



***State of Wisconsin
Investment Board***

FY 2006 Annual Report

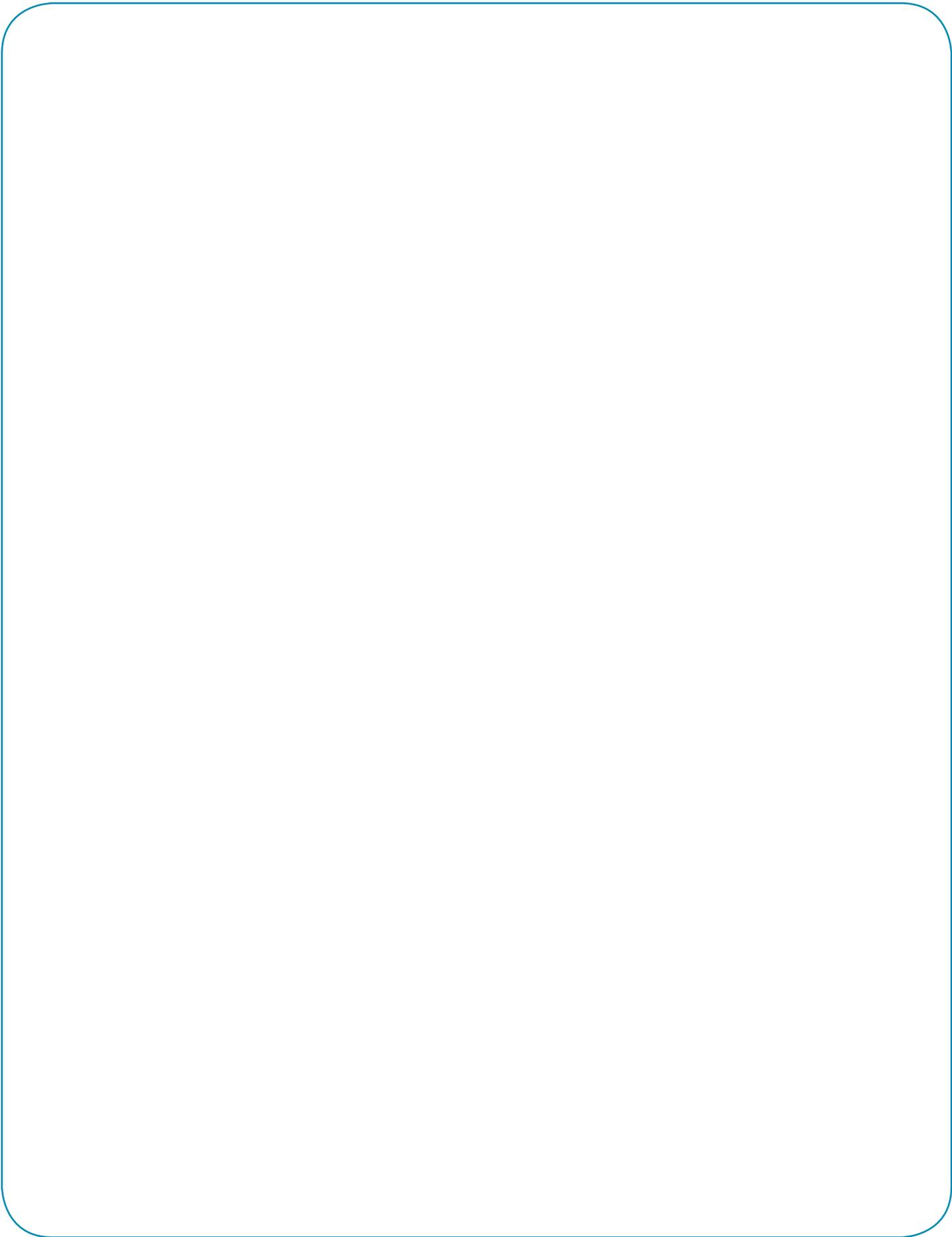


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This document includes a brief overview of the assets under management by the Investment Board and the comparative financial statements and related notes for the fiscal years ending June 30, 2006, and June 30, 2005. A complete listing of the Board's investments held as of June 30, 2006, is available on the Internet at www.swib.state.wi.us or by contacting the State of Wisconsin Investment Board.



Introduction



Message from the Chair

Responsibility for the oversight of over \$75 billion of public trust funds begins with SWIB's nine Trustees. The Trustees rely on their own experiences and knowledge, SWIB staff and the help of outside experts as they set investment policy and protect the retirement funds for over 530,000 participants in the Wisconsin Retirement System.

Trustees have a number of responsibilities ranging from setting the long-term investment policies to monitoring investment performance. Overall, Trustees are responsible for governing the conduct of every aspect of SWIB's operation. While they are not involved in daily investment decisions, they set the guidelines and keep a close eye on SWIB's practices to ensure that the trust funds are managed according to the highest professional standards and the law.

To properly perform their duties, Trustees are schooled in the best practices of both the investment

"Overall, trustees are responsible for governing the conduct of every aspect of SWIB's operation."

industry and pension fund fiduciary requirements. They attend the top training and education programs in addition to inviting some of the leading investment and economic experts to speak to SWIB trustees and staff.

Trustees are involved in the selection process for investment managers and other consultants that advise the Board. This process includes making sure there are no conflicts of interest and the selection is done fairly and in the best interest of the trust funds.

In addition, Trustees appoint the Executive Director, who oversees the staff, develops and recommends policies for Board adoption and ensures adherence to state laws and Board policies in day-to-day operations. The Executive Director works closely with the Trustees in establishing strategic initiatives and monitoring their progress.

They work with an independent fiduciary

counsel along with SWIB's legal counsel. This provides access to expert legal advice regarding operations, Trustee responsibilities and investment policies when needed.



An outside consultant specializing in compensation for the investment industry works with the Board to ensure SWIB's compensation practices are fair and competitive. Investment compensation is tied directly to performance and rigorously measured against industry standards.

An in-depth look at SWIB's operations is provided to Trustees by the internal audit director and his staff. The auditor reports directly to the Board Audit Committee and reviews investment transactions and other areas of operations to ensure that SWIB's management practices and controls are up-to-date and functioning properly.

Trustees and staff are also required to follow strict guidelines regarding their personal investing and reporting to avoid conflicts of interest and insure against the use of confidential or privileged information for personal gain. As a further safeguard, SWIB recently instituted an ethics hotline that allows staff to report concerns anonymously.

As reflected in the title "Trustee", the nine people serving on SWIB's independent Board are committed to the successful investment and protection of the pension funds that have been entrusted to their care. When faced with each decision they are constantly reminded of the importance of their work on behalf of all participants in the Wisconsin Retirement System

James A. Senty, Chair
June 30, 2006

From the Executive Director

Some public pension systems have been making headlines because of looming concerns over severe financial problems. Wisconsin Retirement System members can take comfort in knowing that it is in sound condition. In 2005, an outside review of the WRS found that it is one of the best funded pension funds in the country. That pronouncement reflects the insight that went into designing Wisconsin's public retirement system so that it is prepared to fund pension payments to a growing number of retirees well into the future. SWIB's investment strategy takes into account current and future needs of the system to help it remain strong and viable.

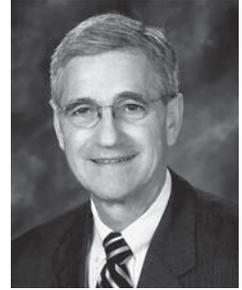
“Earning an optimum rate of return becomes more challenging as the investment environment changes at an ever faster pace.”

In its review, Gabriel, Roeder, Smith & Company (GRS) — the WRS actuary — updated its 50-year financial projection for the pension fund. That review considered the projected increase in future benefit payments as the number of retired participants more than doubles over the next 20 years. This increase was incorporated into the financial planning for the system previously and as a result the WRS is on target in meeting long-term projections.

Employer and employee contributions pay a portion of the cost of WRS benefits. The return on SWIB's investment of these contributions funds over 80% of benefit costs. The WRS financial assumptions anticipate that the Core Fund — the larger of the WRS trust funds — will earn an average 7.8% annual investment return over the long term. SWIB continues to achieve that goal.

The increase in benefit payments should not require changes in basic investment strategy.

SWIB's larger objective is to earn an optimum net rate of return while taking an acceptable level of risk. At 2005 fiscal year end, the annual return for the Core Fund was 12.2% compared to its benchmark of 11.0%. From a long-term viewpoint the five- and ten-year returns are important and as of June 30, the five-year return was 7.7% and the ten-year was 9.0%, ahead of the benchmark returns of 7.0% and 8.3% for the same periods.



Earning an optimum rate of return becomes more challenging as the investment environment changes at an ever faster pace. SWIB must be nimble and well positioned to take advantage of new opportunities as they arise. To help facilitate this, SWIB welcomed David Villa as our new chief investment officer (CIO) in June. He brings experience with strategies and asset

classes in which SWIB does not currently invest. The CIO oversees investments as a whole while SWIB's three existing asset classes — public equities, public fixed income and private markets — are managed individually by directors specializing in each area. This change allows us to consider investment possibilities that may cross the lines of the asset classes or even exist beyond those areas.

We are also reviewing legal mandates and policies that may constrain SWIB's ability to achieve optimal investment returns. The trust funds are better served by SWIB's flexibility to consider all market opportunities based on risk and return. During the next year, SWIB will consider possible ways to modernize our authority that will allow us to continue to help the WRS remain healthy for many years to come.

A handwritten signature in black ink, appearing to read "David C. Mills". The signature is stylized and written in cursive.

David C. Mills, Executive Director
June 30, 2006

The Investment Board was created under section 15.76 of the statutes. The Board's duties as manager of the State's trust funds are provided in chapter 25 of the statutes.

The law also requires SWIB to make investment decisions and conduct every aspect of its operations in the best financial interest of the trust funds.

Mission

To provide prudent and cost-effective management of funds held in trust by the State. This is achieved with solid investment returns, consistent with the purpose and risk profile of each fund.

Vision

SWIB strives 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 and a rewarding work environment will make SWIB the investment management organization of choice.

