</u>

D. Management Operating Expenses

Management operating expenses are SWIB's administrative costs that are allocated, in advance, to the SIF participants. Also, 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 realized investment gains and losses calculated on an amortized cost basis, interest income based on stated rates (both paid and accrued), amortization of discounts and premiums on a straight-line 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 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's Public Deposit Guarantee Fund protects a depositing municipality up to \$400,000 if the local governing body has designated the LGIP as a public depository.

4. Deposits and Investments

Deposits – As of June 30, 2002, the SIF held certificates of deposit with an estimated fair value of \$396.8 million invested pursuant to the Wisconsin Certificate of Deposit Program implemented in July 1987. Banks that are accepted into this program must be located in Wisconsin and meet credit screening criteria designed to assure the safety of the deposits.

The Governmental Accounting Standards Board (GASB) requires deposits with financial institutions to be categorized to indicate the level of risk assumed by the SIF as defined in GASB Statement No. 3. Category 1 consists of deposits that are insured or collateralized with securities held by the State or by its agent in the State's name. Approximately \$379.1 million falls under this category through FDIC insurance, the Wisconsin State Deposit Guarantee Fund, and Financial Securities Assurance Corporation insurance. The remaining \$17.7 million are considered Category 3 uncollateralized deposits. The actual coverage of these deposits fluctuates daily based on the allocable share of participants' accounts.

Investments – The GASB Statement No. 3 also requires investments to be categorized to indicate the level of risk assumed by the SIF at year-end. The categories are:

1. Insured or registered, or securities which are held by the Fund in the Fund's name or its agent in the Fund's name.
2. Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Fund's name.
3. Uninsured and unregistered, with the securities held by the counterparty or by its trust department or agent, but not in the funds name.

Securities Categorized by Level of Risk				
	Category			Fair and Carrying Value
	1	2	3	
<u>Deposits:</u>				
CDs (Nonnegotiable)	\$ 379,114,978	\$ 0	\$ 17,705,022	\$ 396,820,000
<u>Investments:</u>				
Repurchase Agreements	\$ 992,000,000	\$ 0	\$ 0	\$ 992,000,000
Government and Agency	4,915,096,950	0	0	4,915,096,950
Commercial Paper	0	0	0	0
CDs (Negotiable)	0	0	0	0
Asset Backed Securities	1,983,870	0	0	1,983,870
Mortgage Backed Securities	1,924,166	0	0	1,924,166
Yankee/Euro Issues	0	0	0	0
Subtotal	<u>\$ 5,911,004,986</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 5,911,004,986</u>
Not Categorized:				
Swap				<u>\$ (26,806,525)</u>
Total Investments				<u>\$ 6,281,018,461</u>

5. Derivative Financial Instruments

As of June 30, 2002, the only derivative financial instrument held by the SIF was the March 16, 1995 restructured interest rate swap which required periodic payments over ten years, as discussed in detail in Footnote 6. Each swap transaction involves the exchange of interest rate payment obligations without the exchange of underlying principal amounts. The notional amounts used to express the volume of these transactions do not represent the amounts subject to risk, but represent the amount on which both parties calculate interest rate obligations. The settlement of the interest rate exchange occurs at predetermined dates, with the net difference between the interest paid and interest received reflected as an increase in income. Entering into interest rate swap agreements subjects the investor to the possibility of financial loss in the event of adverse changes in market rates or nonperformance by the counterparty to the swap agreement. Selecting creditworthy counterparties mitigates credit risks arising from derivative transactions.

For fiscal years 2002 and 2001, the cash outflow for the restructured interest rate swap was (\$11,602,273) and (\$6,750,199) respectively.

6. 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 requires SWIB to make periodic payments over a period of ten years, while the other agreement requires periodic payment of the loss over a period of five years. Interest cost associated with the periodic payment of the loss over time is estimated to be \$24.8 million. Future earnings will be charged as payments are 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 the Board of Trustees adopted investment guidelines prohibiting the use of such instruments on November 2, 1995. The following schedules provide more analysis of the restructured investments.

Restructured Investments Analysis

	Fair Value		
	June 30, 2002	June 30, 2001	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	\$ 0	\$ 0	\$ (27,926,000)
<u>Restructured Asset Amortizing Swaps</u>			
SLMA Currency Linked NZ\$ vs. Yen	\$ 0	\$ 0	\$ (4,995,000)
Grantor Trust Currency Linked C\$ vs. Lira vs. Yen	0	0	(27,400,000)
Subtotal	\$ 0	\$ 0	\$ (32,395,000)
<u>Mexican - Spread Restructuring Swap</u>			
10.74% - 1m USD Libor	\$ (26,806,525)	\$ (25,889,413)	\$ (35,000,000)
US Treas. 7.50% 2/15/05 Hedge-Unreal. Gain	13,911,884	10,921,881	0
Subtotal	\$ (12,894,641)	\$ (14,967,532)	\$ (35,000,000)
Total Fair Value	\$ (12,894,641)	\$ (14,967,532)	\$ (95,321,000)

As of June 30, 2002, anticipated cash requirements for deferred loss principal and interest payments are as follows:

Fiscal Year Ended:	Deferred Loss Cash Requirements		
	Principal	Interest	Total
June 30, 2003	\$ 4,326,703	\$ 994,930	\$ 5,321,633
June 30, 2004	4,778,983	584,417	5,363,400
June 30, 2005	3,816,569	143,331	3,959,900
June 30, 2006	0	0	0
June 30, 2007	0	0	0
Thereafter	0	0	0
Total	\$ 12,922,255	\$ 1,722,678	\$ 14,644,933

7. Related Party Transactions

The SIF held one bond issued by a State of Wisconsin agency with a remaining par and carrying value totaling \$1.9 million at June 30, 2002. Management believes the rates of interest received are comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.



