

# State of Wisconsin Investment Board



2004 Fiscal Year  
Annual Report

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

**State of Wisconsin  
Investment Board**

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Madison, WI 53707-7842

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(608) 266-2381

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121 East Wilson Street  
Madison, WI 53702

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[www.swib.state.wi.us](http://www.swib.state.wi.us)

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[info@swib.state.wi.us](mailto:info@swib.state.wi.us)

This document includes a brief overview of the assets under management by the Investment Board and the comparative financial statements and related notes for the fiscal years ending June 30, 2004, and June 30, 2003. A complete listing of the Board's investments held as of June 30, 2004, is available on the Internet at [www.swib.state.wi.us](http://www.swib.state.wi.us) or by contacting the State of Wisconsin Investment Board.

# Vision

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

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# INTRODUCTION

# Message from the Chair

Investors today have a great deal of interest in how companies are governed and how shareholders are affected by corporate decisions. Likewise, SWIB and other investment organizations must also focus on their own governance practices to be successful.

With a new executive director and a number of trustees recently joining the Board, it is a particularly appropriate time for us to thoroughly review our governance practices. Key to the effectiveness of the Board is recognition of our fiduciary duties. One of these duties is to act in a prudent manner in setting asset allocation and investment policies that weigh the risks and returns for investment of trust fund assets.

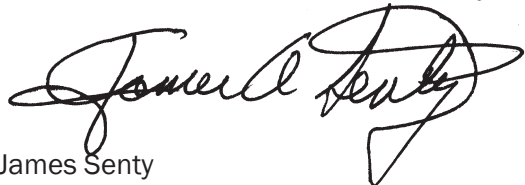
Investment decisions must consider payment commitments that the trust funds support, so the Board works closely with the entities responsible for those payments in carrying out our duties. Whether in the investment process or in other aspects of our operations, SWIB is working to identify and apply industry best practices. As the manager of one of the world's largest pension plans, we seek a leadership role in this endeavor.

We are reviewing roles and responsibilities of trustees for a public pension plan. As Trustees, our primary fiduciary duties are to practice careful, thorough and diligent decision-making and to ensure the trusts are invested solely for the benefit of fund participants. To make sure we are doing our best, we are working with experts on fiduciary responsibilities for public pension plans. With their help we are taking a closer look at our existing processes and addressing a variety of topics including:

- Legal, ethical and fiduciary responsibilities of a trustee
- Trustee training and education
- Division of responsibilities between staff and trustees
- Maximizing the openness and value of board meetings
- Role, selection and oversight of managers and consultants

The review is a work-in-progress. The Board has already reaffirmed its commitment to being as open as possible in conducting SWIB's business. Some governance changes may not be noticeable by the general public but will help us add value and be cost-effective in our management of the trust funds.

Most importantly, Trustees believe this exercise allows the Board to carry out its role overseeing the trust funds with confidence as we face a constantly changing investment world.



James Senty  
Chair  
June 30, 2004



*"As the manager of one of the world's largest pension plans, we seek a leadership role in this endeavor."*

# From the Executive Director

My first months as the newly appointed executive director were filled with challenges and rewards. I am privileged to be working with SWIB trustees and staff, many of whom I came to know in during my service at the Department of Employee Trust Funds (ETF). In this new leadership role, I look forward to continuing to serve the Wisconsin Retirement System and other trust funds SWIB manages.

I am pleased to present the Annual Financial Report on behalf of SWIB for the fiscal year ending June 30, 2004.

Although the first half of fiscal year saw a strong market performance, markets were relatively flat in the second half. Even so, the Fixed Trust Fund reported a 16.6% return for the fiscal year compared to 15.1% for its benchmark. On a ten-year basis, the 9.8% average annual rate of return for the Fixed Fund was well ahead of the 8% actuarial benchmark (changed by ETF to 7.8% December 31, 2003.) The Variable Trust Fund returned 23% for the year compared to 22.2% for the benchmark.

In the past year, as the economy showed signs of strength, the fixed income market weakened. Real estate provided solid investment returns. Several factors continued to cause concern in the equity markets, including increasing oil prices and uncertainty about global events and terrorism. However, there were some bright spots in our equities returns with the small cap stock portfolio delivering the strongest performance.

Based on our annual asset allocation review, we made a number of changes designed to strengthen SWIB's market position. Foreign markets - emerging markets in particular - are expected to outperform domestic public markets. In addition, SWIB is pursuing new opportunities in the fixed income markets. As a result, we made several strategic changes:

- Shifted 1% of the Fixed Fund from domestic equities to international equities
- Increased emerging markets equities by up to \$225 million
- Increased allocations to high yield and emerging markets debt
- Added treasury inflation protection securities (TIPS) to our fixed income portfolio to hedge against inflation

In fiscal year 2004, SWIB also combined the management of real estate and alternative investments into the Private Markets Group because they share similar operation styles. The private equity portfolio was restructured to focus on limited partnerships.

SWIB trustees and staff are committed to achieving outstanding investment performance for the funds entrusted to our care. The asset allocation changes made this year should help position SWIB to take advantage of the longer-term market outlook.



David Mills  
Executive Director  
June 30, 2004



*"We made a number of changes designed to strengthen SWIB's market position."*

# Overview

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

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

## Assets Under Management - June 30, 2004

<u>Fund</u>	<u>\$ in Millions</u>	<u>% of Total</u>
<i>Fixed Retirement Trust Fund</i>	\$ 59,141	84%
<i>Variable Retirement Trust Fund</i>	5,809	8
Wisconsin Retirement System	64,950	92
State Investment Fund*	4,612	7
Various Funds		
Injured Patients and Families Compensation Fund	696	1
State Life Insurance Fund	78	0
Local Gov't Property Insurance Fund	32	0
Historical Society Trust Fund	10	0
Tuition Trust Fund	12	0
	<u>\$ 70,390</u>	<u>100%</u>

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

# Guidelines

Investments must be within guidelines established for each specific fund.

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

# Cost of Management

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

Agency operating expenses for staff compensation, overhead and equipment were \$16.5 million and represented about 11% of total costs. Expenses are paid from investment earnings of the funds SWIB manages.

SWIB participates in an annual independent review of costs which compares SWIB to other investment managers and public pension fund peers. The 2003 analysis provided by Cost Effectiveness Measurement (CEM), Inc.<sup>1</sup> concluded that SWIB's total cost to manage the Fixed Trust Fund was 28¢ per \$100 managed. The CEM report indicated that this amount is similar to the costs incurred by other funds with a similar mix of assets.

The cost to manage the Fixed Trust Fund was \$146.1 million in 2003. This represents 93% of SWIB's total cost of management.

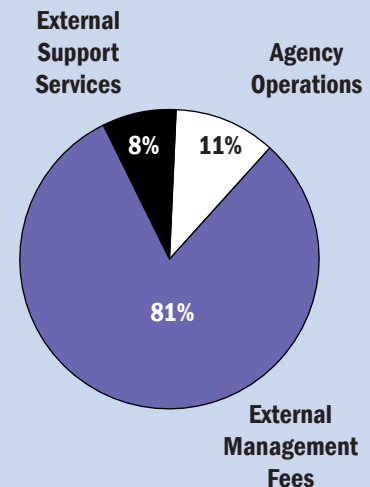
In addition to the Fixed Trust Fund, SWIB manages seven other funds. SWIB's costs to manage all funds were \$156.7 million, or 25¢ per \$100 managed in 2003.

## Total Management Costs

	Calendar Year Ended 12/31/2003
External Management	\$ 127,225,400
Agency Operations	16,462,900
Consulting	3,905,800
Custodial Banking	3,872,600
Investment Research	3,845,900
Legal Fees	1,418,200
	<u>\$ 156,730,800</u>

## Management Costs

As of December 31, 2003



- Costs for managing all funds were 25¢ per \$100 under management.
- All management costs are funded with earnings from the funds.
- Total costs for managing all funds for the calendar year ending December 2003 were \$156.7 million.
- According to CEM<sup>1</sup>, SWIB's costs for the Fixed Trust Fund were considered normal based on the mix of assets managed.