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 (SIF) 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 Core Retirement Investment Trust Fund (Core 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, 2006

Fund	\$ in Millions	% of Total
<i>Core Retirement Investment Trust Fund</i>	\$ 69,984	86%
<i>Variable Retirement Investment Trust Fund</i>	6,437	8
Wisconsin Retirement System	76,421	94
State Investment Fund*	4,250	5
Various Funds		
Injured Patients and Families Compensation Fund	746	1
State Life Insurance Fund	79	0
Local Gov't Property Insurance Fund	53	0
Historical Society Trust Fund	11	0
Tuition Trust Fund	10	0
	<hr/>	
	\$81,570	100%

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

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 and fund managers. Costs of other support services include custodial banking services, investment research, and legal services.

Agency operating expenses for staff compensation, overhead and equipment were \$19.3 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 2005 analysis provided by Cost Effectiveness Measurement (CEM), Inc.¹ concluded that SWIB's total cost to manage the Core Trust Fund was 24¢ per \$100 managed. The CEM report indicated that this amount is similar to the costs incurred by other funds with a similar mix of assets.

The cost to manage the Core Trust Fund was \$160.4 million in 2005. This represents 94% of SWIB's total cost of management.

In addition to the Core Trust Fund, SWIB manages seven other funds. SWIB's costs to manage all funds were \$169.8 million, or 22¢ per \$100 managed in 2005.

Total Management Costs

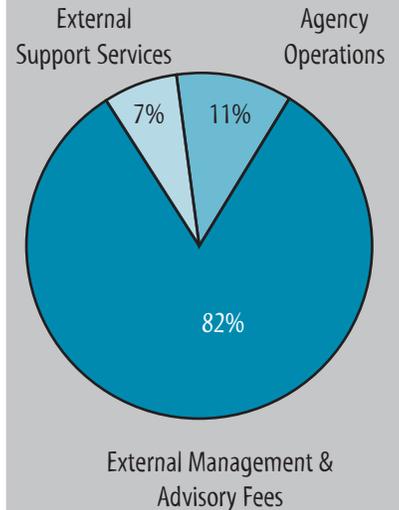
Calendar Year Ended 12/31/05

External Management & Advisory	\$	139,079,800
Agency Operations		19,314,000
Consulting		2,808,700
Custodial Banking		5,011,000
Investment Research		3,535,900
Legal Fees		69,000
	\$	<u>169,818,400</u>

- Costs for managing all funds were 22¢ per \$100 under management.
- All management costs are funded with earnings from the funds.
- Total costs for managing all funds for the calendar year ending December 2005 were \$169.8 million.
- According to CEM¹, SWIB's costs for the Core Trust Fund were considered normal based on the mix of assets managed.

Management Costs

Calendar Year Ended 12/31/05



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

Board Membership

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

Board Responsibilities Include:

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

Board of Trustees



James Senty



Thomas Boldt



David Geertsen



David Kruger



William Levit, Jr.



Deloris Sims



Wayne McCaffery



Eric Stanchfield



Stephen Bablitch

Public Members*

- James Senty, Board Chair**, President, Midwest Gas Companies, La Crosse
Thomas Boldt, Board Vice Chair, President, The Boldt Group, Inc./CEO, The Boldt Co., Appleton
David Geertsen, Local Government, Finance Director, Kenosha County
David Kruger, CEO/Owner, The Fiore Companies, Madison
William Levit, Jr., Attorney, Godfrey & Kahn S.C., Milwaukee
Deloris Sims, President & CEO, Legacy Bank Inc., Milwaukee

WRS Participant Members

- Wayne McCaffery**, Educator, Teacher, Stevens Point
Eric Stanchfield, Board Secretary, Non-educator, Secretary, Department of Employee Trust Funds

Department of Administration

- Stephen Bablitch**, Department Secretary

*Appointed Board members serve six-year terms.

Agency Management

Executive Director
David C. Mills

Deputy Executive Director
Gail L. Hanson

Chief Investment Officer
David C. Villa

Chief Operating Officer/Chief
Financial Officer
Kenneth W. Johnson

Jean C. Ledford - Public Equities

Portfolio Managers

Jackie S. Doeler
William A. McCorkle
John F. Nelson
Chad A. Neumann
Doug H. Peck
Trisha L. Reopelle

J. Alain Hung - Public Fixed Income

Portfolio Managers

Laurel A. Butler
Chirag J. Gandhi
Todd A. Ludgate

Robert H. Severance - Private Markets

Charles R. Carpenter, Managing Director

Real Estate Portfolio Managers

David Lewandowski
Steven C. Spiekerman

Private Equities/Debt Portfolio Managers

Chris P. Prestigiacomio
Francis M. Brenner

Chief Legal Counsel
L. Jane Hamblen

Human Resources Director
Ledell Zellers

Quantitative Analytics Director
Ronald A. Mensink

- SWIB has 104.5 authorized positions.
- There are three investment groups — public equities (stocks), public fixed income, and private markets.
- A majority of the investment staff holds or is pursuing the Chartered Financial Analyst (CFA) designation.
- The Board adheres to the CFA Institute industry standards.
- Top investment staff experience ranges between 5 and 25 years.
- Daily investment decisions are made by SWIB's staff within the parameters of the Board's investment policy.
- Investment staff are supported by administrative, legal and operations staff.

- WRS includes current and former employees of state agencies, the university system, school districts and most local governments.
- 9th largest public pension fund in the US.
- 24th largest pension fund in the world.
- Comprised of Core Trust Fund, a balanced fund, and Variable Trust Fund, a stock fund.
- Core Fund gains and losses are spread over five years to smooth the effect on participants' accounts.
- Variable Fund annuities fully reflect prior year gains and losses of the investments.
- About 106,000 people participate in the Variable Fund.

Wisconsin Retirement System

The Wisconsin Retirement System (WRS) makes up 94% of the assets managed by SWIB. As a fiduciary for the funds, SWIB is dedicated to earning the best possible rate of return within acceptable risk parameters consistent with “prudent expert” standards. As of June 30, 2006, the total assets of the WRS were about \$76.4 billion.

The WRS includes the pension funds available through most public employers in Wisconsin other than the City of Milwaukee and Milwaukee County. Contributions made to the WRS by these employees and their employers are invested by the Investment Board to finance retirement benefits.

More than 533,000 people participate in the WRS. Investment earnings account for the majority of the annuities paid, thus lowering the costs paid by taxpayers. Over \$3 billion in benefits were paid in 2005 to 130,000 annuitants in the WRS.

The WRS is comprised of two trust funds. The larger of the two is the Core 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 Core Trust Funds.

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

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

Annualized Performance Ending 6/30/06			
Retirement Funds	1-Year Return	5-Year Return	10-Year Return
Core Fund	12.2%	7.7%	9.0%
Benchmark	11.0	7.0	8.3
Variable Fund	12.9%	4.8%	8.4%
Benchmark	12.9	5.0	7.6
S&P 500	8.6	2.5	8.3

State Investment Fund

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

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

Over 1,000 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, 2006, were \$4.7 billion.

Portfolio characteristics as of June 30, 2006:

- 80% of Fund invested in US government securities.
- Average maturity 21 days versus iMoneyNet* at 38 days.
- Short term liquidity (0 - 3 months) equal to 166% of LGIP and 95% of SIF.
- 63% of portfolio assets change rates overnight, 95% in three months.

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

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

* iMoneyNet All Taxable Money Market Index

- SIF provided a superior rate of return, ranking 1st out of 212 government money market funds.*
- SIF also ranked 18th out of 1,252 money market funds (top 2%).*

State Investment Fund Annualized Time-Weighted Returns

<u>Fiscal Year</u>	<u>Return</u>
1997	5.3%
1998	5.4
1999	5.0
2000	5.5
2001	6.0
2002	2.5
2003	1.5
2004	1.0
2005	2.1
2006	4.2

* Source: The iMoneyNet financial company money fund statistics.

Contact 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)

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 Historical 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 purchased 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.

Investor Responsibility

SWIB's Investor Responsibility Program, which involves working with directors and management of a company with a goal of increasing economic value, began in 1986. It is one aspect of our duties as manager of the WRS trust funds because SWIB is the shareholder acting on behalf of WRS participants. The program addresses three main areas: corporate governance, social responsibility, and litigation. SWIB's program staff and investment groups identify program strategies within parameters approved by the Trustees.

SWIB's program has two primary goals:

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

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

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

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

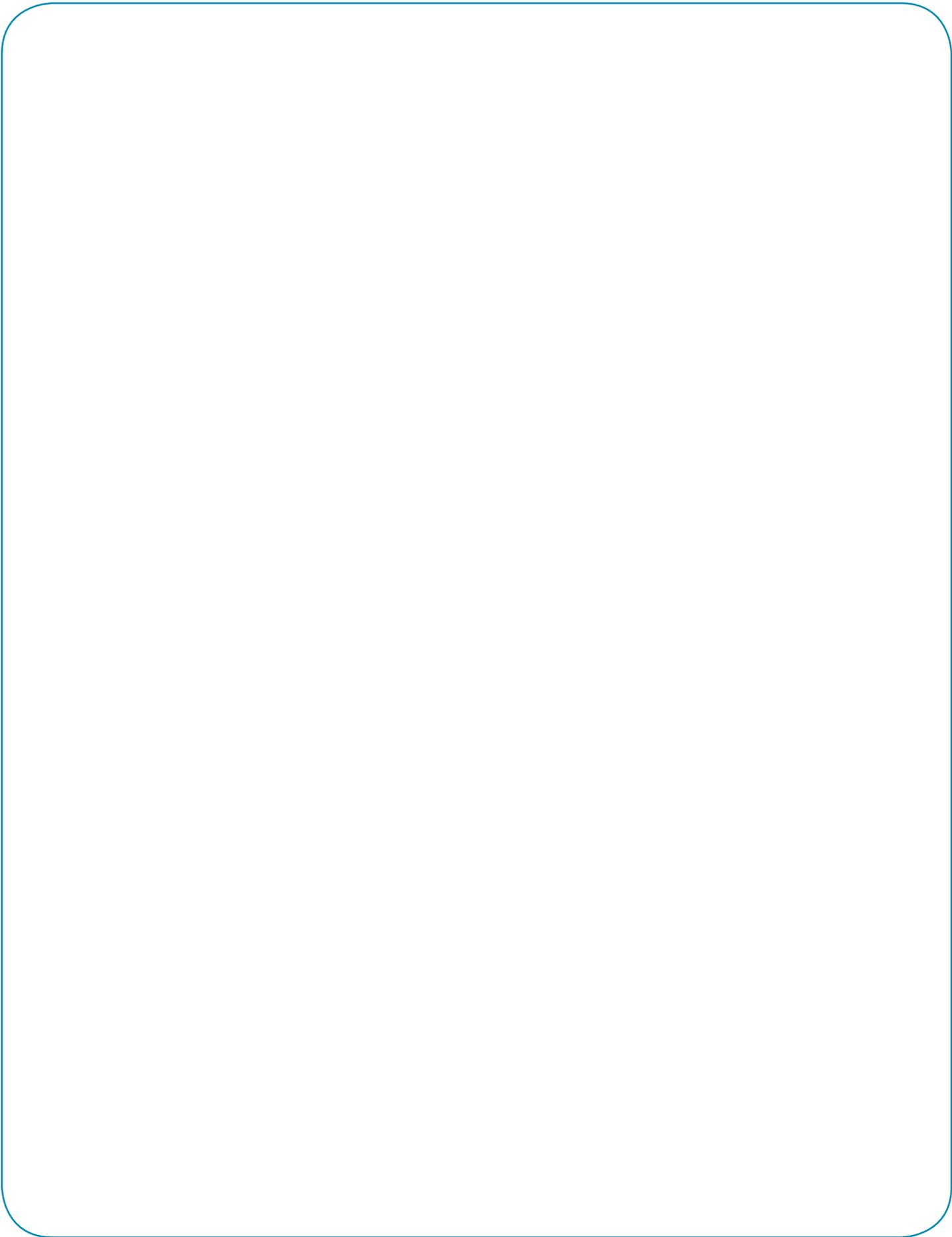
We believe companies with socially unacceptable products or practices will feel the economic consequences of public disapproval or imposition of liability under laws protecting the public health and welfare. The result: negative aspects of a company's behavior will be felt on the economic bottom line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

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

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

Key Issues

1. *Effective corporate boards.* SWIB supports effective boards with a majority of independent directors who are willing to act in the best interest of shareholders. An independent director has no conflicts of interest with shareholders and is one whose only connection to the corporation is as a director and shareholder.
2. *Director elections.* SWIB supports election of directors with a majority vote of shareholders. Although shareholders can currently withhold a vote for a director, the company can decide if the director will remain in office.
3. *Executive compensation plans.* SWIB supports compensating executives at reasonable levels but believes compensation should be strongly correlated with performance. SWIB further supports increased transparency and disclosure of compensation components including the goal setting process and method of attainment.



Financial Section





STATE OF WISCONSIN

Legislative Audit Bureau

22 E. Mifflin St., Ste. 500
Madison, Wisconsin 53703
(608) 266-2818
Fax (608) 267-0410
Leg.Audit.Info@legis.state.wi.us

Janice Mueller
State Auditor

INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for the Retirement Investment Trust Funds (Core Retirement Investment Trust Fund and Variable Retirement Investment Trust Fund) of the State of Wisconsin as of June 30, 2006 and 2005, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

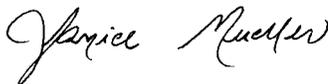
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Retirement Investment Trust Funds as of June 30, 2006 and 2005, and the changes in net investment assets for the years then ended in conformity with accounting 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 supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report dated November 21, 2006, on our consideration of the Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU



November 21, 2006

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, 2006 is presented by management as an introduction to the financial statements. It is meant to assist the reader in understanding the financial statements by providing an overall review of the financial activities during the year as well as to provide a comparison of the prior year's activity and results.

Overview of Basic Financial Statements

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

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

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

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

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

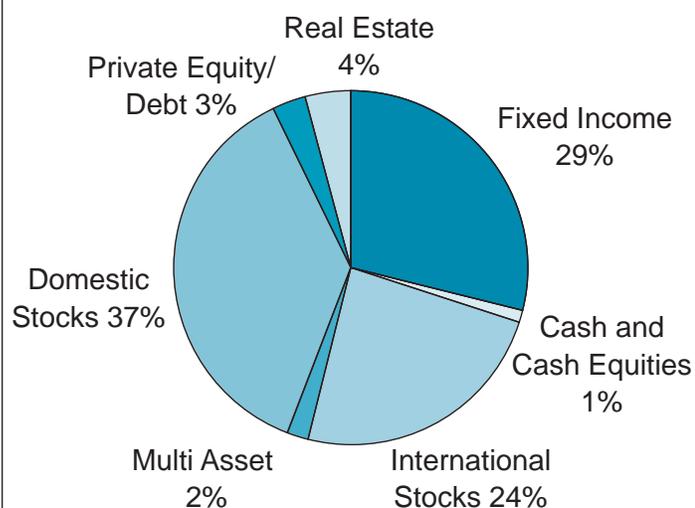
Retirement Trust Funds

Approximately 533,000 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 Core Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund whose combined net investment assets total \$76.4 billion as of June 30, 2006.

Core Retirement Investment Trust Fund (formerly the Fixed Retirement Investment Trust Fund)

The larger of the two trust funds comprising the Wisconsin Retirement System is the Core Retirement Investment Trust Fund (Core Fund) totaling \$70.0 billion. All WRS members have at least half — if not all — of their pension account in the Core Fund. It is a fully diversified, balanced fund invested for the long-term needs of the WRS. 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 an annual 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.

Core Fund Breakdown by Asset Class as of June 30, 2006



The Core Fund net investment assets increased approximately \$6.0 billion or an increase of 9%. This was primarily due to total investment returns of 12.2%. All asset classes beat their benchmark, returning the following amounts over the fiscal year: public equities 15.3%, fixed income 0.2%, real estate 38.5%, private equity 39.8%. Net investment assets were decreased by net disbursements made by the Department of Employee Trust Fund mainly for net benefit payments. The statements presented here reflect the investment activity of these funds, as well as net cash flows from the Department of Employee Trust Funds which include benefit payments, contribution receipts and transfers to/from the Variable Retirement Investment Trust Fund. Excluded from presentation in the statements are, for example, retirement reserves, contribution revenue, and benefit expense.

Core Retirement Investment Trust Fund Condensed Financial Information

Fiscal Year Ended:	2006	2005	% Change
Cash and Cash Equivalents	\$ 1,009,040,194	\$ 1,489,353,668	(32%)
Other Current Assets	408,382,994	330,647,044	24%
Invested Securities Lending Collateral	5,737,851,027	6,567,592,482	(13%)
Other Assets	3,524,562	2,346,305	50%
Investments	68,785,314,741	\$ 62,472,413,289	10%
Total Investment Assets	\$ 75,944,113,518	\$ 70,862,352,788	7%
Current Liabilities	\$ 222,161,733	\$ 298,882,445	(26%)
Securities Lending Collateral Liability	5,737,851,027	6,567,592,482	(13%)
Total Liabilities	\$ 5,960,012,760	\$ 6,866,474,927	(13%)
Net Investment Assets	\$ 69,984,100,758	\$ 63,995,877,861	9%
Investment Revenue (Loss)	\$ 7,755,575,643	\$ 6,425,111,524	21%
Investment Expense	(180,346,957)	(149,630,655)	21%
Net Investment Income (Loss)	\$ 7,575,228,686	\$ 6,275,480,869	21%
Net Receipts (Disbursements)	(1,587,005,789)	(1,420,244,922)	12%
Net Increase (Decrease) in Net Investment Assets	\$ 5,988,222,897	\$ 4,855,235,947	23%

The securities lending collateral and the securities lending collateral liability decreased 13% over the previous year end. The decrease was mainly due to the transfer of assets from separately managed funds, for which securities lending activity is reported, to commingled funds, for which securities lending activity is not reported. While commingled funds partake in securities lending activities, the collateral assets and liabilities on the lending transactions are considered assets and liabilities of the commingled fund, not the Core Fund.

Expenses increased 21% when comparing fiscal year 2005 to fiscal year 2006. Nearly all of this increase can be attributed to higher management fees. Assets under management that are subject to base

management fees, have increased \$7.9 billion over the past year. This increase translated to \$13.2 million more in base management fees being incurred in fiscal year 2006.

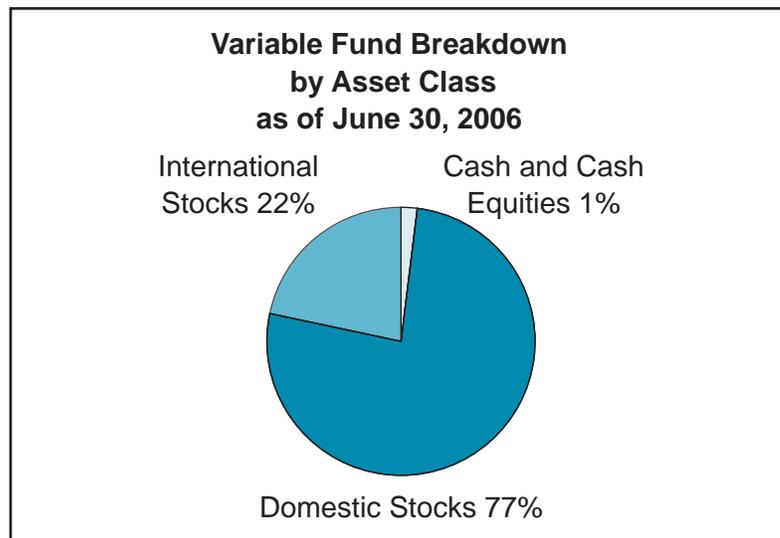
Management fees incurred on private market assets have also increased \$9.8 million over the fiscal year. Two factors contributed to this increase. First, the assets under management have grown by \$764.5 million over the past year. Second, this type of asset tends to have higher fees at the beginning of the asset's life because management fees are based on committed assets rather than assets under management. During the fiscal year SWIB has committed to funding an additional \$2.2 billion in assets.