INDEPENDENT AUDITOR'S REPORT

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Ms. Patricia Lipton, Executive Director
State of Wisconsin Investment Board

We have audited the accompanying Statements of Net Investment Assets for the Retirement Trust Funds (Fixed Retirement Trust Fund and Variable Retirement Trust Fund) of the State of Wisconsin, as of June 30, 2002 and 2001, 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 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 present only the investment activity of the Retirement Trust Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements are not intended to present the financial activity of the Retirement Trust Funds attributable to the Department of Employee Trust Funds, nor are they intended to 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.

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 Trust Funds as of June 30, 2002 and 2001, and the changes in net investment assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

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.

As discussed in Note 9, during fiscal year 2001-02, the Investment Board changed the method by which it estimates fair values for its private placement portfolios. The new valuation method resulted in a net decrease in value of \$167.1 million during the fiscal year because it recognizes the investment return more gradually over the life of the investment than the previous method had.

Our audits were made for the purpose of forming an opinion on the financial statements of the Retirement Trust Funds of the State of Wisconsin. The Management Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and supplementary information 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 was not audited by us and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated December 3, 2002, on our consideration of the Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. 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 read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

December 3, 2002

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, 2002 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 provide a comparison of the prior year's activity and results.

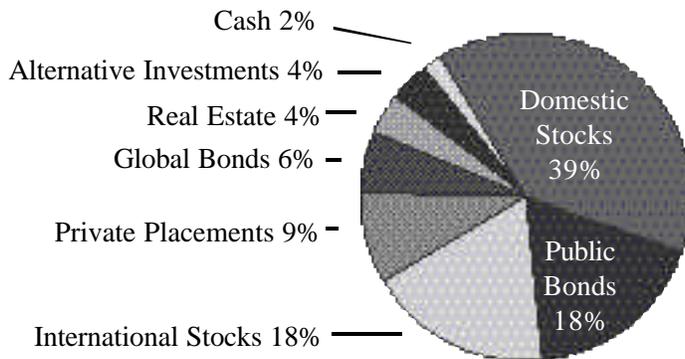
Following this section are the financial statements and footnotes which reflect only the investment activity of these funds. Retirement reserves, contribution revenue and benefit expense are excluded from presentation in these statements.

The financial statements consist of the Statement of Net Investment Assets and the Statement of Changes in Net Investment Assets. 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 for 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 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.

More than 492,000 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 benefits. The WRS is comprised of the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund. As of June 30, 2002, the total net assets of the WRS were \$54.7 billion.

The WRS is basically a defined benefit (DB) plan, meaning that a participant who meets certain criteria is entitled to a lifetime annuity. That annuity is based on a formula determined by the person's age, years of service, average three highest salary years and a multiplier. However, because WRS participants share in the earnings of the fund during their working years, the WRS also acts like a defined contribution (DC) plan in some respects. At the time of retirement, the participant will receive the higher of either an annuity determined using the formula or an annuity based on the accumulated effective rate earnings in his or her account. The latter is referred to as a money purchase annuity.

Fixed Retirement Trust Fund



The larger of the two trust funds comprising the Wisconsin Retirement System is the Fixed Retirement Trust Fund (FRTF) totaling \$49.3 billion. All WRS members have at least half — if not all — of their pension account in the FRTF. 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 8% annual return over the

long-term and a rate of return of 3.5% 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.

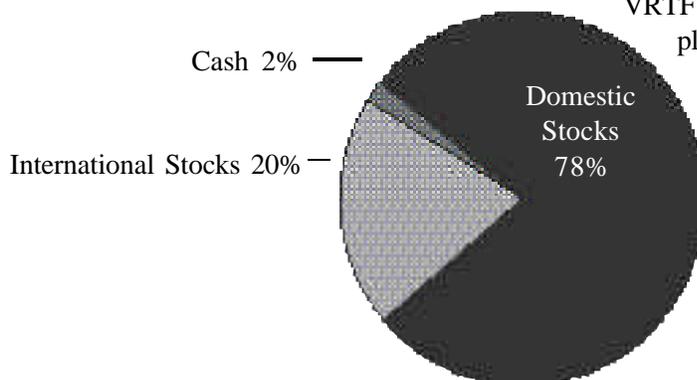
Fixed Retirement Trust Fund Condensed Financial Information			
Fiscal Year Ended:	2002	2001	% Change
Total Assets	\$ 52,710,409,313	\$ 56,677,322,949	(7.00)
Total Liabilities	3,439,086,591	3,263,414,229	5.38
Net Assets	<u>\$ 49,271,322,722</u>	<u>\$ 53,413,908,720</u>	(7.76)
Investment Revenue (Loss)	\$ (2,531,335,286)	\$ (3,059,540,050)	17.26
Expenses	(135,272,310)	(112,676,966)	20.05
Net Investment Income (Loss)	<u>\$ (2,666,607,596)</u>	<u>\$ (3,172,217,016)</u>	15.94

The FRTF net investment assets decreased by \$4.1 billion or a decline of 7.76%. This was primarily due to a decline in investment returns as a result of the downturn in the equities market. The equity investments annualized rate of return was negative 13.7%. This compares favorably with SWIB's FRTF equity investment benchmark which returned a negative 14.8% over the same period. On the other hand, fixed income investments returned 7.6% and real estate investments earned 7.9%. Net investment assets were further reduced over the fiscal year by net benefit payments exceeding contribution revenues by \$1.3 billion, representing a 2.5% reduction in net assets over the fiscal year.