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



# Board of Trustees



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



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



**Eric Stanchfield**  
**Secretary**  
*WRS, Wisc. Retirement*  
*Board Appointee*  
Secretary, Department  
of Employee  
Trust Funds



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



**David Geertsens**  
*Local Government*  
*Public Member*  
Finance Director,  
Kenosha County



**William Levitt, Jr.**  
*Public Member*  
Attorney, Godfrey  
& Kahn S.C.,  
Milwaukee



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



**Laura Engan**  
*DOA Designee*  
Deputy Secretary of  
the Department of  
Revenue



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



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

## Board Membership

- Six public members appointed by the Governor and confirmed by the State Senate including:
  - *Four with at least 10 years investment experience.*
  - *One with at least 10 years financial experience and who works for a local government in the Local Government Investment Pool.*
- Teacher participant in the Wisconsin Retirement System (WRS) appointed by the Teacher Retirement Board.

- Non teacher participant in the WRS appointed by the Wisconsin Retirement Board.
- Secretary of the Department of Administration or designee.

*(Appointed Board members serve six-year terms.)*

## Board Responsibilities Include:

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

# Agency Management

## Senior Management

Executive Director - David C. Mills

Deputy Executive Director - Gail L. Hanson

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

Chief Investment Officer - Public Equities - Jean C. Ledford

Chief Investment Officer - Private Markets - Robert H. Severance

Chief Operating Officer - Kenneth W. Johnson

Chief Legal Officer - Keith L. Johnson

Director of Human Resources - Ledell Zellers

Director of Quantitative Research and Risk Analytics - Ronald A. Mensink

## Investment Managers

### Public Equities

#### Domestic

Jackie S. Doeler

Steven F. Hilmer

William A. McCorkle

John F. Nelson

Chad A. Neumann

Trisha L. Reopelle

#### International

Charles D. Saunders

### Fixed Income

#### Domestic

Laurel A. Butler

Sally J. Lee

#### Global

J. Alain Hung

### Private Markets

Charles R. Carpenter

#### Real Estate

David Lewandowski

Steven C. Spiekerman

#### Private Equities

Monica A. Jaehnig

Thomas P. Olson

### SWIB Staff Quick Facts

- 104.5 authorized positions.
- A majority of the investment staff holds or is pursuing the Chartered Financial Analyst (CFA) designation.
- Top investment staff experience ranges between 11 and 34 years.
- The Board adheres to the industry standards of the CFA Institute.
- Professional standards and continuing education are stressed for staff.

# Investor Responsibility

SWIB's Investor Responsibility Program began in 1986. Our goal is to enhance long-term investment prospects and potential. SWIB's program staff and investment groups identify program strategies within parameters approved by the Trustees.

SWIB's Corporate Governance Program has two primary goals:

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

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

SWIB determines ways to work with company management, corporate boards and other shareholders to make changes that should have a positive impact. Our first approach is to communicate with companies with poor records. SWIB will work with companies to resolve concerns. When necessary, SWIB will withhold votes from director candidates and use its proxy vote to support shareholder resolutions if companies fail to act in the interests of shareholders. SWIB's proxy votes are posted on the website.

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

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

We believe companies with socially unacceptable products or practices will feel the economic consequences of public disapproval or imposition of liability under laws protecting the public health and welfare. The result: negative aspects of a company's behavior will be felt on the economic bottom line over the long term. These issues are considered when voting our proxies and evaluating investments. Issues are brought to the attention of the Trustees if they have a significant financial impact on the companies involved.

## Corporate Governance Issues:

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

**2. Limited stock options.** Stock options, or the right to buy company stock at a preset price, are often issued to employees as compensation. Excessive use of options can cause the value of stock owned by non-employee shareholders to erode. A company should be required to get approval by shareholder vote before repricing options or setting aside blocks of stock for options awarded to insiders.

### **3. Executive compensation plans.**

Companies should adopt an executive compensation process which includes: a) authority for the compensation committee to retain outside compensation experts, b) a requirement that pay be consistent with similar companies, c) compensation criteria based on performance as measured against meaningful benchmarks and d) general consistency and fairness between compensation for management and other employees.

### **4. Anti-takeover devices.**

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

# Wisconsin Retirement System

The Wisconsin Retirement System (WRS) makes up 92% 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. As of June 30, 2004, the total assets of the WRS were \$64.9 billion.

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

Nearly 510,000 people participate in the WRS. Investment earnings account for the majority of the annuities paid, thus lowering the costs paid by taxpayers. Over \$2.6 billion was paid in 2003 to 122,000 annuitants in the WRS.

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

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

The Department of Employee Trust Funds (ETF) is responsible for administering the benefits of the WRS. ETF computes those amounts based on the December 31 rate of return for each of the two trust funds to determine the impact on participants. Most employees who retire receive a pension annuity initially determined by a formula (calculated by ETF) using years of service, salary, and job type.

## WRS Quick Facts

- System includes nearly 510,000 participants.
- 9th largest public pension fund in the US.
- 23rd largest pension fund in the world.
- Comprised of Fixed Trust Fund, a balanced fund, and Variable Trust Fund, a stock fund.
- Fixed Fund gains and losses are spread over five years to smooth the effect on participants' accounts.
- Variable Fund annuities fully reflect prior year gains and losses of the investments.
- More than 108,000 people participate in the Variable Fund.

## Annualized Performance Ending 6/30/04

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
<b>Fixed Fund</b>	<b>16.6%</b>	<b>4.3%</b>	<b>9.8%</b>
Benchmark	15.1	3.4	9.3
<b>Variable Fund</b>	<b>23.0%</b>	<b>1.0%</b>	<b>10.1%</b>
Benchmark	22.2	-0.5	9.5
S&P 500	19.1	-2.2	11.8

# State Investment Fund

The State Investment Fund (SIF) is a pool of cash balances of various state and local governmental units. The objectives of this fund are to provide 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 groups. This fund also functions as the State's cash management fund. By pooling the idle cash balances of all 58 state funds, it provides the State's general fund with the needed liquidity for operating expenses.

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

The cash balances available for investment vary daily as cash is accumulated or withdrawn from the agency funds. The SIF is invested primarily in obligations of the US government and its agencies, and high quality commercial bank and corporate debt obligations. Net assets of the State Investment Fund as of June 30, 2004, were \$5.6 billion.

#### Portfolio Characteristics as of June 30, 2004:

- 79% of Fund invested in US government securities.
- Average maturity 49 days versus iMoneyNet\* at 46 days.
- Short term liquidity (0 - 3 months) equal to 148% of LGIP and 85% of SIF.
- 27% of portfolio assets change rates overnight, 82% in three months.

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.

#### SIF Quick Facts

- SIF provided a superior rate of return, ranking 1st out of 228 government money market funds.\*
- SIF also ranked 6th out of 1,233 money market funds (top 1%).\*

#### State Investment Fund Annualized Time-Weighted Returns

<u>Fiscal Year</u>	<u>Return</u>
1995	5.4 %
1996	5.4
1997	5.3
1998	5.4
1999	5.0
2000	5.5
2001	6.0
2002	2.5
2003	1.5
2004	1.0

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

\* iMoneyNet All Taxable Money Market Index

# Various Funds

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

## **HISTORICAL SOCIETY TRUST FUND**

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

## **LOCAL GOVERNMENT PROPERTY INSURANCE FUND**

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

## **STATE LIFE INSURANCE FUND**

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

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

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

## **TUITION TRUST FUND**

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

### **For More Information:**

#### **State Historical Society**

(608) 264-6400

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

Office of the Commissioner of Insurance

(608) 266-3585 (Madison) or

(800) 236-8517 (toll-free)

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

Office of the Commissioner of Insurance

(608) 266-0107 (Madison) or

(800) 562-5558 (toll-free)

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

Office of the Commissioner of Insurance

(608) 266-6830 (Madison)

#### **EdVest**

Office of the State Treasurer

(608) 264-7899 (Madison) or

(888) 338-3789 (toll-free)

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# Financial Section





## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statement of Net Assets for the State Investment Fund of the State of Wisconsin as of June 30, 2004 and 2003, 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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements present only the investment activity of the State Investment Fund and do not purport to, and do not, present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the State Investment Fund as of June 30, 2004 and 2003, 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 of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the State Investment Fund of the State of Wisconsin. The Management's 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, accordingly, we


express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we also issued a report dated August 27, 2004, 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, regulations, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which 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 considered in assessing the results of our audits.