Other shifts in management fee expenses have occurred over the year. Performance based fees have increased primarily due to higher returns. This type of fee is earned by an external manager when the portfolio's performance meets or exceeds an agreed upon performance objective. These funds outperformed their benchmarks by \$99.8 million over the fiscal year which more than offsets the \$4.2 million increase in performance fees when comparing the two fiscal years.

Net disbursements edged up slightly when compared to fiscal year 2005. This line item represents the net cash flows of non-investment related activity such as net benefit payments/receipts, and expenses related to administering the benefit programs.

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 (Variable Fund) for new contributions, effective January 1, 2001. Act 11 allows active employees participating in the WRS to put half of their pension fund contributions into this stock fund. Approximately 20% of WRS members participate in the Fund, which totaled \$6.4 billion at the end of fiscal year 2006. It is 98.8% 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 Variable Fund is to exceed similar equity-oriented portfolios over a full market cycle.



The Variable Fund net investment assets increased \$419 million over the fiscal year. The increase stemmed from the equity portfolios returning 12.9% for the fiscal year ended June 30, 2006. 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 Variable Fund. At

the end of each calendar year, individual participants in the Variable Fund may elect to terminate their variable participation and transfer their account to the Core Fund.

Variable Retirement Investment Trust Fund Condensed Financial Information			
Fiscal Year Ended:	<u>2006</u>	<u>2005</u>	<u>% Change</u>
Cash and Cash Equivalents	\$ 74,835,155	\$ 91,041,623	(18%)
Other Current Assets	14,603,576	18,453,145	(21%)
Invested Securities Lending Collateral	104,281,904	263,784,057	(60%)
Investments	6,358,890,898	5,948,991,680	7%
Total Investment Assets	<u>\$6,552,611,533</u>	<u>\$6,322,270,505</u>	4%
Current Liabilities	\$ 11,207,894	\$ 40,174,553	(72%)
Securities Lending Collateral Liability	104,281,904	263,784,057	(60%)
Total Liabilities	<u>\$ 115,489,798</u>	<u>\$ 303,958,610</u>	(62%)
Net Investment Assets	<u>\$6,437,121,735</u>	<u>\$6,018,311,895</u>	7%
Investment Revenue (Loss)	\$ 764,627,343	\$ 491,090,691	56%
Investment Expense	(9,075,052)	(7,149,605)	27%
Net Investment Income (Loss)	<u>\$ 755,552,291</u>	<u>\$ 483,941,086</u>	56%
Net Receipt (Disbursements)	<u>(336,742,451)</u>	<u>(274,901,773)</u>	23%
Net Increase (Decrease) in Net Investment Assets	<u>\$ 418,809,840</u>	<u>\$ 209,039,313</u>	100%

The securities lending collateral and the securities lending collateral liability decreased 60% over the previous year end. The decrease was mainly due to SWIB transferring assets from separately managed funds, that do report securities lending activity, to commingled funds, that do not report securities lending activity. While commingled funds partake in securities lending activities, the collateral assets and liabilities on the lending transactions are considered assets and liabilities of the commingled fund, not the Variable Fund.

Expenses increased 27% when comparing fiscal year 2005 to fiscal year 2006. The vast majority of this increase is due to higher management fees in fiscal year 2006. Assets under management that are subject to management fees have increased \$1.1 billion over the past year. This increase resulted in approximately \$2.1 million more in management fees incurred during fiscal year 2006.

Total Rate of Return - As of June 30, 2006	Time Weighted Total Rate of Return		
	Fiscal Year	Core Trust Fund	Variable Trust Fund
	1997	18.9	25.0
	1998	17.6	20.6
	1999	9.8	15.1
	2000	12.5	17.8
	2001	(5.4)	(13.5)
	2002	(4.8)	(14.7)
	2003	4.6	(1.9)
	2004	16.6	23.0
	2005	11.1	8.6
	2006	12.2	12.9
	10 Yr. Annualized Return	9.0%	8.4%

Retirement Funds
Statement of Net Investment Assets
June 30, 2006

Assets	Core Retirement Investment Trust Fund	Variable Retirement Investment Trust Fund
Cash and Cash Equivalents	\$ 1,009,040,194	\$ 74,835,155
Receivable:		
Investment Income	181,182,412	3,010,786
Securities Lending Income	2,596,326	170,673
Investment Sales	224,604,256	11,422,117
Invested Securities Lending Collateral	5,737,851,027	104,281,904
Other Assets	3,524,562	0
Investments (at fair value):		
Fixed Income	20,531,929,711	0
Preferred Securities	385,686,805	9,152,798
Convertible Securities	51,571,890	0
Stocks	42,910,481,978	6,349,738,100
Limited Partnerships	3,317,658,368	0
Mortgages	344,115,595	0
Real Estate Owned	561,310,835	0
Debt on Real Estate	(83,206,856)	0
Multi Asset	765,766,415	0
Total Investment Assets	\$ 75,944,113,518	\$ 6,552,611,533
Liabilities		
Investment Purchases Payable	172,588,926	7,762,790
Interest Payable	334,732	0
Foreign Currency Contracts	3,745,423	28,708
Financial Futures Contracts	872,322	0
Vouchers Payable	44,620,330	3,416,396
Securities Lending Collateral Liability	5,737,851,027	104,281,904
Total Investment Liabilities	\$ 5,960,012,760	\$ 115,489,798
Net Investment Assets Held in Trust	\$ 69,984,100,758	\$ 6,437,121,735

The accompanying notes on pages 26 through 37 are an integral part of this statement.

Retirement Funds
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2006

	Core Retirement Investment Trust Fund	Variable Retirement Investment Trust Fund
Additions:		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ 6,679,804,772	\$ 711,362,347
Interest	582,007,458	2,497,322
Dividends	412,101,211	49,956,297
Securities Lending Commissions	255,200,694	7,798,574
Other Income	69,069,897	0
Less:		
Investment Expense	(180,346,957)	(9,075,052)
Securities Lending Rebates	(239,478,590)	(6,784,386)
Securities Lending Fees	(3,129,799)	(202,811)
 Total Investment Income (Loss)	 \$ 7,575,228,686	 \$ 755,552,291
 Deductions:		
Net Receipts (Disbursements) - Department of Employee Trust Funds	(1,587,005,789)	(336,742,451)
 Net Increase (Decrease)	 \$ 5,988,222,897	 \$ 418,809,840
 Net Investment Assets Held in Trust:		
Beginning of Year	<u>63,995,877,861</u>	<u>6,018,311,895</u>
 End of Year	 <u>\$ 69,984,100,758</u>	 <u>\$ 6,437,121,735</u>

The accompanying notes on pages 26 through 37 are an integral part of this statement.

Retirement Funds
Statement of Net Investment Assets
June 30, 2005

	<u>Core Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
Assets		
Cash and Cash Equivalents	\$ 1,489,353,668	\$ 91,041,623
Due from Other Funds	20,468,848	0
Receivable:		
Investment Income	171,926,032	4,161,654
Securities Lending Income	2,739,135	197,573
Investment Sales	135,185,986	14,093,918
Invested Securities Lending Collateral	6,567,592,482	263,784,057
Financial Futures Contracts	327,043	0
Other Assets	2,346,305	0
Investments (at fair value):		
Fixed Income	17,749,033,906	0
Preferred Securities	309,930,639	6,523,215
Convertible Securities	37,295,767	0
Stocks	40,387,136,556	5,942,468,465
Limited Partnerships	2,553,144,446	0
Mortgages	369,286,488	0
Real Estate Owned	420,395,968	0
Debt on Real Estate	(43,188,073)	0
Multi Asset	689,377,592	0
Total Investment Assets	\$ 70,862,352,788	\$ 6,322,270,505
Liabilities		
Investment Purchases Payable	266,281,790	38,216,482
Foreign Currency Contracts	4,049,021	9,135
Vouchers Payable	28,551,634	1,948,936
Securities Lending Collateral Liability	6,567,592,482	263,784,057
Total Investment Liabilities	\$ 6,866,474,927	\$ 303,958,610
Net Investment Assets Held in Trust	\$ 63,995,877,861	\$ 6,018,311,895

The accompanying notes on pages 26 through 37 are an integral part of this statement.

Retirement Funds
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2005

	Core Retirement Investment Trust Fund	Variable Retirement Investment Trust Fund
Additions:		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ 5,236,233,322	\$ 436,091,322
Interest	573,737,649	983,028
Dividends	515,205,324	53,101,161
Securities Lending Commissions	125,760,438	4,349,996
Other Income	87,366,047	0
Less:		
Investment Expense	(149,630,655)	(7,149,605)
Securities Lending Rebates	(110,013,581)	(3,206,057)
Securities Lending Fees	(3,177,675)	(228,759)
Total Investment Income (Loss)	\$ 6,275,480,869	\$ 483,941,086
Deductions:		
Net Receipts (Disbursements) - Department of Employee Trust Funds	(1,420,244,922)	(274,901,773)
Net Increase (Decrease)	\$ 4,855,235,947	\$ 209,039,313
Net Investment Assets Held in Trust:		
Beginning of Year	59,140,641,914	5,809,272,582
End of Year	\$ 63,995,877,861	\$ 6,018,311,895

The accompanying notes on pages 26 through 37 are an integral part of this statement.

1. Description of Funds

The State of Wisconsin Investment Board (SWIB) has control of the investment and collection of principal, interest, and dividends of all monies invested of the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable 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 Wisconsin Statutes s. 25.18(1)(a) and (m) and SWIB's administrative receipts and disbursements. The directly charged expenses include external management fees, legal fees, custodial bank fees, 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 the Core Fund and Variable Fund are billed to the respective Fund and included in the Statement of Changes in Net Investment Assets as "Investment Expense".

A. Core Retirement Investment Trust Fund

The Core Retirement Investment Trust Fund, formerly known as the Fixed Retirement Investment Trust Fund, consists mainly of retirement contributions for the participants in the Wisconsin Retirement System (WRS). The WRS is administered by the Department of Employee Trust Funds (DETF) in accordance with Chapter 40 of the Wisconsin Statutes. All retirement fund contributions are invested in this trust fund unless participants have elected to have part of their 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 Core Retirement Investment Trust Fund as listed in the table below.