Expenses increased 20.05% over fiscal year 2001. Most of this increase can be attributed to costs associated with new portfolios managed outside of SWIB. During this time period, SWIB allocated more assets to external managers, thus increasing base management fees. Base management fees are traditional flat fees based on the market value of managed assets. In addition, the FRTF began moving assets to portfolios where performance based management fees are earned. Performance fees are earned by an external manager when the portfolio's performance meets or exceeds an agreed upon performance objective. The \$18.5 million paid in performance fees in fiscal year 2002 were more than offset by the \$85.6 million by which the managers outperformed their benchmarks.

Variable Retirement Trust Fund

The Wisconsin Legislature passed, and the Governor signed into law, 1999 Wisconsin Act 11 which reopened the VRTF 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 18% of WRS members participate in the Fund, which totaled \$5.5 billion at the end of fiscal year 2002. It is 98% invested in equities with the remainder in cash. Employees who choose this fund accept a higher degree of risk for the potential of greater long-run returns. The investment objective of the VRTF is to exceed similar equity-oriented portfolios over a full market cycle.



Variable Retirement Trust Fund Condensed Financial Information			
Fiscal Year Ended:	2002	2001	% Change
Total Assets	\$ 5,854,559,417	\$ 6,968,287,538	(15.98)
Total Liabilities	387,615,118	208,090,952	86.27
Net Assets	<u>\$ 5,466,944,299</u>	<u>\$ 6,760,196,586</u>	(19.13)
Investment Revenue (Loss)	\$ (983,028,610)	\$ (1,101,884,662)	10.79
Expenses	(11,827,145)	(9,013,649)	31.21
Net Investment Income (Loss)	<u>\$ (994,855,755)</u>	<u>\$ (1,110,898,311)</u>	10.45

The VRTF net investment assets decreased by \$1.3 billion or a decline of 19.13%. The majority of this reduction was due to the downturn in the equities market. VRTF equity investments earned an annualized rate of return of negative 15.1%. This compares favorably with SWIB's VRTF equity investment benchmark which returned a negative 15.3% over the same period. Total liabilities increased 86.27% primarily because investment purchases pending over year-end were higher at June 30, 2002 than the prior year-end. Net investment assets were further reduced over the fiscal year by net benefit payments exceeding contribution revenues by \$290 million, representing a 4.3% reduction in net assets over the fiscal year.

Expenses increased 31.21% over fiscal year 2001. Most of this increase can be attributed to costs associated with new portfolios managed outside of SWIB. The VRTF also allocated more assets to external managers, thus increasing base management fees. Base management fees are traditional flat fees based on the market value of managed assets. In addition, the VRTF began moving assets to portfolios where performance based management fees are earned. Performance based compensation links external managers pay to performance. The \$3.5 million paid in performance fees in fiscal year 2002 were more than offset by the \$20.9 million by which the managers outperformed their benchmarks.

Total Rate of Return - As of June 30, 2002

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

Fiscal Year	Fixed Trust Fund	Variable Trust Fund
1993	14.2%	15.0%
1994	3.8	6.1
1995	16.7	19.6
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)
10 Yr. Avg.	9.5%	10.2%

RETIREMENT FUNDS
Statement of Net Investment Assets
June 30, 2002

	Fixed Retirement Trust Fund	Variable Retirement Trust Fund
Assets		
Cash and Cash Equivalents	\$ 1,360,148,648	\$ 102,292,292
Receivable:		
State Investment Fund Earnings	887,677	74,290
Accrued Interest & Dividends Receivables	200,814,022	3,328,109
Sales Receivables	1,151,126,643	275,171,974
Securities Lending Collateral	2,233,869,161	101,784,031
Foreign Currency Contracts	17,453,303	802,332
Other Assets	3,040,649	0
Investments (at fair value):		
Bonds	11,581,062,057	196,425
Private Placements	3,530,009,371	0
Stocks	28,885,893,981	5,370,734,216
Limited Partnerships	2,598,401,452	173,712
Mortgages	685,784,188	0
Real Estate Owned	461,911,678	0
Financial Futures Contracts	6,483	2,036
Total Investment Assets	\$ 52,710,409,313	\$ 5,854,559,417
Liabilities		
Purchases Payable	1,178,839,674	282,633,734
Mortgage Escrow Account	975	0
Vouchers Payable	26,376,781	3,197,353
Securities Lending Collateral Liability	2,233,869,161	101,784,031
Total Investment Liabilities	\$ 3,439,086,591	\$ 387,615,118
Net Investment Assets Held in Trust	\$ 49,271,322,722	\$ 5,466,944,299

The accompanying notes, on pages 33 through 39, are an integral part of this statement.