LEGISLATIVE AUDIT BUREAU

August 27, 2004

by

A handwritten signature in cursive script, appearing to read "Janice Mueller".

Janice Mueller  
State Auditor

Management 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>2004</u>	<u>2003</u>
1. Various State of Wisconsin agencies	26%	28%
2. Wisconsin public retirement funds	17%	9%
3. Local Government Investment Pool	57%	63%

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, 2004 and 2003 is as follows:

SIF Condensed Financial Information			
Fiscal Year Ended:	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Total Assets	\$ 5,968,063,859	\$ 5,946,141,114	0.4
Total Liabilities	333,785,051	301,194,092	10.8
Net Assets	<u>\$ 5,634,278,808</u>	<u>\$ 5,644,947,022</u>	(0.2)
Investment Revenue	\$ 68,514,330	\$ 100,647,744	(31.9)
Expenses	1,320,577	1,309,314	0.9
State Working Bank	2,628,605	2,819,260	(6.8)
Net Investment Income	<u>\$ 64,565,148</u>	<u>\$ 96,519,170</u>	(33.1)
Average Daily Cash Balance	\$ 6,466,656,488	\$ 6,521,867,789	(0.8)
Time Weighted Annual Yield	1.03%	1.49%	(30.9)

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, 2004, SIF Net Assets had decreased slightly, by \$10,668,214 from the prior year, due to participant withdrawals exceeding contributions. The Average Daily Cash Balance was also slightly lower than the previous year and peaked at \$7.486 billion in March 2004.

The Net Investment Income decrease of 33.1% was largely due to the Federal Open Markets Committee maintaining the Fed Funds Target rate at 1.00% until it was increased to 1.25% on June 30, 2004. This also caused the Time Weighted Annual Yield to drop from 1.49% to 1.03%.

## STATE INVESTMENT FUND

## Statement of Net Assets

As of June 30, 2004 and June 30, 2003

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
<b>Assets</b>		
Investments (at fair value):		
Repurchase Agreements	\$ 1,268,000,000	\$ 1,777,000,000
Government and Agency	3,467,477,867	3,328,181,066
Commercial Paper	636,893,516	455,091,011
Certificates of Deposit (CDs)	596,996,534	400,000,000
Mortgage Backed Securities	862,947	1,277,259
Swap(s)	<u>(9,126,554)</u>	<u>(22,933,004)</u>
Total Net Investments (at fair value)	\$ 5,961,104,310	\$ 5,938,616,332
Other Assets:		
Accrued Interest Receivable	<u>6,959,549</u>	<u>7,524,782</u>
Total Assets	<u>\$ 5,968,063,859</u>	<u>\$ 5,946,141,114</u>
<b>Liabilities</b>		
Check Float Invested	\$ 328,135,862	\$ 294,206,252
Earnings Distribution Payable	5,068,647	6,397,351
Accrued Swap Payments	516,542	520,489
Accrued Expenses	<u>64,000</u>	<u>70,000</u>
Total Liabilities	<u>\$ 333,785,051</u>	<u>\$ 301,194,092</u>
<b>NET ASSETS</b>	<u><u>\$ 5,634,278,808</u></u>	<u><u>\$ 5,644,947,022</u></u>
Net Assets consist of:		
Participating Shares	\$ 5,641,214,000	\$ 5,652,998,000
Undistributed Unrealized Gains (Losses)	<u>(6,935,192)</u>	<u>(8,050,978)</u>
<b>NET ASSETS</b>	<u><u>\$ 5,634,278,808</u></u>	<u><u>\$ 5,644,947,022</u></u>

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

**STATE INVESTMENT FUND****Statement of Operations and Changes in Net Assets****For the Fiscal Years Ended June 30, 2004 and 2003**

	<b>June 30, 2004</b>	<b>June 30, 2003</b>
<b>Investment Revenue</b>		
Investment Income	\$ 82,208,976	\$ 113,735,036
Net Swaps Revenue (Expense)	(13,694,646)	(13,087,292)
Total Investment Revenue	\$ 68,514,330	\$ 100,647,744
<b>Expenses</b>		
Management Operating Expense Allocation	\$ 897,558	\$ 907,989
Custodial Bank Charges	195,043	202,431
State Treasurer Costs	46,461	40,549
Electronic Services	140,189	115,505
Legal and Consulting Fees	41,326	42,840
Total Expenses	\$ 1,320,577	\$ 1,309,314
NET INVESTMENT REVENUE	\$ 67,193,753	\$ 99,338,430
State Working Bank Charges Allocation	2,628,605	2,819,260
<b>Net Investment Income</b>	\$ 64,565,148	\$ 96,519,170
Distributions Paid and Payable	63,449,362	92,836,178
Change in Undistributed Unrealized Gains (Losses)	\$ 1,115,786	\$ 3,682,992
Beginning of Period Undistributed Unrealized Gains (Losses)	(8,050,978)	(11,733,970)
End of Period Undistributed Unrealized Gains (Losses)	\$ (6,935,192)	\$ (8,050,978)
Participant Transactions		
Receipts by Transfer to Fund	\$ 26,525,022,000	\$ 25,565,361,000
Disbursements by Transfer from Fund	(26,536,806,000)	(25,860,367,000)
Net Change in Participating Shares	\$ (11,784,000)	\$ (295,006,000)
Beginning of Period Participating Shares	5,652,998,000	5,948,004,000
End of Period Participating Shares	\$ 5,641,214,000	\$ 5,652,998,000
<b>Net Assets</b>	\$ 5,634,278,808	\$ 5,644,947,022

The accompanying notes, on pages 21 through 25, 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 pro rata portion 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 staff of the State of Wisconsin Investment Board (SWIB) manages the SIF with oversight by the Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. The SWIB is not registered with the SEC as an investment company.

Wisconsin Statutes 25.17(3)(b), (ba) and (bd) enumerate the various types of securities 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

Summary Information by Investment Classification						
	June 30, 2004				June 30, 2003	
	Interest Rates	Maturity Dates	Fair Value	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)
Repurchase Agreements	1.35	07/01/04	\$ 1,268,000,000	\$ 1,268,000,000	\$ 1,777,000,000	\$ 1,777,000,000
Government and Agency	1.01-7.02	07/01/04-02/15/05	3,467,477,867	3,465,264,977	3,328,181,066	3,313,284,035
Commercial Paper	1.01-1.44	07/01/04-08/02/04	636,893,516	636,911,578	455,091,011	455,106,016
Certificates of Deposit	1.05-4.24	07/12/04-06/15/07	596,996,534	597,000,000	400,000,000	400,000,000
Asset Backed Securities	N/A	N/A	0	0	0	0
Mortgage Backed Securities	2.33	04/27/05	862,947	862,947	1,277,259	1,277,259
Yankee/Euro Issues	N/A	N/A	0	0	0	0
Swap(s)	N/A	03/16/05	(9,126,554)	0	(22,933,004)	0
Total Investments			\$ 5,961,104,310	\$ 5,968,039,502	\$ 5,938,616,332	\$ 5,946,667,310
Ratio of Fair Value to Book Value				99.8838%		99.8646%

June 30, 2004 of \$0.9 million, is valued at par, which management believes approximates fair value. The fair value of investments is determined at the end of each month.