Other Benefit Programs Within the Core Retirement Investment Trust Fund		
	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Accumulated Sick Leave	\$1,991,587,407	\$1,788,220,276
Long Term Disability Insurance	292,270,842	271,843,477
Duty Disability	245,447,586	201,058,793
Police and Firefighters	75,568,996	115,955,991
Income Continuation Insurance	89,791,862	85,403,583
Milwaukee Retirement System	94,660,521	76,933,254
Total	<u>\$2,789,327,214</u>	<u>\$2,539,415,374</u>

The Core Fund is managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statutes s. 25.14 and 25.17. The Core Fund and SWIB are not registered with the Securities and Exchange Commission as an investment company. The investments of the Core 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 Systems had \$21.4 million and \$25.1 million invested in the Variable Fund as of June 30, 2006 and June 30, 2005 respectively.

Participation in the Variable 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 Core Fund. Individual participants in the variable program have a one time option to terminate their variable participation and transfer their account to the Core Fund.

The Variable Fund is managed by SWIB with oversight by a Board of Trustees as authorized by Wisconsin Statutes s. 25.14 and 25.17. The Variable Fund and SWIB are not registered with the Securities and Exchange Commission as an investment company. Wisconsin Statutes s. 25.17(5) states assets of the Variable 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 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 Core Fund and the Variable Fund are valued at fair value, per Wisconsin Statutes s. 25.17(14). Monthly, the investments are adjusted to fair value, with unrealized gains and losses reflected in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments".

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

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

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

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

In a few instances private placements cannot be priced by 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 independent appraisals, which are prepared once every three years. In years when appraisals are not performed the asset managers are responsible for providing market valuations.

A limited number of securities are carried at cost. Certain non-public or closely held stocks 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 at least monthly, with valuation changes recognized in income. Gains and losses are recorded in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments" during the period the instruments are held and when the instrument is sold or expires. The nature and use of derivative instruments is discussed in Note 5.

D. Use of Estimates

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

3. Deposit and Investment Risk

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

A. Credit Risk

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

The following schedule displays the lowest credit rating assigned by several nationally recognized statistical rating organizations on debt securities held by the Core Fund and the Variable Fund as of June 30, 2006. Included in this schedule are fixed income securities including certain short term securities classified as cash equivalents on the Statement of Net Investment Assets. Obligations of the United States and obligations explicitly guaranteed by the US government have been included in the AAA rating below although they are considered to be without credit risk.

Credit Quality Distribution		
<u>Ratings</u>	<u>Fair Value</u>	<u>% of Total</u>
P-1	\$2,427,950,162	9%
AAA	11,017,718,037	40%
AA	2,492,636,103	9%
A	5,811,605,940	21%
BBB	657,799,309	3%
BB	539,081,980	2%
B	338,262,533	1%
CCC	81,123,473	0%
CC	1,083,050	0%
D	10,648,714	0%
Not Rated	4,197,927,196	15%
Total	<u>\$27,575,836,497</u>	100%

B. Custodial Credit Risk

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

Deposits — Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. Bank deposits as of June 30, 2006 were \$105.4 million. A portion of the deposits, totaling \$7.2 million are covered by federal depository insurance. The remaining uninsured and uncollateralized deposits, totaling \$98.2 million, were held in foreign currencies in SWIB's custodian's nominee name. In addition, SWIB held a number of time deposits with foreign financial institutions with a fair value of \$259.7 million, all of which were uncollateralized and uninsured.

Investments — Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, SWIB will not be able to recover the value of investments that are in the possession of an outside party. As of June 30, 2006 the Retirement Funds held 13 tri-party repurchase agreements totaling \$894.2 million. SWIB's securities lending collateral account and cash management account participate in repurchase agreement pools, purchasing only a portion of a repurchase agreement in which the manager of these accounts is the buyer-lender. Since the manager that purchased the repurchase agreement is the counterparty, the securities are not held in SWIB's name. They are held in the counterparty's name and held by the counterparty's agent.

C. Concentration of Credit Risk

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

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SWIB uses a number of different methods to analyze interest rate risk.

Generally, SWIB analyzes long or intermediate term portfolios' interest rate risk using various duration calculations. Modified duration, which is stated in years, is the measure of price sensitivity of a fixed income security to an interest rate change of 100 basis points. The calculation is based on the weighted average of the present values for all cash flows. Some pooled investments are analyzed using an option adjusted duration

calculation which is similar to the modified duration method. Option adjusted duration incorporates the duration shortening effect of any embedded call provisions in the securities.

On the other hand, short term portfolios use the weighted average maturity to analyze interest rate risk. Weighted average maturity is the maturity of each position in a portfolio weighted by the dollar value of the position to compute an average maturity for the portfolio as a whole. This measure indicates a portfolio's sensitivity to interest rate changes: a longer average weighted maturity implies greater volatility in response to interest rate changes. SWIB's investment guidelines related to interest rate risk vary by portfolio. Some fixed income portfolios are required to be managed within a range of a targeted duration, while others are required to maintain a weighted average maturity at or below a specified number of days or years.

As of June 30, 2006 SWIB had interest rate risk exposure stated in terms of modified duration, related to the following assets in its Core Fund and Variable Fund:

Modified Duration by Investment Type		
<u>Investment Type</u>	<u>Fair Value</u>	<u>Modified Duration (years)</u>
Asset Backed Securities	\$ 161,070,604	3.2714
Asset Backed Securities	4,743,581	N/A
Certificate of Deposit	451,056,806	0.4363
Certificate of Deposit	10,000,000	N/A
Commercial Paper	1,997,383,174	0.1088
Commercial Paper	11,498,800	N/A
Corporate Bonds	3,340,911,494	3.6121
Corporate Bonds	1,756,563	N/A
Government Agency	697,136,395	3.1538
Mortgages	344,115,595	2.6411
Municipalities	3,951,400	9.6070
Pooled Investments	11,895,912,732	See below
Private Debt	616,869,587	3.7301
Private Debt	546,288	N/A
Repurchase Agreements	894,217,430	0.0080
Sovereign Debt	3,373,384,877	5.4764
Sovereign Debt	5,838,412	N/A
United States Treasury Securities	3,765,442,759	7.7767
Total Fair Value	<u>\$ 27,575,836,497</u>	

N/A = data not available

Breakdown of Pooled Investments			
<u>Pooled Investments</u>	<u>Fair Value</u>		
Short Term Investment Funds	\$ 1,796,650,979	30	Weighted Average Days to Maturity
Emerging Market Fixed Income Funds	407,557,171	6.6939	Modified Duration (years)
Global Fixed Income Funds	1,104,105,424	5.7648	Option Adjusted Duration (years)
Domestic Fixed Income Funds	8,587,599,158	4.7593	Option Adjusted Duration (years)
Total Pooled Investments	<u>\$11,895,912,732</u>		

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. Currency risk includes both the risk that currencies in which a portfolio's investments are

denominated or currencies in which a portfolio has taken on an active position will decline in value relative to the U.S. dollar.

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

SWIB does have policies related to foreign currency risk but due to their complexity they are not listed here in detail.

As of June 30, 2006 the Core Fund and the Variable Fund assets were denominated in the currencies shown in the schedule on pages 32 and 33.

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

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

The majority of securities loans can be terminated on demand by the Retirement Funds or the borrower. The average term of the loans is approximately one week which is shorter than the weighted average maturity of 39 days for investments made with the US dollar cash collateral and the weighted average maturity of 31 days for investments made with Euro cash collateral at June 30, 2006.

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

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

Currency Exposures by Investment Type June 30, 2006

Currency	Cash and		Convertible	Fixed		
	Cash	Equivalents		Stocks	Income	
Argentine Peso	\$	321,328	\$	0	\$	7,291,857
Australian Dollar		3,799,408		0		110,715,985
Brazilian Real		2,139,357		0		21,649,135
British Pound Sterling		22,524,181		0		317,018,473
Canadian Dollar		27,889,493		0		106,605,872
Columbian Peso		0		0		3,498,009
Czech Koruna		105		0		0
Danish Krone		242,587		0		25,406,538
Euro Currency Unit		32,870,759		0		1,449,861,511
German Mark		0		0		2,011,964
Hong Kong Dollar		5,477,876		0		0
Hungarian Forint		127,037		0		0
Indian Rupee		1,194,132		0		0
Indonesian Rupiah		0		0		21,423,149
Israeli Shekel		445,671		0		0
Italian Lira		0		0		962,130
Japanese Yen		14,349,169		0		728,249,072
Malaysian Ringgit		180,276		0		13,323,445
Mexican New Peso		343,755		0		51,466,142
New Zealand Dollar		706,525		0		37,555,471
Norwegian Krone		1,182,439		0		6,331,463
Pakistan Rupee		0		0		0
Peruvian Nuevo Sol		0		0		3,491,450
Philippine Peso		155,189		0		0
Polish Zloty		26,792		0		60,250,568
Singapore Dollar		1,883,778		0		60,056,690
South African Rand		2,811,981		0		2,350,820
South Korean Won		10,256		0		7,714,852
Swedish Krona		745,208		0		87,937,607
Swiss Franc		4,327,905		0		0
Taiwan Dollar		2,146,755		0		0
Thailand Baht		403,260		0		6,859,248
Turkish Lira		425,575		0		56
	\$	126,730,797	\$	0	\$	6,741,148,376
	\$		\$		\$	
United States Dollar	\$	957,144,552	\$	51,571,890	\$	42,519,071,702
	\$		\$		\$	
Total Investments by Currency Exposure	\$	<u>1,083,875,349</u>	\$	<u>51,571,890</u>	\$	<u>49,260,220,078</u>
	\$		\$		\$	<u>20,531,929,711</u>