RETIREMENT FUNDS
Statement of Net Investment Assets
June 30, 2001

	<u>Fixed Retirement Trust Fund</u>	<u>Variable Retirement Trust Fund</u>
Assets		
Cash and Cash Equivalents	\$ 1,236,774,034	\$ 166,649,127
Receivable:		
State Investment Fund Earnings	1,917,619	245,987
Accrued Interest & Dividends Receivables	215,284,314	3,245,304
Sales Receivables	403,051,936	17,104,512
Due From Other Funds	4	41
Securities Lending Collateral	2,939,618,468	185,314,731
Other Assets	2,440,994	51
Investments (at fair value):		
Bonds	13,399,255,713	451,233
Private Placements	3,757,794,140	0
Stocks	30,779,259,094	6,595,273,034
Limited Partnerships	2,772,892,081	0
Mortgages	667,941,865	0
Real Estate Owned	501,079,814	0
Financial Futures Contracts	12,873	3,518
Total Investment Assets	\$ 56,677,322,949	\$ 6,968,287,538
Liabilities		
Due to Other Funds	\$ 41	\$ 357
Purchases Payable	294,628,934	19,232,274
Foreign Currency Contracts	14,357,511	1,399,321
Mortgage Escrow Account	81,743	0
Vouchers Payable	14,727,532	2,144,269
Securities Lending Collateral Liability	2,939,618,468	185,314,731
Total Investment Liabilities	\$ 3,263,414,229	\$ 208,090,952
Net Investment Assets Held in Trust	\$ 53,413,908,720	\$ 6,760,196,586

The accompanying notes, on pages 33 through 39, 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 Trust Fund and the Variable Retirement Trust Fund. 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 directly charged to the trust funds per s. 25.18(1)(a) and (m) Wis. Stats. 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.

A. Fixed Retirement Trust Fund

The Fixed Retirement 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 had elected to have part of the contributions invested in the Variable Retirement Trust Fund. In addition to the retirement contributions, the assets of various other benefit programs are invested as part of the Fixed Retirement Trust Fund as listed in the table below.

Other Benefit Programs Within the Fixed Retirement Trust Fund

Accumulated Sick Leave	\$ 646,724,331
Long Term Disability Insurance	221,131,942
Police and Firefighters	144,027,872
Duty Disability	104,423,635
Income Continuation Insurance	75,442,139
Milwaukee Retirement System	49,808,919
Special Death Benefits	<u>1,163,566</u>
Total	<u>\$ 1,242,722,404</u>

The Fixed Retirement Trust Fund is managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. It is not registered with the Securities and Exchange Commission as an investment company. The investments of the Fixed Retirement Trust Fund 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 Trust Fund

The Variable Retirement Trust Fund consists mainly of retirement contributions for the participants in the WRS. In addition, the Milwaukee Retirement System had \$15,303,006 invested in the Variable Retirement Trust Fund at June 30, 2002.

Participation in the Variable Retirement Trust Fund is at the option of the WRS 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 Fixed Retirement Trust Fund. Individual participants in the variable program may elect to terminate their variable participation and transfer their account to the Fixed Retirement Trust Fund. The variable program was closed to further enrollment in April 1980, but new legislation has reopened the Variable Retirement Trust Fund to new participants. See Note 7.

The Variable Retirement Trust Fund is managed by SWIB with oversight by a Board of Trustees as authorized by Wisconsin Statutes 25.14 and 25.17. It is not registered with the Securities and Exchange Commission. Wisconsin Statute 25.17(5) states assets of the Variable Retirement Trust Fund 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 Variable Retirement Trust Fund 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 Fixed Retirement Trust Fund and the Variable Retirement Trust Fund are valued at fair value, per s. 25.17(14), Wis. Stats. 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 is based on quoted market prices but a number of other pricing methods are used for various types of investments.

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, which is discussed further in Note 9.

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

The basis for valuing real estate is 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, regardless of whether the instruments are held for hedging or trading purposes. 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. Deposits, Investments, and Securities Lending Transactions

Deposits — GASB Statement 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed. Bank deposits as of June 30, 2002 included \$51,199 deposited in two financial institutions. Federal depository insurance covers \$1,227 of the deposits, while the remainder is uninsured. In addition, SWIB held a number of nonnegotiable short-term certificates of deposit. The fair value of these certificates of deposit was approximately \$65.4 million, all of which was uncollateralized.

Investments — The following tables present the investments held by SWIB as of June 30, 2002, categorized to give an indication of the level of risk assumed by SWIB at year end. The categories are:

1. Insured or registered, or securities which are held by SWIB in SWIB's name or its agent in SWIB's name.
2. Uninsured and unregistered, with the securities held by the counterparty's trust department or agent in SWIB's name.
3. Uninsured and unregistered, with the securities held by the counterparty, or by its trust department or agent, but not in SWIB's name.

June 30, 2002	Fixed Retirement Trust Fund			Fair and Carrying Value
	Category			
	1	2	3	
Stocks	\$ 12,723,870,838	\$ 0	\$ 0	\$ 12,723,870,838
Bonds	6,658,047,678	0	0	6,658,047,678
Repurchase Agreements	97,651,373	0	0	97,651,373
Bankers Acceptances	284,059,843	0	0	284,059,843
Total	<u>\$ 19,763,629,732</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 19,763,629,732</u>
Private Placements				3,530,009,371
Limited Partnerships				2,598,401,452
Pooled Equities				15,401,905,894
Pooled Bonds				4,830,800,980
Mortgages				685,784,188
Real Estate Owned				461,911,678
Financial Futures Contracts				6,483
State Investment Fund				648,143,953
Pooled Cash and Cash Equivalents				605,466,157
Investments held by broker dealers under securities loans				
Bonds				1,438,272,378
Equities				760,117,250
Securities lending cash collateral pooled investments				516,467,664
Total				<u>\$ 51,240,917,180</u>