#### 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 the Financial Security Assurance Corporation. Further, the Federal Deposit Insurance Corporation (FDIC) insures the prorata share of Certificates of Deposit held by the LGIP. Finally, the State of Wisconsin's Public Deposit Guarantee Fund



protects a depositing municipality by 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, 2004, the SIF held certificates of deposit with an estimated fair value of \$450.0 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 GASB Statement No. 3 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 \$400.0 million falls under this category through FDIC insurance, the Wisconsin State Deposit Guarantee Fund, and Financial Securities Assurance Corporation insurance. The remaining \$50.0 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 Fund's name.

Securities Categorized by Level of Risk				
	Category			Fair and
	1	2	3	Carrying Value
<u>Deposits:</u>				
CDs (Nonnegotiable)	\$ 400,000,000	\$ 0	\$ 50,000,000	\$ 450,000,000
<u>Investments:</u>				
Repurchase Agreements	\$ 1,268,000,000	\$ 0	\$ 0	\$ 1,268,000,000
Government and Agency	3,467,477,867	0	0	3,467,477,867
Commercial Paper	636,893,516	0	0	636,893,516
CDs (Negotiable)	146,996,534	0	0	146,996,534
Mortgage Backed Securities	862,947	0	0	862,947
Subtotal	\$ 5,520,230,864	\$ 0	\$ 0	\$ 5,520,230,864
<u>Not Categorized:</u>				
Swap				\$ (9,126,554)
Total Investments				\$ 5,961,104,310



## 5. Derivative Financial Instruments

As of June 30, 2004, 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 2004 and 2003, the cash outflow for the restructured interest rate swap was (\$13,698,323) and (\$13,016,747) 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, 2004	June 30, 2003	March 16, 1995
<b>Restructured Interest Rate Mirror Swaps</b>			
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)
<b>Restructured Asset Amortizing Swaps</b>			
SLMA Currency Linked NZ\$ vs. Yen	\$ 0	\$ 0	\$ (4,995,000)
Grantor Trust Crncy Linked C\$ vs. Lira vs. Yen	0	0	(27,400,000)
Subtotal	\$ 0	\$ 0	\$ (32,395,000)
<b>Mexican - Spread Restructuring Swap</b>			
10.74% - 1m USD Libor	\$ (9,126,554)	\$ (22,933,004)	\$ (35,000,000)
US Treas. 7.50% 2/15/05 Hedge-Unreal. Gain	4,698,948	13,510,388	0
Subtotal	\$ (4,427,606)	\$ (9,422,616)	\$ (35,000,000)
Total Fair Value	\$ (4,427,606)	\$ (9,422,616)	\$ (95,321,000)

As of June 30, 2004, anticipated cash requirements for deferred loss principal and interest payments are as follows:

Deferred Loss Cash Requirements			
Fiscal Year Ended:	Principal	Interest	Total
June 30, 2005	\$ 3,816,569	\$ 143,331	\$ 3,959,900
June 30, 2006	0	0	0
June 30, 2007	0	0	0
June 30, 2008	0	0	0
June 30, 2009	0	0	0
Thereafter	0	0	0
Total	\$ 3,816,569	\$ 143,331	\$ 3,959,900

## 7. Related Party Transactions

The SIF held one bond issued by a State of Wisconsin agency with a remaining par and carrying value of \$0.9 million at June 30, 2004. Management believes the rate of interest received is comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.



## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for the Retirement Investment Trust Funds (Fixed Retirement Investment Trust Fund and Variable Retirement Investment Trust Fund) of the State of Wisconsin, as of June 30, 2004 and 2003, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

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

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Retirement Investment Trust Funds as of June 30, 2004 and 2003, and the changes in net investment assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2, the financial statements include investments that do not have readily ascertainable market prices and are valued based on a variety of third-party pricing methods. We have reviewed the procedures used by the Investment Board in arriving at estimates of the values of such investments and have inspected underlying documentation, and, given the circumstances,

we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ from the values that would have been used had a ready market for the investments existed.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Retirement Investment Trust Funds of the State of Wisconsin. The Management's 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 has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated November 19, 2004, on our consideration of the Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

LEGISLATIVE AUDIT BUREAU

November 19, 2004

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, 2004 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.

## Overview of Basic Financial Statements

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

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

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

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

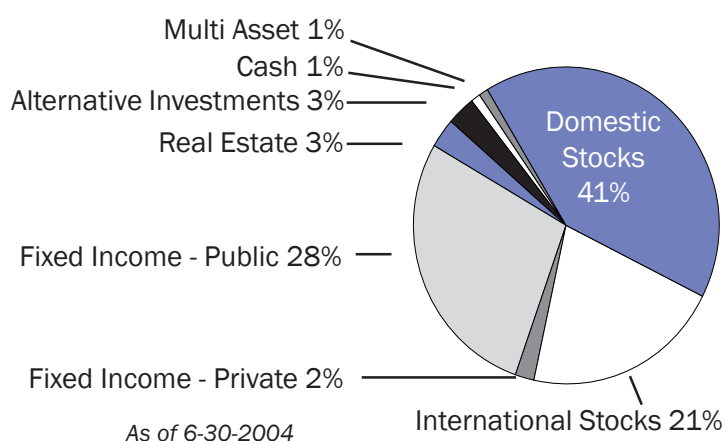
The financial statements and related notes are prepared in accordance with Governmental Accounting Standards Board Pronouncements.

## Retirement Trust Funds

Approximately 510,000 people participate in the Wisconsin Retirement System (WRS), including current and former employees of Wisconsin's state agencies and most local governments. Contributions made to the WRS by these employees and their employers are invested by the State of Wisconsin Investment Board to finance retirement and other benefits. The WRS is comprised of the Fixed Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund whose combined net investment assets total \$64.9 billion as of June 30, 2004.

### Fixed Retirement Investment Trust Fund

The larger of the two trust funds comprising the Wisconsin Retirement System is the Fixed Retirement Investment Trust Fund (FRITF) totaling \$59.1 billion. All WRS members have at least half - if not all - of their pension account in the FRITF. It is a fully diversified, balanced fund invested for the long-term needs of the



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

The FRITF net investment assets increased approximately \$8.9 billion or an increase of 17.64%. This was primarily due to investment returns of 16.6%. The various asset classes returned the following amounts over the fiscal year: public equities 24.2%, fixed income 2.3%, real estate 15.7%, alternative investments 19.0%. Net investment assets were further increased by the receipt of over \$1.5 billion from the State and various municipalities, for the payment of unfunded pension and other benefit liabilities. The statements presented here reflect only the investment activity of these funds including cash flows from benefit payments and contribution receipts. Excluded from presentation in the statements are, for example, retirement reserves, contribution revenue, and benefit expense.

Cash and Cash Equivalents (C&CE) were up 84.68% over the prior fiscal year end balance. At June 30, 2004, C&CE were up in part due to a pending asset reallocation. SWIB had raised capital to fund purchases settling over the next few days. In addition, at the fiscal year end, SWIB was holding more cash in anticipation of interest rates rising.

Both the Other Current Assets and Other Current Liabilities fiscal year end balances increased from June 30, 2003 to June 30, 2004. The increase in balances was caused by a pending reallocation of assets that occurred over the June 30, 2004 year end.