**Currency Exposures by
Investment Type
June 30, 2006**

Currency	Preferred	Limited		Real		Total Exposure	
	<u>Securities</u>	<u>Partnerships</u>	<u>Mortgages</u>	<u>Estate</u>	<u>Multi Asset</u>	<u>by Currency</u>	
Argentine Peso	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7,613,185
Australian Dollar	0	0	0	0	0	0	309,912,023
Brazilian Real	72,119,777	0	0	0	0	0	102,073,494
British Pound Sterling	0	112,993,273	0	0	0	0	1,855,771,388
Canadian Dollar	0	33,686,202	0	0	0	0	559,667,380
Columbian Peso	0	0	0	0	0	0	3,498,009
Czech Koruna	0	0	0	0	0	0	105
Danish Krone	0	0	0	0	0	0	52,019,807
Euro Currency Unit	34,720,162	173,318,488	0	0	0	0	3,772,113,208
German Mark	0	0	0	0	0	0	2,011,964
Hong Kong Dollar	0	0	0	0	0	0	126,430,494
Hungarian Forint	0	0	0	0	0	0	5,609,215
Indian Rupee	0	0	0	0	0	0	8,540,008
Indonesian Rupiah	0	0	0	0	0	0	22,980,472
Israeli Shekel	0	0	0	0	0	0	12,159,355
Italian Lira	0	0	0	0	0	0	962,130
Japanese Yen	0	1,865,229	0	0	0	0	2,246,925,513
Malaysian Ringgit	0	0	0	0	0	0	38,951,572
Mexican New Peso	0	0	0	0	0	0	59,784,160
New Zealand Dollar	0	0	0	0	0	0	42,327,032
Norwegian Krone	0	0	0	0	0	0	69,844,438
Pakistan Rupee	0	0	0	0	0	0	174,763
Peruvian Nuevo Sol	0	0	0	0	0	0	3,491,450
Philippine Peso	0	0	0	0	0	0	6,969,665
Polish Zloty	0	0	0	0	0	0	77,161,159
Singapore Dollar	0	0	0	0	0	0	105,439,738
South African Rand	95,762	0	0	0	0	0	38,779,188
South Korean Won	0	0	0	0	0	0	145,070,904
Swedish Krona	0	0	0	0	0	0	215,964,544
Swiss Franc	0	0	0	0	0	0	371,277,881
Taiwan Dollar	0	0	0	0	0	0	115,684,813
Thailand Baht	0	0	0	0	0	0	18,984,222
Turkish Lira	0	0	0	0	0	0	30,516,294
	\$ 106,935,701	\$ 321,863,192	\$ 0	\$ 0	\$ 0	\$ 0	\$ 10,428,709,573
United States Dollar	\$ 287,903,902	\$ 2,995,795,176	\$ 344,115,595	\$ 478,103,979	\$ 765,766,415	\$ 65,799,371,415	
Total Investments by Currency Exposure	<u>\$ 394,839,603</u>	<u>\$ 3,317,658,368</u>	<u>\$ 344,115,595</u>	<u>\$ 478,103,979</u>	<u>\$ 765,766,415</u>	<u>\$ 76,228,080,988</u>	

5. Derivative Financial Instruments

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

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

A. Foreign Currency Forwards and Options

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

During the fiscal years presented in these financial statements SWIB's currency exposure management involved foreign currency spot and forward contracts only. Generally, SWIB enters into these contracts to hedge foreign exchange risk. At June 30, 2006 the fair value of foreign currency forward contract assets totaled \$2.193 billion, while the liabilities totaled \$2.197 billion. Whereas the June 30, 2005 fair value of foreign currency forward contract assets totaled \$1.802 billion, while the liabilities totaled \$1.806 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 fixed income portfolio managers to manage interest rate exposure only through the use of exchange-traded interest rate instruments. The Retirement Funds were invested in exchange-traded interest rate futures contracts with a net exposure totaling \$777.5 million and \$1.087 billion as of June 30, 2006 and June 30, 2005 respectively.

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

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

C. Asset Backed Securities

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

Asset backed securities are debt securities whose value is derived from payments and prepayments of principal and interest generated from whole loan mortgages, mortgage pass-through securities, credit card receivables, car loan and lease receivables, insurance proceeds receivable, as well as, airline and railroad car loan receivables. In some cases, cash flows are distributed to different investment classes or tranches in accordance with the security's established payment order. Some tranches have more stable cash flows relative to changes in interest rates while others are significantly more sensitive to interest rate fluctuations. In a declining interest rate environment, some asset backed securities may be subject to a reduction in interest payments as a result of prepayments of underlying mortgages, leases, or loans which make up the collateral pool. A reduction in interest payments causes a decline in cash flows and thus a decline in the fair value of the security. Rising interest rates may cause an increase in anticipated interest payments, thus an increase in fair value of the security. The Core Fund holds only high quality, senior tranches, resulting in minimal risks of default and prepayment. The degree of prepayment risk also varies with the type of underlying assets. Mortgage backed securities tend to have a higher degree of prepayment risk due to the long term nature of the security. SWIB held mortgage backed securities with a fair value totaling \$4.3 million and \$10.0 million at June 30, 2006 and June 30, 2005 respectively.

D. Credit-Linked Trust Certificates

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

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

E. Options

Option contracts give the purchaser of the contract the right to buy (call) or sell (put) the security or index underlying the contract at an agreed upon price on or before the expiration of the option contract. The seller of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk to the extent of the premium paid to enter into the contract. SWIB investment guidelines allow internal U.S. equity portfolios to buy put options and sell call options in connection with existing portfolio positions. Generally, external international equity managers are allowed to invest in futures and options as long as the equity equivalent value of the equity futures and optioned equities does not exceed 20% of total portfolio assets. In addition, most fixed income portfolios are permitted to enter into option contracts to manage interest rate exposure. The Retirement Funds held no options at June 30, 2006 or June 30, 2005.

6. Summary of Investments

The following schedules provide summary information by investment classification for the Core Fund and Variable Fund at June 30, 2006.

Core Retirement Investment Trust Fund				
June 30, 2006				
Classification	Coupon Rate (%)	Maturity Dates	Cost	Fair Value
Fixed Income	Variable and .10 to 24.00	7/2006 to 12/2055	\$19,945,983,003	\$20,531,929,711
Preferred Securities	N/A	N/A	223,151,221	385,686,805
Convertible Securities	.50 to 6.75	3/2007 to 6/2024	42,281,681	51,571,890
Stocks	N/A	N/A	33,138,002,112	42,910,481,978
Limited Partnerships	N/A	N/A	3,071,531,929	3,317,658,368
Mortgages	6.77 to 7.88	11/2006 to 12/2014	334,971,448	344,115,595
Real Estate	N/A	N/A	371,536,709	561,310,835
Debt on Real Estate	Variable and 5.05 to 5.15	6/2015 to 5/2027	(84,206,957)	(83,206,856)
Multi Asset	N/A	N/A	549,000,000	765,766,415
			<u>\$57,592,251,146</u>	<u>\$68,785,314,741</u>

Variable Retirement Investment Trust Fund				
June 30, 2006				
Classification	Coupon Rate (%)	Maturity Dates	Cost	Fair Value
Preferred Securities	N/A	N/A	\$ 6,246,749	\$ 9,152,798
Stock	N/A	N/A	5,328,997,702	6,349,738,100
			<u>\$ 5,335,244,451</u>	<u>\$ 6,358,890,898</u>

7. Milwaukee Retirement System

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

8. Unfunded Capital Commitments

The Core Fund has committed to fund various limited partnerships and side-by-side agreements related to its private equity and real estate holdings. Commitments that have not been funded totaled \$3.1 billion and

\$1.6 billion as of June 30, 2006 and June 30, 2005 respectively. Unfunded commitments are not included in the financial statements since the timing of the funding is not certain.

9. Debt on Real Estate

At June 30, 2006, four real estate properties with a fair value of \$207.5 million had been financed in part with \$85.6 million (\$83.2 million fair value) in mortgage debt. With the exception of annual principal payments of \$1,000, all payments are interest only, until June 2015 when \$62.5 million becomes due. After which monthly principal reserve fund payments related to the remaining \$23.1 million bonds commence and continue through maturity in May 2027. At maturity the balance of the principal reserve fund will be applied to the redemption of the bonds. The following schedule shows the payment requirements of the debt assuming the variable rate mortgage remains at the current rate.

Fiscal Year	<u>Principal Reserve</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Fund</u>
2007	\$ 1,000	\$ 4,099,905	\$ 0
2008	1,000	4,099,855	0
2009	1,000	4,099,804	0
2010	1,000	4,099,754	0
2011	1,000	4,099,703	0
2012-2016	62,495,000	18,184,886	681,479
2017-2021	0	4,578,403	1,982,943
2022-2026	0	4,578,403	2,593,426
2027	23,065,000	381,534	555,675
Total	\$ 85,565,000	\$ 48,222,247	\$ 5,813,523



STATE OF WISCONSIN

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State Auditor

INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statement of Net Assets for the State Investment Fund of the State of Wisconsin as of June 30, 2006 and 2005, 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 referred to in the first paragraph present only 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, 2006 and 2005, and the results of its 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. The supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries

of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, 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 have also issued a report dated August 23, 2006, 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, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which is included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU



August 23, 2006

by

Janice Mueller
State Auditor

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

	<u>2006</u>	<u>2005</u>
1. Various State of Wisconsin Agencies	30%	28%
2. Wisconsin public retirement funds	9%	15%
3. Local Government Investment Pool	61%	57%

Following this section are the financial statements and notes. 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, 2006 and 2005 is as follows:

SIF Condensed Financial Information			
Fiscal Year Ended:	<u>2006</u>	<u>2005</u>	<u>% Change</u>
Total Assets	\$ 5,042,059,008	\$ 5,192,261,599	(2.9)
Total Liabilities	310,358,008	380,167,796	(18.4)
Net Assets	<u>\$ 4,731,701,000</u>	<u>\$ 4,812,093,803</u>	(1.7)
Investment Revenue	\$ 223,789,411	\$ 115,968,159	93.0
Expenses	1,529,439	1,685,823	(9.3)
State Working Bank	3,392,340	2,784,478	21.8
Net Investment Income	<u>\$ 218,867,632</u>	<u>\$ 111,497,858</u>	96.3
Average Daily Cash Balance	\$ 5,297,875,389	\$ 5,177,694,170	2.3
Time Weighted Annual Yield	4.23%	2.08%	103.4

Because the SIF is used to fund participants' operating cash flows, investments are in highly liquid, short-term fixed income securities. At June 30, 2006, SIF Net Assets had decreased by \$80,392,803 from the prior year due to participant withdrawals exceeding contributions. The Average Daily Cash Balance was also slightly higher than the previous year and peaked at \$6.241 billion in March 2006.