June 30, 2002	Variable Retirement Trust Fund			Fair and Carrying Value
	Category			
	1	2	3	
Stocks	\$ 2,485,370,625	\$ 0	\$ 0	\$ 2,485,370,625
Bonds	61,528,266	0	0	61,528,266
Repurchase Agreements	4,449,388	0	0	4,449,388
Bankers Acceptances	12,942,905	0	0	12,942,905
Total	<u>\$ 2,564,291,184</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 2,564,291,184</u>
Pooled Equities				2,785,110,112
Limited Partnerships				173,712
Financial Futures Contracts				2,036
State Investment Fund				70,357,538
Pooled Cash and Cash Equivalents				29,138,409
Investments held by broker dealers under securities loans				
Equities				100,253,478
Securities lending cash collateral pooled investments				23,532,336
Total				<u>\$ 5,572,858,805</u>

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. See Note 2(C).

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 for collateral of 102 percent and 105 percent, respectively, of the loaned securities' fair value. The cash collateral is reinvested by the lending agent 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, results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

Securities on loan at June 30, 2002 are presented as unclassified in the preceding schedule of custodial risk. At year end, SWIB had no credit risk exposure to borrowers because the amounts SWIB owed the borrowers exceeded the amounts the borrowers owed SWIB. The contract with the lending agent requires them to indemnify SWIB 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 SWIB or the borrower, although the average term of the loans is approximately one week. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short-term investments with a weighted average maturity of 25 days.

The ability to pledge or sell collateral securities cannot be made without a borrower default. In addition, no restrictions on the amount of loans exist.

5. Derivative Financial Instruments

A. Foreign Currency Forwards and Options

SWIB's derivative activities primarily involve forward contracts and foreign currency options. Generally foreign currency forwards and options are held to hedge foreign exchange risk. Market risk is controlled by holding substantially offsetting purchase and sell positions. At June 30, 2002 the fair value of foreign currency forward contract assets totaled \$1.43 billion, while the liabilities totaled \$1.41 billion.

B. Futures Contracts

One outside investment manager uses futures contracts to manage its exposure to the stock market. This manager is authorized to utilize futures up to 25% of the fair value of the portfolio. Upon entering into a futures contract, the outside manager is required to deposit with the broker, in SWIB's name, an amount of U.S. government obligations in accordance with the initial margin requirements of the broker. Futures contracts are marked to market daily with gains and losses being recognized. The variation margin is settled daily until the contracts expire or are closed. 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 the changes in the value of the underlying instrument, illiquidity in the secondary market for the contracts, or if the counterparties do not perform under the terms of the contract. Futures contracts are valued each day at the settlement price established by the board of trade or exchange on which they are traded. As of June 30, 2002 SWIB held S&P 500 index futures with a face value of \$3.2 million, which are set to expire on September 19, 2002. There was no initial cost upon entering into the contracts, but a net accumulated loss of \$251,883 has been realized on these contracts from contract date to the fiscal year end.

C. Collateralized Mortgage Obligations

Collateralized mortgage obligations (CMOs) are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes or tranches in accordance with each CMOs established payment order. Some CMO 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 CMOs may be subject to a reduction in interest payments as a result of prepayments of mortgages 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 interest payments, thus an increase in fair value of the security. CMOs are held to maximize yields and in part to hedge against a rise in interest rates.

At June 30, 2002 and June 30, 2001, SWIB held CMOs valued at \$306 million and \$395 million respectively. SWIB holds only high quality, senior tranches, resulting in minimal risks of default and prepayment.

D. Principal Only Strips

Principal only strips are securities that derive cash flow from the payment of principal on underlying debt securities. SWIB holds several principal only strips for yield enhancing purposes. The underlying securities are United States Treasury obligations, therefore the credit risk is low. On the other hand, principal only strips are more volatile in terms of pricing, and thus the market risk is higher than traditional United States Treasury obligations. During fiscal year 2002, principal only strips with a combined total cost of \$114 million were sold for a net gain of \$62 million. As of June 30, 2002 and June 30, 2001, SWIB held principal only strips valued at \$491 million and \$616 million, respectively.

6. Milwaukee Retirement Systems

The Milwaukee Retirement Systems (MRS), consisting of the City of Milwaukee Retirement System and the Milwaukee Public School Retirement System, invests in the Fixed and Variable Retirement Trust Funds through the WRS. Since the MRS is a separate legal entity from the WRS, both the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund qualify as external investment trust funds. Participation by the MRS in the Fixed and Variable Retirement Trust Fund is described in the DETF Administrative Code, Chapter 10.12. MRS pro-

vides assets to DETF for investment in the Fixed and Variable Retirement Trust Funds which are managed by SWIB. Each month the DETF distributes the pro-rata share of the total Fixed Retirement Trust Fund's earnings less administrative expenses, as well as the Variable Retirement Trust Fund'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). The fair value of the MRS position in the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund is the same as the value of the pool shares. Neither State statute, a legal provision, nor a legally binding guarantee exist to support the value of MRS's portion of the Fixed Retirement Trust Fund or the Variable Retirement Trust Fund.