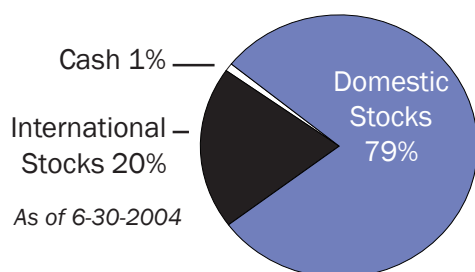
<b>Fixed Retirement Investment Trust Fund Condensed Financial Information</b>			
<b>Fiscal Year Ended:</b>	<b>2004</b>	<b>2003</b>	<b>% Change</b>
Cash and Cash Equivalents	\$ 1,643,140,381	\$ 889,700,794	84.68%
Other Current Assets	439,888,821	250,563,827	75.56%
Invested Securities Lending Collateral	4,850,012,855	3,053,566,720	58.83%
Other Assets	2,353,702	5,550,905	-57.60%
Investments	57,710,738,435	49,365,424,960	16.91%
Total Investment Assets	<u>\$ 64,646,134,194</u>	<u>\$ 53,564,807,206</u>	20.69%
Current Liabilities	\$ 655,479,425	\$ 239,470,409	173.72%
Securities Lending Collateral Liability	4,850,012,855	3,053,566,720	58.83%
Total Liabilities	<u>\$ 5,505,492,280</u>	<u>\$ 3,293,037,129</u>	67.19%
Net Investment Assets	<u>\$ 59,140,641,914</u>	<u>\$ 50,271,770,077</u>	17.64%
Investment Revenue (Loss)	\$ 8,313,745,557	\$ 2,205,818,984	276.90%
Investment Expense	(139,134,958)	(145,873,414)	-4.62%
Net Investment Income (Loss)	<u>\$ 8,174,610,599</u>	<u>\$ 2,059,945,570</u>	296.84%
Net Receipt (Disbursements)	694,261,238	(1,059,498,215)	165.53%
Net Increase (Decrease)	<u>\$ 8,868,871,837</u>	<u>\$ 1,000,447,355</u>	786.49%

Expenses decreased 4.62% when comparing fiscal year 2003 to fiscal year 2004. Half of this decrease can be attributed to a decrease in management fees. As the limited partnerships age, the method of calculating management fees is often based on fair value rather than total commitments, reducing the amount subject to management fees. The fair value of the assets on which fees are calculated is reduced as distributions are made. The decrease can also be attributed to a reduction in management fee expense resulting from renegotiating management fee agreements. The other reduction in total expenses was caused by the receipt in full of an interest payment that had been previously considered uncollectible, and had been expensed as a bad debt.



## Variable Retirement Investment Trust Fund

The Wisconsin Legislature passed, and the Governor signed into law, 1999 Wisconsin Act 11 which reopened the Variable Retirement Investment Trust Fund (VRITF) for new contributions, effective January 1, 2001. Act 11 allows active employees participating in the WRS to put half of their pension fund contributions into this stock fund. Approximately 21% of WRS members participate in the Fund, which totaled \$5.8 billion at the end of fiscal year 2004. It is 99.6% invested in equities with the remaining assets held in money market investments. Employees who choose this fund accept a higher degree of risk for the potential of greater long-run returns. The investment objective of the VRITF is to exceed similar equity-oriented portfolios over a full market cycle.



The VRITF net investment assets increased \$758.8 million over the fiscal year. The increase stemmed from the equity portfolios returning 24.1% for the fiscal year ended June 30, 2004. Investment returns and employee and employer contributions were offset by disbursements out of the fund. These disbursements include annuity payments to retirees and active participants opting out of the VRITF. At the end of each calendar year, individual participants in the VRITF may elect to terminate their variable participation and transfer their account to the FRITF. Participants in the WRS may elect to credit one half of their retirement contributions and matching amounts of employer contributions to this fund, and have the remainder credited to the FRITF.

### Variable Retirement Investment Trust Fund Condensed Financial Information

Fiscal Year Ended:	2004	2003	% Change
Cash and Cash Equivalents	\$ 63,212,332	\$ 135,659,884	-53.40%
Other Current Assets	114,422,148	10,093,762	1033.59%
Invested Securities Lending Collateral	203,046,268	155,904,058	30.24%
Other Assets	64	566,607	-99.99%
Investments	5,747,730,369	4,931,515,965	16.55%
Total Investment Assets	\$ 6,128,411,181	\$ 5,233,740,276	17.09%
Current Liabilities	\$ 116,092,331	\$ 27,327,250	324.82%
Securities Lending Collateral Liability	203,046,268	155,904,058	30.24%
Total Liabilities	\$ 319,138,599	\$ 183,231,308	74.17%
Net Investment Assets	\$ 5,809,272,582	\$ 5,050,508,968	15.02%
Investment Revenue (Loss)	\$ 1,144,303,042	\$ (136,017,499)	941.29%
Investment Expense	(7,416,493)	(10,425,558)	-28.86%
Net Investment Income (Loss)	\$ 1,136,886,549	\$ (146,443,057)	876.33%
Net Receipt (Disbursements)	(378,122,935)	(269,992,274)	40.05%
Net Increase (Decrease)	\$ 758,763,614	\$ (416,435,331)	282.20%

The VRITF was also undergoing a shift in asset allocation at June 30, 2004. As a result Other Current Assets and Other Current Liabilities balances increased over the previous fiscal year end.

Expenses decreased 28.86% over fiscal year 2003. The decrease can be attributed to a reduction in management fee expense resulting from renegotiating management fee agreements.

### Total Rate of Return — As of June 30, 2004

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

<b>Fiscal Year</b>	<b>Fixed Trust Fund</b>	<b>Variable Trust Fund</b>
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
2003	4.6	-1.9
2004	16.6	23.0
10 Yr. Avg.	9.8 %	10.1 %



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

	<b>Fixed Retirement Investment Trust Fund</b>	<b>Variable Retirement Investment Trust Fund</b>
<b>Assets</b>		
Cash and Cash Equivalents	\$ 1,643,140,381	\$ 63,212,332
Receivables:		
Interest & Dividends	180,432,744	3,324,073
Securities Lending Income	1,876,837	152,275
Sales	257,490,868	110,945,800
Invested Securities Lending Collateral	4,850,012,855	203,046,268
Financial Futures Contracts	88,372	0
Other Assets	2,353,702	64
Investments (at fair value):		
Fixed Income	16,500,477,148	0
Stocks	37,333,313,051	5,747,730,369
Limited Partnerships	2,529,989,393	0
Mortgages	593,064,485	0
Real Estate Owned	417,080,474	0
Multi Asset	336,813,884	0
<b>Total Investment Assets</b>	<b>\$ 64,646,134,194</b>	<b>\$ 6,128,411,181</b>
<b>Liabilities</b>		
Purchases Payable	629,819,946	114,660,101
Foreign Currency Contracts	5,355,871	1,205
Vouchers Payable	20,303,608	1,431,025
Securities Lending Collateral Liability	4,850,012,855	203,046,268
<b>Total Investment Liabilities</b>	<b>\$ 5,505,492,280</b>	<b>\$ 319,138,599</b>
<b>Net Investment Assets Held in Trust</b>	<b>\$ 59,140,641,914</b>	<b>\$ 5,809,272,582</b>

*The accompanying notes, on pages 36 through 43, are an integral part of this statement.*

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

	<b>Fixed Retirement Investment Trust Fund</b>	<b>Variable Retirement Investment Trust Fund</b>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in Fair Value of Investments	\$ 7,396,288,642	\$ 1,102,491,081
Interest	547,506,062	785,540
Dividends	263,790,230	40,447,153
Securities Lending Commissions	44,421,835	1,652,290
Other Income	97,994,765	0
Less:		
Investment Expense	(139,134,958)	(7,416,493)
Securities Lending Rebates	(34,214,324)	(943,898)
Securities Lending Fees	(2,041,653)	(129,124)
<b>Total Investment Income (Loss)</b>	<b>\$ 8,174,610,599</b>	<b>\$ 1,136,886,549</b>
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	694,261,238	(378,122,935)
<b>Net Increase (Decrease)</b>	<b>\$ 8,868,871,837</b>	<b>\$ 758,763,614</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<b>50,271,770,077</b>	<b>5,050,508,968</b>
<b>End of Year</b>	<b>\$ 59,140,641,914</b>	<b>\$ 5,809,272,582</b>

The accompanying notes, on pages 36 through 43, are an integral part of this statement.