The Net Investment Income increase of 96.3% was largely due to the Federal Open Markets Committee raising the Fed Funds Target rate eight times during the fiscal year 2006, from 3.25% to 5.25%. This also caused the Time Weighted Annual Yield to increase from 2.08% to 4.23%.

State Investment Fund
Statement of Net Assets
As of June 30, 2006 and June 30, 2005

STATE INVESTMENT FUND
Statement of Net Assets
As of June 30, 2006 and June 30, 2005

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Assets		
Investments (at fair value):		
Repurchase Agreements	\$ 2,789,000,000	\$ 2,071,000,000
Government and Agency	1,217,783,613	1,890,046,080
Commercial Paper	374,309,451	523,325,131
Certificates of Deposit (CDs)	650,000,000	700,000,000
Asset Backed Securities	0	0
Mortgage Backed Securities	364,205	616,012
Yankee/Euro Issues	0	0
	<hr/>	<hr/>
Total Net Investments (at fair value)	\$ 5,031,457,269	\$ 5,184,987,223
Other Assets:		
Accrued Interest Receivable	10,601,739	7,274,376
	<hr/>	<hr/>
Total Assets	\$ 5,042,059,008	\$ 5,192,261,599
	<hr/>	<hr/>
Liabilities		
Check Float Invested	\$ 288,307,518	\$ 367,426,645
Earnings Distribution Payable	21,960,490	12,671,151
Accrued Expenses	90,000	70,000
	<hr/>	<hr/>
Total Liabilities	\$ 310,358,008	\$ 380,167,796
	<hr/>	<hr/>
NET ASSETS	<u>\$ 4,731,701,000</u>	<u>\$ 4,812,093,803</u>
Net Assets consist of:		
Participating Shares	\$ 4,731,701,000	\$ 4,812,220,000
Undistributed Unrealized Gains (Losses)	0	(126,197)
	<hr/>	<hr/>
NET ASSETS	<u>\$ 4,731,701,000</u>	<u>\$ 4,812,093,803</u>

The accompanying notes, on pages 43 through 47, 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, 2006 and 2005

STATE INVESTMENT FUND
Statement of Operations and Changes in Net Assets
For the Fiscal Years Ended June 30, 2006 and 2005

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Investment Revenue		
Investment Income	\$ 223,789,411	\$ 124,796,956
Net Swaps Revenue (Expense)	0	(8,828,797)
Total Investment Revenue	<u>\$ 223,789,411</u>	<u>\$ 115,968,159</u>
Expenses		
Management Operating Expense Allocation	\$ 1,152,585	\$ 1,325,852
Custodial Bank Charges	175,000	177,500
Electronic Services	195,321	159,589
Legal and Consulting Fees	6,533	22,882
Total Expenses	<u>\$ 1,529,439</u>	<u>\$ 1,685,823</u>
NET INVESTMENT REVENUE	<u>\$ 222,259,972</u>	<u>\$ 114,282,336</u>
State Working Bank Charges	<u>3,392,340</u>	<u>2,784,478</u>
Net Investment Income	<u>\$ 218,867,632</u>	<u>\$ 111,497,858</u>
Distributions Paid and Payable	<u>218,741,435</u>	<u>104,688,863</u>
Change in Undistributed Unrealized Gains (Losses)	\$ 126,197	\$ 6,808,995
Beginning of Period Undistributed Unrealized Gains (Losses)	<u>(126,197)</u>	<u>(6,935,192)</u>
End of Period Undistributed Unrealized Gains (Losses)	<u>\$ 0</u>	<u>\$ (126,197)</u>
Participant Transactions		
Receipts by Transfer to Fund	\$ 25,408,377,000	\$ 23,909,576,000
Disbursements by Transfer from Fund	<u>(25,488,896,000)</u>	<u>(24,738,570,000)</u>
Net Change in Participating Shares	\$ (80,519,000)	\$ (828,994,000)
Beginning of Period Participating Shares	<u>4,812,220,000</u>	<u>5,641,214,000</u>
End of Period Participating Shares	<u>\$ 4,731,701,000</u>	<u>\$ 4,812,220,000</u>
Net Assets	<u><u>\$ 4,731,701,000</u></u>	<u><u>\$ 4,812,093,803</u></u>

The accompanying notes, on pages 43 through 47, are an integral part of this statement

1. Description of Fund

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

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

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

2. Significant Accounting Policies

A. Basis of Presentation

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

B. Basis of Accounting

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

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

C. Valuation of Securities

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

Government/U.S. Agency securities and Commercial Paper are priced using matrix pricing. This method estimates a security’s fair value by using quoted market prices for securities with similar interest rates, maturities, and credit ratings. Further, beginning with fiscal year 2005, short-term debt investments with remaining maturities

of up to ninety days are valued using amortized cost to estimate fair value, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors.

Repurchase Agreements and nonnegotiable Certificates of Deposit are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. In addition, a bond issued by a State of Wisconsin Agency, having a par value at June 30, 2006 of \$0.4 million, is valued at par, which management believes approximates fair value.

Summary Information by Investment Classification

	June 30, 2006				June 30, 2005	
	Interest Rates	Maturity Dates	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)	Fair Value
Repurchase Agreements	4.50-5.15	07/03/06-07/03/06	\$ 2,789,000,000	\$ 2,789,000,000	\$ 2,071,000,000	\$ 2,071,000,000
Government and Agency	3.30-5.41	07/03/06-06/18/07	1,217,783,613	1,217,783,613	1,890,172,277	1,890,046,080
Commercial Paper	5.02-5.30	07/03/06-07/27/06	374,309,451	374,309,451	523,325,131	523,325,131
Certificates of Deposit	2.99-5.42	07/17/06-09/15/08	650,000,000	650,000,000	700,000,000	700,000,000
Asset Backed Securities	N/A	N/A	0	0	0	0
Mortgage Backed Securities	6.35	12/27/08	364,205	364,205	616,012	616,012
Yankee/Euro Issues	N/A	N/A	0	0	0	0
Total Investments			<u>\$ 5,031,457,269</u>	<u>\$ 5,031,457,269</u>	<u>\$ 5,185,113,420</u>	<u>\$ 5,184,987,223</u>
Ratio of Fair Value to Book Value				<u>100.0000%</u>		<u>99.9976%</u>

D. Management Operating Expenses

Management operating expenses are SWIB's administrative costs that are allocated, in advance, to the SIF participants.

E. State Working Bank Charges

State Working Bank Charges represent charges for various state banking services such as lockbox, e-pay, and depository services. These expenses are allocated to SIF participants based on their proportionate usage of banking services and, accordingly, reduce the participant's share of the Net Investment Revenue.

3. Pool Earnings and Pool Shares

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

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

4. Deposit and Investment Risk

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

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the SIF. The SIF's investment guidelines establish numerous, very specific maximum exposure limits based on the minimum credit ratings as issued by nationally recognized statistical rating organizations (NRSROs). As of June 30, 2006, these credit ratings and aggregate exposures by investment type were as follows:

Credit Quality Distribution for Fixed Income Securities			
	Ratings	Fair Value	%
Repurchase Agreements:			
U.S. Government Debt collateral	N/A	\$ 2,234,250,000	44.4%
U.S. Agency collateral	AAA/Aaa	554,750,000	11.0%
Federal Home Loan Board (FHLB)	A-1+/P-1	499,300,563	9.9%
Federal Home Loan Mortgage Corp (FHLMC)	A-1+/P-1	256,219,917	5.1%
Federal National Mortgage Assoc (FNMA)	A-1+/P-1	412,264,451	8.2%
Federal Home Loan Board - Note	AAA/Aaa	24,998,682	0.5%
Federal Home Loan Mortgage Corp - Note	AAA/Aaa	25,000,000	0.5%
Commercial Paper	A-1+/P-1	349,373,701	7.0%
Commercial Paper	A-1 /P-1	24,935,750	0.5%
Certificates of Deposit:			
Nonnegotiable (Bankers Bank)	N/A	500,000,000	9.9%
Negotiable	A-1+/P-1	150,000,000	3.0%
Mortgage Backed (Wisc Dept of Vets Affairs)	Not Rated	364,205	0.0%
Totals		\$ <u>5,031,457,269</u>	<u>100.0%</u>

B. Custodial Credit Risk

Deposits — Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. SWIB does not have a deposit policy specifically for custodial credit risk. As of June 30, 2006, the SIF held certificates of deposit with an estimated fair value of \$500 million invested pursuant to the Wisconsin Certificate of Deposit Program (administered by Bankers Bank) implemented in July 1987. Investment guidelines provide that banks accepted into this program must accept deposits in Wisconsin and meet credit-screening criteria designed to assure the safety of the deposits. Approximately \$421 million is insured through FDIC insurance and the State of Wisconsin Public

Deposit Guarantee Account. The remaining \$79 million is considered uninsured and uncollateralized. The actual coverage of these deposits fluctuates daily based on the allocable share of participants' accounts.

C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The SIF's investment guidelines limit concentrations of credit risk by establishing numerous maximum issuer and/or issue exposure limits based on credit rating. These guidelines do not place a limit on maximum exposure for any U.S. Agency. As of June 30, 2006 the SIF has more than five percent of its investments in FHLB (10.4%), FHLMC (5.6%), FNMA (8.2%), and Repurchase Agreement collateral consisting of various securities issued by these same three U.S. Agencies (11.0%). Since the Repurchase Agreements mature each day, new collateral, consisting of a different blend of U. S. Treasury and Agency securities, is assigned each night.