As of June 30, 2002, the Fixed Retirement Trust Fund held \$47,743 million of investments, as well as \$2,234 million of securities lending collateral, and the Variable Retirement Trust Fund held \$5,371 million of investments, as well as \$101.8 million of securities lending collateral. The tables included in Note 3 present investments of the Fixed and Variable Retirement Trust Funds at June 30, 2002, categorized in accordance with the level of risk requirements of GASB Statement 3.

The following schedules provide summary information by investment classification for the Fixed and Variable Retirement Trust Funds at June 30, 2002.

Fixed Retirement Fund

June 30, 2002

Classification	Interest/Coupon Rates	Maturity Dates	Cost	Fair Value
Bonds	Variable and .1 to 25.4	9/02 to 10/49	\$ 10,700,775,935	\$ 11,581,062,057
Common and Preferred Stock	N/A	N/A	32,889,031,430	28,885,893,981
Limited Partnerships	N/A	N/A	2,765,777,608	2,598,401,452
Mortgages	6.77 to 12.25	08/04 to 06/22	639,000,585	685,784,188
Real Estate	N/A	N/A	396,579,716	461,911,678
Financial Futures Contracts	N/A	N/A	0	6,483
Private Placements	Variable and 5.95 to 24.00	9/02 to 12/31	3,464,511,207	3,530,009,371
			<u>\$ 50,855,676,481</u>	<u>\$ 47,743,069,210</u>

Variable Retirement Fund

June 30, 2002

Classification	Interest/Coupon Rates	Maturity Dates	Cost	Fair Value
Bonds	N/A	9/02 to 8/05	\$ 191,644	\$ 196,425
Common and Preferred Stock	N/A	N/A	6,370,547,194	5,370,734,216
Limited Partnerships	N/A	N/A	172,758	173,712
Financial Futures Contracts	N/A	N/A	0	2,036
			<u>\$ 6,370,911,596</u>	<u>\$ 5,371,106,389</u>

7. Benefit Improvement Legislation

Wisconsin 1999 Act 11 (Act 11) was signed by the Governor on December 16, 1999 and became effective on December 30, 1999. On December 29, 1999 the Wisconsin Supreme Court (Court) granted a complete injunction preventing implementation of the provisions of Act 11 until further order of the Court.

The DETF Board and the DETF Secretary filed a petition seeking a declaratory ruling on the legal issues surrounding Act 11. On February 10, 2000, the Court dismissed the petition and ruled that the above parties had no standing to sue another agency of the State regarding the constitutionality of a law. On March 8, 2000, the Court denied a formal request from the original DETF petitioners to reconsider its decision.

The Wisconsin Education Association Council, the State Engineers Association and the Wisconsin Professional Police Association petitioned the Court to be allowed to intervene in the Wisconsin Act 11 lawsuit, asserting



INDEPENDENT AUDITOR'S REPORT

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Ms. Patricia Lipton, 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, Patients Compensation Fund, Historical Society Trust Fund, EdVest Tuition Trust Fund, and Tobacco Permanent Endowment Fund) of the State of Wisconsin as of June 30, 2002 and 2001, 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 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 present only the investment activity of the Various Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements are not intended to present the financial activity of the Various Funds attributable to other state agencies, nor are they intended to fairly present 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.

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, 2002 and 2001, and the changes in net investment assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

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.

As discussed in Note 5, during fiscal year 2001-02, the Investment Board changed the method by which it estimates fair values for its private placement portfolios. The new valuation method resulted in a net decrease in value of \$0.9 million during the fiscal year because it recognizes the investment return more gradually over the life of the investment than the previous method had.

Our audits were made for the purpose of forming an opinion on the financial statements of the Various Funds of the State of Wisconsin. The Management Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and supplementary information 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 was not audited by us and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated December 3, 2002 on our consideration of the State of Wisconsin Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. 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 read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

December 3, 2002

by



Janice Mueller
State Auditor

Management's 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), Patients Compensation Fund (PCF), Historical Society Trust Fund, EdVest Tuition Trust Fund (EdVest), and Tobacco Permanent Endowment Fund (Tobacco).

Following this section are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the Various Funds. The Statement of Operations and Changes in Net 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, 2002 and 2001 is as follows:

Various Funds Condensed Financial Information			
Fiscal Year Ended:	2002	2001	% Change
<u>Net Assets:</u>			
Local Govt Property Ins Fund	\$ 27,779,712	\$ 31,244,065	(11.1)
State Life Insurance Fund	73,123,968	71,146,090	2.8
Patients Compensation Fund	588,346,567	576,068,408	2.1
Historical Society Trust Fund	10,019,995	11,419,875	(12.3)
EdVest Tuition Trust Fund	14,770,185	9,828,563	50.3
Tobacco Permanent Endowment	595,154,873	0	New
<u>Net Investment Income:</u>			
Local Govt Property Ins Fund	\$ 1,685,402	\$ 2,302,685	(26.8)
State Life Insurance Fund	4,634,174	6,265,283	(26.0)
Patients Compensation Fund	21,021,991	40,232,611	(47.7)
Historical Society Trust Fund	(925,730)	(1,156,277)	19.9
EdVest Tuition Trust Fund	1,099,900	751,640	46.3
Tobacco Permanent Endowment	1,152,473	0	New

Changes in the Net Assets of the Various Funds were small, except for EdVest, which saw a 50.3% increase due to new contributions to the program, and the Tobacco Permanent Endowment Fund, which was a newly created fund.