## RETIREMENT FUNDS

## Statement of Net Investment Assets

June 30, 2003

	Fixed Retirement Investment Trust Fund	Variable Retirement Investment Trust Fund
<b>Assets</b>		
Cash and Cash Equivalents	\$ 889,700,794	\$ 135,659,884
Receivables:		
State Investment Fund Earnings	749,744	92,996
Interest & Dividends	167,989,869	3,418,102
Sales	81,824,214	6,582,664
Invested Securities Lending Collateral	3,053,566,720	155,904,058
Foreign Currency Contracts	2,397,054	566,607
Other Assets	3,153,851	0
Investments (at fair value):		
Fixed Income	14,489,276,071	24,856
Stocks	30,734,715,564	4,931,491,109
Limited Partnerships	2,693,112,962	0
Mortgages	726,725,125	0
Real Estate Owned	436,628,080	0
Multi Asset	284,967,158	0
<b>Total Investment Assets</b>	<b>\$ 53,564,807,206</b>	<b>\$ 5,233,740,276</b>
<b>Liabilities</b>		
Purchases Payable	217,840,434	24,561,166
Mortgage Escrow Account	75,975	0
Vouchers Payable	21,554,000	2,766,084
Securities Lending Collateral Liability	3,053,566,720	155,904,058
<b>Total Investment Liabilities</b>	<b>\$ 3,293,037,129</b>	<b>\$ 183,231,308</b>
<b>Net Investment Assets Held in Trust</b>	<b>\$ 50,271,770,077</b>	<b>\$ 5,050,508,968</b>

The accompanying notes, on pages 36 through 43, are an integral part of this statement.

**RETIREMENT FUNDS****Statement of Changes in Net Investment Assets****For the Fiscal Year Ended June 30, 2003**

	<b><u>Fixed Retirement Investment Trust Fund</u></b>	<b><u>Variable Retirement Investment Trust Fund</u></b>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ 1,179,730,145	\$ (176,967,019)
Interest	681,869,790	1,359,343
Dividends	237,523,874	38,872,619
Securities Lending Commissions	40,237,989	1,746,246
Other Income	98,467,890	0
Less:		
Investment Expense	(145,873,414)	(10,425,558)
Securities Lending Rebates	(29,856,650)	(871,653)
Securities Lending Fees	<u>(2,154,054)</u>	<u>(157,035)</u>
<b>Total Investment Income (Loss)</b>	<b>\$ 2,059,945,570</b>	<b>\$ (146,443,057)</b>
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	<u>(1,059,498,215)</u>	<u>(269,992,274)</u>
<b>Net Increase (Decrease)</b>	<b>\$ 1,000,447,355</b>	<b>\$ (416,435,331)</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<u>49,271,322,722</u>	<u>5,466,944,299</u>
<b>End of Year</b>	<u><b>\$ 50,271,770,077</b></u>	<u><b>\$ 5,050,508,968</b></u>

*The accompanying notes, on pages 36 through 43, are an integral part of this statement.*

## 1. Description of Funds

The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Fixed Retirement Investment Trust Fund and the Variable Retirement Investment 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 charged directly 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 as "Investment Expense".

### A. Fixed Retirement Investment Trust Fund

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

Other Benefit Programs Within the Fixed Retirement Investment Trust Fund	
Accumulated Sick Leave	\$ 1,612,672,334
Long Term Disability Insurance	252,861,764
Duty Disability	164,967,237
Police and Firefighters	110,693,009
Income Continuation Insurance	81,476,506
Milwaukee Retirement System	55,830,194
Total	\$ 2,278,501,044

The Fixed Retirement Investment 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 Investment 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 Investment Trust Fund

The Variable Retirement Investment Trust Fund also consists mainly of retirement contributions for the participants in the WRS. In addition, the Milwaukee Retirement System had \$35.2 million invested in the Variable Retirement Investment Trust Fund at June 30, 2004.

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

The Variable Retirement Investment 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 Investment 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 Investment 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 Investment Trust Fund and the Variable Retirement Investment 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 that prices each holding based on the best available information using the following hierarchy of pricing sources:

1. Custodian supplied prices for assets that are in the Lehman Aggregate Bond Index

2. Prices provided by a contracted third party with expertise in the bond market
3. Modeled prices utilizing CMS BondEdge where spreads are supplied by the same contracted third party

In a few instances private placements cannot be priced by 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.

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

The basis for valuing real estate is 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 custodial risk assumed. Bank deposits as of June 30, 2004 were \$76,187,831. A portion of the deposits, totaling \$15,929,233 are covered by federal depository insurance. The remaining uninsured and uncollateralized deposits were held in foreign currencies in the SWIB's custodian's nominee name. In addition, SWIB held a number of US denominated time deposits with foreign financial institutions with a fair value of \$251 million, all of which was uncollateralized and uninsured.

*Investments* - The following tables present the investments held by SWIB as of June 30, 2004, 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.

<b>Fixed Retirement Trust Fund</b>				
June 30, 2004	Category			Fair and Carrying Value
	1	2	3	
Stocks	\$ 11,719,519,746	\$ 0	\$ 0	\$ 11,719,519,746
Fixed Income	8,365,293,896	0	0	8,365,293,896
Repurchase Agreements	1,281,416,689	0	0	1,281,416,689
Certificates of Deposit	426,549,291	0	0	426,549,291
Subtotal	<u>\$ 21,792,779,622</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 21,792,779,622</u>
Limited Partnerships				2,529,989,393
Pooled Multi Asset Fund				336,813,884
Pooled Equity Funds				24,591,358,147
Pooled Fixed Income Funds				6,698,966,115
Mortgages				593,064,485
Real Estate Owned				417,080,474
State Investment Fund				928,885,380
Pooled Cash and Cash Equivalents				370,316,952
Investments held by broker dealers under securities loans:				
Fixed Income				3,764,962,436
Equities				1,022,435,158
Securities lending cash collateral pooled investments				800,406,806
Total				<u>\$ 63,847,058,852</u>

<b>Variable Retirement Trust Fund</b>				
June 30, 2004	Category			Fair and Carrying Value
	1	2	3	
Stocks	\$ 2,228,819,802	\$ 0	\$ 0	\$ 2,228,819,802
Fixed Income	92,152,564	0	0	92,152,564
Repurchase Agreements	53,646,636	0	0	53,646,636
Certificates of Deposit	14,424,590	0	0	14,424,590
Subtotal	<u>\$ 2,389,043,592</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 2,389,043,592</u>
Pooled Equity Funds				3,320,054,903
State Investment Fund				41,642,555
Pooled Cash and Cash Equivalents				17,995,167
Investments held by broker dealers under securities loans:				
Equities				198,855,664
Securities lending cash collateral pooled investments				33,509,110
Total				<u>\$ 6,001,100,991</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 or its affiliate in accordance with contractual investment guidelines which are designed to insure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, 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, 2004 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 somewhat shorter than the weighted average maturity of 24 days for investments made with the cash collateral.

Pledging or selling collateral securities cannot be done without a borrower default. In addition, no restrictions on the amount of loans exist.

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

#### **5. Derivative Financial Instruments**

Investment guidelines prohibit the use of derivatives for speculative purposes or leveraging of the assets. Below are the types of derivative financial instruments that SWIB uses in its direct managed portfolios. SWIB also invests in derivative instruments indirectly through several commingled funds. These derivatives have not been included in the following totals.

##### *A. Foreign Currency Forwards and Options*

Currency exposure management is permitted through the use of exchange traded currency instruments, and through the use of spot and forward contracts in foreign currencies provided the issuer or counterparty is a recognized exchange or is a bank or broker dealer with an actual credit rating of at least: (1) 'B/C' or better from Thomson Bankwatch (Keefe); (2) 'A1/P1' or better on short term debt from S&P or Moody's; or (3) 'A' or better on long term debt from S&P or Moody's. Direct currency hedging is permitted to hedge

currency exposure back to the U. S. dollar. Cross-currency exposure management to transfer out of an exposed currency and into a benchmark currency is permitted. Total effective currency exposure from held securities and currency management activities are not permitted to exceed the aggregate value of security holdings.

SWIB's derivative activities 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, 2004 the fair value of foreign currency forward contract assets totaled \$1.702 billion, while the liabilities totaled \$1.707 billion.

#### *B. Futures Contracts*

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

Investment guidelines allow external portfolio managers to manage interest rate exposure only through the use of exchange-traded interest rate instruments. As of June 30, 2004, SWIB was invested in exchange-traded interest rate futures contracts with a net exposure totaling negative \$379.7 million.

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

In addition, investment guidelines allow internally managed active U.S. equity managers to use index futures, index options, and options on index futures up to 20% of the aggregate value of all SWIB U.S equity portfolios, subject to review by the SWIB Risk and Investment Committee when entered into for the purpose of equitizing cash holdings. During the periods presented in these financial statements, no index futures, index options, or options on index futures were held.

One outside equity manager is permitted by the investment guidelines to use exchange-traded S&P Equity Index futures contracts to manage its exposure to the stock market during the fiscal years presented. This manager is authorized to utilize futures up to 5% of the fair value of the portfolio although it held no futures during the fiscal years presented.

#### *C. Collateralized Mortgage Obligations*

Collateralized mortgage obligations (CMO's) 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 CMO's 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 CMO's 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. CMO's are held to maximize yields and in part to hedge against a rise in interest rates.

At June 30, 2004 and June 30, 2003, SWIB held CMO's valued at \$8.2 million and \$90 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 has held principal only strips for yield enhancing purposes. The majority of the underlying securities have been 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 2003, principal only strips with a combined total cost of \$376.6 million were sold for a net gain of \$212 million. The remaining strip was sold during fiscal year 2004 at a loss of \$591,019. As of June 30, 2004 SWIB holds no principal only strips.

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

SWIB has allowed one external manager credit exposure management through the use of credit-linked trust certificates, provided the counter-party is a recognized exchange or is a bank or broker dealer with an actual credit rating of at least: (1) 'B/C' or better from Thomson Bankwatch (Keefe); (2) 'A1/P1' or better on short term debt from S&P or Moody's; or (3) 'A' or better on long term debt from S&P or Moody's. Credit-Linked trust certificates are exchange-traded securities, created through a Special Purpose Company, or trust. Proceeds from the sale of the certificates are invested in AAA rated securities, then lent out under a securities lending agreement. The trust also enters into a credit default swap that references 100 high yield corporate bonds. The trust pays a variable coupon and receives a fixed coupon on the notional value during the life of the note. If the issuer of one or more of the 100 high yield corporate bond defaults, the trust will receive the current market value of the defaulted asset and the notional value will be reduced, lessening future interest earnings.

By investing in credit-linked trust certificates, SWIB gains immediate, diversified exposure to the high yield fixed income market. For taking on the risk associated with the 100 high yield corporate bonds, SWIB earns a premium rate of return. Investment in these certificates involves risk of loss from credit downgrades, illiquidity, and counterparty risk. Valuation of this security is calculated by the party marketing the security. At June 30, 2004, SWIB was invested in credit-linked trust certificates totaling \$20 million.

### **6. Summary of Investments**

The following schedule provides summary information by investment classification for the Fixed Retirement Investment Trust Fund and Variable Retirement Investment Trust Funds at June 30, 2004.

As of June 30, 2004, the Fixed Retirement Investment Trust Fund held \$57,711 million of investments, as well as, \$4,850 million of securities lending collateral, and the Variable Retirement Investment Trust Fund held \$5,748 million of investments, as well as, \$203 million of securities lending collateral. The tables included in Note 3 present investments of the Fixed and Variable Retirement Investment Trust Funds at June 30, 2004, categorized in accordance with the level of risk requirements of GASB Statement No. 3.

Fixed Retirement Investment Trust Fund				
June 30, 2004				
Classification	Interest/Coupon Rates	Maturity Dates	Cost	Fair Value
Fixed Income	Variable and .3 to 28.70	7/04 to 11/49	\$ 15,665,998,111	\$ 16,500,477,148
Common & Preferred Stock	N/A	N/A	31,115,940,418	37,333,313,051
Limited Partnerships	N/A	N/A	2,741,923,855	2,529,989,393
Mortgages	6.77 to 12.25	08/04 to 06/22	539,949,296	593,064,485
Real Estate	N/A	N/A	318,806,948	417,080,474
Multi Asset	N/A	N/A	250,000,000	336,813,884
			<u>\$ 50,632,618,628</u>	<u>\$ 57,710,738,435</u>

Variable Retirement Investment Trust Fund				
June 30, 2004				
Classification	Interest/Coupon Rates	Maturity Dates	Cost	Fair Value
Common & Preferred Stock	N/A	N/A	\$ 4,926,422,091	\$ 5,747,730,369
			<u>\$ 4,926,422,091</u>	<u>\$ 5,747,730,369</u>

## 7. Milwaukee Retirement System

The Milwaukee Retirement System (MRS), consisting of two funds within the Milwaukee Public School Retirement System, invests in the Fixed and Variable Retirement Investment Trust Funds through the WRS. Since the MRS is a separate legal entity from the WRS, both the Fixed Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund qualify as external investment trust funds. Participation by the MRS in the Fixed and Variable Investment Retirement Trust Fund is described in the DETF Administrative Code, Chapter 10.12. MRS provides assets to DETF for investment in the Fixed and Variable Retirement Investment Trust Funds which are managed by SWIB. Each month the DETF distributes the pro-rata share of the total Fixed Retirement Investment Trust Fund's earnings less administrative expenses as well as, the Variable Retirement Investment 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 Investment Trust Fund and the Variable Retirement Investment Trust Fund is the same as the value of the pool shares. Neither State statute, a legal provision, or a legally binding guarantee exist to support the value of MRS's portion of the Fixed Retirement Investment Trust Fund or the Variable Retirement Investment Trust Fund.

## 8. Unfunded Capital Commitments

Partnership agreements generally set a limit on the total dollar amount that limited partners must commit to funding when entering the partnership. Over the life of the partnership, the general partner will request capital contributions totaling the agreed upon limit. As of June 30, 2004, unfunded capital commitments totaled \$1.3 billion.



## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for the Various Funds (Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, EdVest Tuition Trust Fund, and Tobacco Permanent Endowment Fund) of the State of Wisconsin as of June 30, 2004 and 2003, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the investment activity of the Various Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Various Funds attributable to other state agencies. Further, they do not purport to, and do not, 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 of America.