Net Investment Income was significantly lower in the Local Government Property Insurance Fund due to higher coupon bonds maturing and not being replaced, in the State Life Insurance Fund due to a change in the method of valuing private placements, and in the Patients Compensation Fund due to losses in the equity markets. Net Investment Income was significantly higher in the EdVest Tuition Trust Fund due to income on new investments made as a result of the new contributions to the program.

In November 2002, the net assets in the Tobacco Permanent Endowment Fund were used to make State of Wisconsin shared revenue payments to county and municipal governments, as authorized by Wisconsin Statute 20.855(4)(rb).

VARIOUS FUNDS
Statement of Net Investment Assets
June 30, 2002

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Patients Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund	Tobacco Permanent Endowment Fund
Assets						
Cash and Cash Equivalents	\$ 11,999,450	\$ 3,294,757	\$ 16,899,604	\$ 144,162	\$ 2,840,102	\$ 826,154,873
Receivables						
Investment Income Receivable	327,108	1,228,801	10,545,737	8,624	147,455	0
Investment Sales Receivable	0	3,743,016	0	0	0	0
Investments						
Bonds	15,453,404	52,174,824	491,523,086	3,722,504	11,782,628	0
Stocks	0	0	69,383,719	6,145,231	0	0
Private Placements	0	16,403,817	0	0	0	0
Total Investment Assets	\$ 27,779,962	\$ 76,845,215	\$ 588,352,146	\$ 10,020,521	\$ 14,770,185	\$ 826,154,873
Liabilities						
Payables	250	3,721,247	5,579	526	0	0
Due to Other Funds	0	0	0	0	0	231,000,000
Total Liabilities	\$ 250	\$ 3,721,247	\$ 5,579	\$ 526	\$ 0	\$ 231,000,000
Net Investment Assets	\$ 27,779,712	\$ 73,123,968	\$ 588,346,567	\$ 10,019,995	\$ 14,770,185	\$ 595,154,873

The accompanying notes, on pages 45 through 48, are an integral part of this document.

VARIOUS FUNDS
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2002

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Patients Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund	Tobacco Permanent Endowment Fund
From Investment Activities:						
Investment Income						
Net Increase (Decrease) in						
Fair Value of Investments	\$ 295,716	\$ (93,576)	\$ (11,585,648)	\$ (1,225,665)	\$ 275,251	\$ 0
Interest	1,393,156	4,745,298	32,652,621	239,700	824,649	1,152,473
Dividends	0	0	0	68,221	0	0
Investment Expenses	(3,470)	(17,548)	(44,982)	(7,986)	0	0
Increase (Decrease) in Net Investments Derived from Investment Activities	\$ 1,685,402	\$ 4,634,174	\$ 21,021,991	\$ (925,730)	\$ 1,099,900	\$ 1,152,473
From Participant Transactions:						
Net Receipts (Disbursements) -						
Non-Investment Activity	(5,149,755)	(2,656,296)	(8,743,832)	(474,150)	3,841,722	594,002,400
Net Increase (Decrease) in Net Investment Assets	\$ (3,464,353)	\$ 1,977,878	\$ 12,278,159	\$ (1,399,880)	\$ 4,941,622	\$ 595,154,873
Net Investment Assets						
Beginning of Period	31,244,065	71,146,090	576,068,408	11,419,875	9,828,563	0
End of Period	\$ 27,779,712	\$ 73,123,968	\$ 588,346,567	\$ 10,019,995	\$ 14,770,185	\$ 595,154,873

The accompanying notes, on pages 45 through 48, are an integral part of this document.

VARIOUS FUNDS
Statement of Net Investment Assets
June 30, 2001

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Patients Compensation Fund	Historical Society Trust Fund	Tuition Trust Fund
Assets					
Cash and Cash Equivalents	\$ 11,127,508	\$ 3,987,416	\$ 7,904,592	\$ 200,878	\$ 740,425
Receivables					
Investment Income Receivable	436,307	1,221,295	9,001,948	64,154	61,671
Investment Sales Receivable	0	17,618	0	0	0
Investments					
Bonds	19,680,333	46,949,642	487,152,683	3,903,169	9,543,550
Stocks	0	0	72,009,676	7,251,757	0
Private Placements	0	18,970,202	0	0	0
Total Investment Assets	\$ 31,244,148	\$ 71,146,173	\$ 576,068,899	\$ 11,419,958	\$ 10,345,646
Liabilities					
Payables	\$ 83	\$ 83	\$ 491	\$ 83	\$ 517,083
Net Investment Assets	\$ 31,244,065	\$ 71,146,090	\$ 576,068,408	\$ 11,419,875	\$ 9,828,563

The accompanying notes, on pages 45 through 48, are an integral part of this document.

VARIOUS FUNDS
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2001

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Patients Compensation Fund	Historical Society Trust Fund	Tuition Trust Fund
From Investment Activities:					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ 546,490	\$ 1,357,276	\$ 5,553,743	\$ (1,503,123)	\$ 153,978
Interest	1,761,139	4,917,072	33,946,265	290,961	597,662
Dividends	0	0	739,118	83,108	0
Securities Lending Net Income	0	0	22,040	0	0
Investment Expenses	(4,944)	(9,065)	(28,555)	(27,223)	0
Increase (Decrease) in Net Investments Derived from Investment Activities	\$ 2,302,685	\$ 6,265,283	\$ 40,232,611	\$ (1,156,277)	\$ 751,640
From Participant Transactions:					
Net Receipts (Disbursements) - Non-Investment Activity	362,330	(2,953,704)	(6,336,924)	(729,467)	2,922,734
Net Increase (Decrease) in Net Investment Assets	\$ 2,665,015	\$ 3,311,579	\$ 33,895,687	\$ (1,885,744)	\$ 3,674,374
Net Investment Assets					
Beginning of Period	28,579,050	67,834,511	542,172,721	13,305,619	6,154,189
End of Period	\$ 31,244,065	\$ 71,146,090	\$ 576,068,408	\$ 11,419,875	\$ 9,828,563