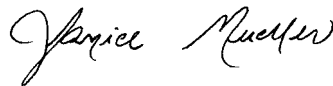
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Various Funds as of June 30, 2004 and 2003, and the changes in net investment assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Various Funds of the State of Wisconsin. The Management's 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 has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it

In accordance with *Government Auditing Standards*, we will also issue a report dated November 19, 2004, on our consideration of the Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

LEGISLATIVE AUDIT BUREAU



November 19, 2004

by

Janice Mueller  
State Auditor



Management Discussion and Analysis provides general information on the investment financial activities of the Various Funds. The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund (LGPIF), State Life Insurance Fund (SLIF), Injured Patients and Families Compensation Fund (IPFCF), Historical Society Trust Fund, 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, 2004 and 2003 is as follows:

<b>Various Funds Condensed Financial Information</b>			
<b>Fiscal Year Ended:</b>	<b>2004</b>	<b>2003</b>	<b>% Change</b>
<b><u>Net Assets:</u></b>			
Local Govt Property Ins Fund	\$ 32,401,356	\$ 24,115,262	34.4%
State Life Insurance Fund	77,501,384	82,212,946	(5.7%)
Inj Patients & Families Comp Fd	695,628,368	665,963,611	4.5%
Historical Society Trust Fund	10,807,768	9,905,909	9.1%
EdVest Tuition Trust Fund	11,758,127	13,392,180	(12.2%)
Tobacco Permanent Endowment	0	0	NA
<b><u>Net Investment Income:</u></b>			
Local Govt Property Ins Fund	\$ 260,187	\$ 922,416	(71.8%)
State Life Insurance Fund	(2,019,445)	11,825,253	(117.1%)
Inj Patients & Families Comp Fd	20,617,861	74,522,263	(72.3%)
Historical Society Trust Fund	1,253,115	507,307	147.0%
EdVest Tuition Trust Fund	(300,995)	2,110,768	(114.3%)
Tobacco Permanent Endowment	0	3,353,278	(100.0%)

Percentage changes in the Net Assets of the Various Funds were relatively small, except for Local Government Property Insurance Fund and EdVest Tuition Trust Fund, which were due to fund non-investment related activities. Net Investment Income was significantly lower in all Various Funds, except Historical Society, primarily due to current year decreases in the fair value of bonds as a result of rising interest rates as compared to the prior year, when the fair value of the bonds was increasing due to falling interest rates. The Local Government Property Insurance Fund was less impacted by this trend because it held shorter maturity bonds and a higher percentage of cash equivalents over the prior year. The Historical Society Trust Fund held an indexed stock fund, representing 70.3% of net assets, which experienced a \$1.1 million increase in fair value over the prior year.

In November 2002, the Tobacco Permanent Endowment Fund used its net assets 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, 2004**

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

The accompanying notes, on pages 49 through 52, are an integral part of this document.

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

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

The accompanying notes, on pages 49 through 52, are an integral part of this document.



# VARIOUS FUNDS

## Statement of Net Investment Assets

### June 30, 2003

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund	Tobacco Permanent Endowment Fund
<b>Assets</b>						
Cash and Cash Equivalents	\$ 11,440,713	\$ 3,787,759	\$ 4,774,598	\$ 111,103	\$ 35,564	\$ 0
Receivables						
Investment Income Receivable	256,654	1,204,665	8,404,308	141	67,653	0
Investment Sales Receivable	0	7,236	0	0	0	0
Investments						
Fixed Income	12,417,895	77,213,286	573,861,350	3,423,937	13,288,963	0
Stocks	0	0	78,927,021	6,371,132	0	0
<b>Total Investment Assets</b>	<b>\$ 24,115,262</b>	<b>\$ 82,212,946</b>	<b>\$ 665,967,277</b>	<b>\$ 9,906,313</b>	<b>\$ 13,392,180</b>	<b>\$ 0</b>
<b>Liabilities</b>						
Accounts Payable	0	0	3,666	404	0	0
<b>Total Liabilities</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 3,666</b>	<b>404</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Net Investment Assets</b>	<b>\$ 24,115,262</b>	<b>\$ 82,212,946</b>	<b>\$ 665,963,611</b>	<b>\$ 9,905,909</b>	<b>\$ 13,392,180</b>	<b>\$ 0</b>

The accompanying notes, on pages 49 through 52, are an integral part of this document.

# VARIOUS FUNDS

## Statement of Changes in Net Investment Assets

### For the Fiscal Year Ended June 30, 2003

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund	Tobacco Permanent Endowment Fund
<b>From Investment Activities:</b>						
Investment Income						
Net Increase (Decrease) in						
Fair Value of Investments	\$ (18,490)	\$ 7,290,460	\$ 44,810,991	\$ 524,885	\$ 1,271,297	\$ 0
Interest	944,310	4,540,691	29,747,742	2,191	839,471	3,353,278
Investment Expenses	(3,404)	(5,898)	(36,470)	(19,769)	0	0
Increase (Decrease) in Net						
Investments Derived from						
Investment Activities	\$ 922,416	\$ 11,825,253	\$ 74,522,263	\$ 507,307	\$ 2,110,768	\$ 3,353,278
<b>From Participant Transactions:</b>						
Net Receipts (Disbursements) -						
Non-Investment Activity	(4,586,866)	(2,736,275)	3,094,781	(621,393)	(3,488,773)	(598,508,151)
Net Increase (Decrease) in						
Net Investment Assets	\$ (3,664,450)	\$ 9,088,978	\$ 77,617,044	\$ (114,086)	\$ (1,378,005)	\$ (595,154,873)
<b>Net Investment Assets</b>						
Beginning of Period	27,779,712	73,123,968	588,346,567	10,019,995	14,770,185	595,154,873
End of Period	\$ 24,115,262	\$ 82,212,946	\$ 665,963,611	\$ 9,905,909	\$ 13,392,180	\$ 0

The accompanying notes, on pages 49 through 52, are an integral part of this document.

## 1. Description of Funds

The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, 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 that provides for a high degree of liquidity, a relatively moderate degree of risk, and a high rate of return consistent with the priorities of liquidity and protection of principal. Wisconsin Statute 25.17(3)(b) allows investments in direct obligations of the United States and Canada, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, Yankee/Euro dollar issues, certificates of deposit issued by banks in the United States, and solvent financial institutions in this state.

### *B. State Life Insurance Fund*

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

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

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

*D. Historical Society Trust Fund*

The State Historical Society of Wisconsin collects and preserves historical and cultural resources relating to the history of Wisconsin and the western United States, conducts historical research, facilitates and encourages education in Wisconsin history, and serves as the Trustee of the State for the preservation and care of government records. In addition to state and federal funds, the Historical Society receives gifts, grants, and bequests to assist it in carrying out its mission. The gifts, grants and bequests are deposited into the Historical Society Trust Fund. SWIB is responsible for managing and supervising the fund's investments. Any income earned, except where reinvestment is required by the terms of the gift or bequest, may be expended by the Historical Society in accordance with provisions of the gift, grant or bequest. The Historical Society funds available for investment are authorized to be invested in "every kind of property, real, personal or mixed, and every kind of investment, specifically including but not by the way of limitation, bonds, debentures, and other corporate obligations, stocks, preferred or common, and shares of investment companies and investment trusts, which persons of prudence, discretion, and intelligence acquire or retain for their own account."

*E. EdVest Tuition Trust Fund*

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

*F. Tobacco Permanent Endowment Fund*

The Tobacco Permanent Endowment Fund was established as a separate non-lapsable 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. All assets were expended during the fiscal year ended June 30, 2003.

**2. Significant Accounting Policies***A. Basis of Presentation*

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

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

*B. Basis of Accounting*

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

*C. Valuation of Securities*

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

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

*D. Use of Estimates*

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

**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, 2004, included \$3,336 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, 2004, 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.

Securities Categorized by Level of Risk				
	Category			Fair and
	1	2	3	Carrying Value
Fixed Income	\$ 662,817,826	\$ 0	\$ 0	\$ 662,817,826
Stocks	113,031,866	0	0	113,031,866
<b>Subtotal</b>	<b>\$ 775,849,692</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 775,849,692</b>
Pooled Cash and Equivalents				0
State Investment Fund				52,352,099
<b>Total</b>				<b>\$ 828,201,791</b>

#### 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. The Various Funds hold several principal only strips for yield enhancing purposes. The majority of 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, 2004 and 2003, the EdVest Tuition Trust Fund held principal only strips valued at \$8.5 and \$9.7 million, representing approximately 74.4% and 73.0% of portfolio assets, respectively.

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