The accompanying notes, on pages 45 through 48, 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, Patients Compensation Fund, Historical Society Trust Fund, EdVest Tuition Trust Fund, and Tobacco Permanent Endowment Fund (collectively known as the “Various Funds”). The schedules presented here reflect only the investment activity of the Various Funds. Excluded from the presentation in the schedules 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, except for the Tobacco Permanent Endowment Fund. The State of Wisconsin Investment Board manages the SIF with oversight by a Board of Trustees, as authorized in Wisconsin Statutes 25.14 and 25.17. It 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 which 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 Statutes 25.17(3)(b) allows investment 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 not exceeding \$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 Statutes 25.17(3)(a) allow 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. Patients Compensation Fund

The Patients Compensation Fund (PCF) provides medical malpractice insurance protection to health care providers permanently practicing or operating in Wisconsin. The Office of the Commissioner of Insurance is responsible for administering the operations of the PCF. 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 PCF. Wisconsin Statutes 25.17(3)(a) allow 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. 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 new 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 the State Treasurer is responsible for the administration of the EdVest Wisconsin program. Wisconsin Statutes 14.63(10)(b) directs SWIB to invest monies held in the Tuition Trust Fund in investments with maturities and liquidity that are appropriate to 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.

F. Tobacco Permanent Endowment Fund

The Tobacco Permanent Endowment Fund was established as a separate nonlapsible trust fund consisting of all of the proceeds from the sale of the state's right to receive payments under the Attorneys General Master Tobacco Settlement Agreement of November 23, 1998 and all investment earnings on the proceeds. Wisconsin Statute 25.18(1)(o) authorizes SWIB to invest the assets of the Tobacco Permanent Endowment Fund in any investment that is an authorized investment for assets in the fixed or variable retirement trust fund. SWIB has invested the assets in a tax-free obligations money market 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 Patients 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.

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.

C. Valuation of Securities

The investments of the Various Funds are valued at fair value. 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 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 (See 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. Deposits and Investments

Deposits — Governmental Accounting Standards Board Statement No. 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed. Deposits, as of June 30, 2002, included \$3,650 deposited in a single financial institution in the State Treasury account covered by federal depository insurance.

Investments — The following table presents investments held as of June 30, 2002, categorized to give an indication of the level of risk assumed by the Funds at year-end. The categories are as follows:

1. Insured or registered, or securities held by a Fund in the Fund's name or its agent in the Fund's name.
2. Uninsured and unregistered, with the securities held by the counterparty's trust department or agent in the Fund's name.
3. Uninsured and unregistered, with the securities held by the counterparty, or by its trust department or agent, but not in the Fund's name.

	CATEGORY			Fair and Carrying Value
	1	2	3	
Bonds	\$ 574,656,446	\$ 0	\$ 0	\$ 574,656,446
Stocks	75,528,951	0	0	75,528,951
Subtotal	\$ 650,185,397	\$ 0	\$ 0	\$ 650,185,397
Private Placements				16,403,817
Pooled Cash & Cash Equivalents				826,234,871
State Investment Fund				35,094,427
Total				\$ 1,527,918,512

4. Derivative Financial Instruments

Principal Only Strips — Principal only strips are securities that derive cash flow from the payment of principal on underlying debt securities. SWIB holds principal only strips for yield enhancing purposes. The underlying securities are United States Treasury obligations; therefore, the credit risk is low. On the other hand, principal 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, 2002 and June 30, 2001, the Patients Compensation Fund held principal only strips valued at \$15.5 and \$14.1 million, representing approximately 2.6% and 2.4% of portfolio net assets, respectively. As of June 30, 2002 and June 30, 2001, the EdVest Tuition Trust Fund held principal only strips valued at \$8.4 and \$6.7 million, representing approximately 57.2% and 67.9% of portfolio net assets, respectively.

5. Private Placements Pricing Method Change

During the fiscal year, SWIB completed a review of valuation practices for private placements. Since quoted market prices are not available for a substantial portion of these assets, fair values are typically estimated by investors or broker/dealers using financial models or evaluations based on security and market characteristics.

Prior to April 2002, SWIB utilized a financial model to calculate the fair value of private placements. A matrix model from CMS BondEdge provided prices based on corporate yield spread over treasury securities with

comparable durations. The spread was based on a matrix of factors including credit rating, sector, average life or cashflow and any call features.

Since that time, SWIB has moved to a multi-tiered method of pricing private placements. The method 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, securities cannot be priced by one 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.

The change in methods of estimating fair values for the private placement portfolios resulted in a net decrease of \$0.9 million. The new valuation method is more conservative in that it recognizes the investment return gradually over the life of the investment. The valuation process does not, however, alter the expected receipt of coupon and final principal, or alter the security's economic value or risk of default to SWIB. The adjustment in fair value is presented in the financial statements in the Statement of Net Investment Assets as a reduction to "Private Placements," and in the Statement of Changes in Net Investment Assets as a decrease to "Net Increase (Decrease) in Fair Value of Investments."