D. Interest Rate Risk

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

Weighted Average Maturities for Fixed Income Securities		
	Fair Value	Weighted Ave Maturity (Days)
Repurchase Agreements:	\$ 2,789,000,000	3
Government and Agency	1,217,783,613	17
Commercial Paper	374,309,451	14
Certificates of Deposit	650,000,000	109
Asset Backed Securities	0	--
Mortgage Backed Securities	364,205	911
Yankee/Euro Issues	0	--
Total Fair Value	<u>\$ 5,031,457,269</u>	
Portfolio Weighted Ave. Maturity		21

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SIF guidelines allow the investment in Canadian or Yankee/Euro denominated issues provided they are fully hedged against foreign currency risk. As of June 30, 2006 the SIF did not own any issues denominated in a foreign currency.

5. Restructured Investments – March 16, 1995

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

SWIB has suspended the use of non-risk reducing derivatives in the SIF and on November 2, 1995 the Board of Trustees adopted investment guidelines prohibiting the use of such instruments.

For fiscal year 2005, the cash outflow for the restructured interest rate swap was (\$9,345,609). At June 30, 2006 and 2005, all restructured investments had matured, and the SIF did not hold any derivative financial instruments.

6. Related Party Transactions

The SIF held one bond issued by a State of Wisconsin agency, the Department of Veterans Affairs, with a remaining par and carrying value of \$0.4 million at June 30, 2006. Management believes the rate of interest received is comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.



STATE OF WISCONSIN

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State Auditor

INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for the Various Funds (Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, and EdVest Tuition Trust Fund) of the State of Wisconsin as of June 30, 2006 and 2005, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Various Funds as of June 30, 2006 and 2005, 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.

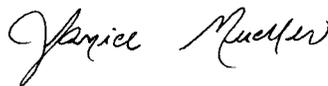
Our audits were conducted for the purpose of forming an opinion on the financial statements of the Various Funds of the State of Wisconsin. The supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional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

In accordance with *Government Auditing Standards*, we will also issue a report dated November 21, 2006, on our consideration of the Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which will be included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

November 21, 2006

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 (Life Fund), Injured Patients and Families Compensation Fund (IPFCF), Historical Society Trust Fund (HSTF), and EdVest Tuition Trust Fund (EdVest) (collectively known as the "Various Funds").

Following this section are the financial statements and notes. The Statement of Net Investment Assets provides information on the types of investments and the liabilities of the Various Funds. The Statement of Changes in Net Investment Assets provides information on the investment income of the Various Funds and their net assets at year-end. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the funds' financial statements. Condensed Various Funds financial information for the fiscal years ended June 30, 2006 and 2005 is as follows:

Various Funds Condensed Financial Information				
<u>Fiscal Year Ended</u>	2006	2005	Change	Change
	(\$)	(\$)	(\$)	(%)
<u>Net Investment Assets:</u>				
Local Govt Property Ins Fund	53,122,557	43,436,557	9,686,000	22.3%
State Life Insurance Fund	79,220,638	86,770,246	(7,549,608)	(8.7%)
Inj Patients & Families Comp Fd	746,027,152	757,837,949	(11,810,797)	(1.6%)
Historical Society Trust Fund	11,356,277	11,129,168	227,109	2.0%
EdVest Tuition Trust Fund	10,157,429	11,496,037	(1,338,608)	(11.6%)
<u>Net Investment Income:</u>				
Local Govt Property Ins Fund	2,093,134	836,237	1,256,897	150.3%
State Life Insurance Fund	(4,964,133)	12,226,681	(17,190,814)	(140.6%)
Inj Patients & Families Comp Fd	6,893,927	58,154,145	(51,260,218)	(88.1%)
Historical Society Trust Fund	694,603	818,365	(123,762)	(15.1%)
EdVest Tuition Trust Fund	(141,476)	952,971	(1,094,447)	(114.8%)

Percentage changes in the Net Investment Assets of the Various Funds were relatively small, except for Local Government Property Insurance Fund and EdVest Tuition Trust Fund which were due to program activities within the fund that were not investment related.

With the exception of the Local Government Property Insurance Fund, Net Investment Income was significantly lower in the Various Funds, primarily due to current year decreases in the fair value of bonds as a result of rising long-term interest rates. The Local Government Property Insurance Fund increase in Net Investment Income was due to shorter maturity bonds as well as a relatively high percentage of cash equivalents which earned much higher interest rates over the prior year.

The Injured Patients and Families Compensation Fund held four indexed stock funds, representing 19.2% of net investment assets, which experienced a \$16.5 million increase in fair value during the current year as compared to a \$21.0 million increase in fair value during the prior year. The Historical Society Trust Fund held an indexed stock fund, representing 75.1% of net investment assets, which experienced a \$0.6 million increase in fair value during the current year as compared to a \$0.4 million increase in fair value during the prior year.

Various Funds
Statement of Net Investment Assets
June 30, 2006

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
Investment Assets					
Cash and Cash Equivalents	\$ 48,932,996	\$ 2,181,839	\$ 13,615,947	\$ 232,393	\$ 428,503
Receivables					
Investment Income Receivable	225,301	1,188,659	8,923,960	26,464	34,570
Investment Sales Receivable	0	0	0	10,967	0
Investments					
Fixed Income	3,964,260	75,850,140	580,496,575	2,558,965	9,694,356
Stocks	0	0	143,009,008	8,528,486	0
Total Investment Assets	<u>\$ 53,122,557</u>	<u>\$ 79,220,638</u>	<u>\$ 746,045,490</u>	<u>\$ 11,357,275</u>	<u>\$ 10,157,429</u>
Liabilities					
Investment Purchases Payable	0	0	2,788	73	0
Accounts Payable	0	0	15,550	925	0
Total Liabilities	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 18,338</u>	<u>\$ 998</u>	<u>\$ 0</u>
Net Investment Assets	<u>\$ 53,122,557</u>	<u>\$ 79,220,638</u>	<u>\$ 746,027,152</u>	<u>\$ 11,356,277</u>	<u>\$ 10,157,429</u>

Various Funds
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2006

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	Historical Society Trust Fund	EdVest Tuition Trust Fund
From Investment Activities:					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ (52,604)	\$ (9,381,209)	\$ (24,681,064)	\$ 704,696	\$ (757,442)
Interest	2,150,677	4,430,506	31,643,362	9,141	615,966
Investment Expenses	(4,939)	(13,430)	(68,371)	(19,234)	0
Increase (Decrease) in Net Investments from Investment Activities	\$ 2,093,134	\$ (4,964,133)	\$ 6,893,927	\$ 694,603	\$ (141,476)
From Participant Transactions:					
Net Receipts (Disbursements) - Non-Investment Activity	7,592,866	(2,585,475)	(18,704,724)	(467,494)	(1,197,132)
Net Increase (Decrease) in Net Investment Assets	\$ 9,686,000	\$ (7,549,608)	\$ (11,810,797)	\$ 227,109	\$ (1,338,608)
Net Investment Assets					
Beginning of Year	43,436,557	86,770,246	757,837,949	11,129,168	11,496,037
End of Year	<u>\$ 53,122,557</u>	<u>\$ 79,220,638</u>	<u>\$ 746,027,152</u>	<u>\$ 11,356,277</u>	<u>\$ 10,157,429</u>

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

Various Funds
Statement of Net Investment Assets
June 30, 2005

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

Various Funds
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2005

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

The accompanying notes on pages 53 through 57 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 Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, and EdVest Tuition Trust Fund (collectively known as the "Various Funds"). The statements presented herein reflect only the investment activity of the Various Funds. Excluded from the presentation in the statements are, for example, claim reserves, reserves for life policies and contracts, contribution revenue, premiums earned, benefit expense, and expenditures from endowment income. Also excluded from the statements are SWIB's administrative receipts and disbursements related to the investment function.

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

A. Local Government Property Insurance Fund

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

B. State Life Insurance Fund

The State Life Insurance Fund (Life Fund) 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 Life Fund. SWIB's investment objective is to maintain a diversified portfolio of high quality fixed income obligations that will preserve principal, maximize income while minimizing costs to policyholders, and approximate the expected life of the Fund's insurance contracts. Wisconsin Statute 25.17(3)(a) allows investments in loans, securities and any other investments as authorized by s. 620.22, Wis. Stats. Permitted classes of investments include bonds of government units or of private corporations, loans secured by mortgages, preferred or common stocks, real property and other investments not specifically prohibited by statute.

C. Injured Patients and Families Compensation Fund

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

D. Historical Society Trust Fund

The State Historical Society of Wisconsin collects and preserves historical and cultural resources relating to the history of Wisconsin and the western United States, conducts historical research, facilitates and encourages education in Wisconsin history, and serves as the Trustee of the State for the preservation and care of government records. In addition to state and federal funds, the Historical Society receives gifts, grants, and bequests to assist

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

E. EdVest Tuition Trust Fund

The EdVest Wisconsin program offers families a way to prepare for future higher education costs. When the program was established in 1997, it offered a bond-based tuition unit investment option. 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. The sale of tuition units was discontinued in 2002. Other investment options are available under the EdVest program, but these are not managed by the Investment Board.

2. Significant Accounting Policies

A. Basis of Presentation

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

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

B. Basis of Accounting

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

C. Valuation of Securities

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

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

D. Use of Estimates

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

E. Cash and Cash Equivalents

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

3. Deposits and Investments

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

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Various Funds. The Various Funds' (except for EdVest) investment guidelines require that issues be rated "A-" or better at the time of purchase based on the minimum credit ratings as issued by nationally recognized statistical rating organizations (NRSROs). EdVest guidelines do not specifically list a minimum credit quality. As of June 30, 2006, these credit ratings were as follows:

Credit Quality Distribution for Fixed Income Securities										
	LGPIF		Life Fund		IPFCF		Historical Society		EdVest	
	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%
US Treasury	\$1,980,160	3.7%	\$31,646,568	40.6%	\$185,707,635	31.3%	\$0	0.0%	\$156,726	1.6%
AAA	1,984,100	3.8%	4,948,415	6.3%	90,947,029	15.3%	0	0.0%	8,110,239	80.1%
AA	0	0.0%	6,947,266	8.9%	65,190,999	11.0%	2,558,965	91.8%	476,446	4.7%
A	0	0.0%	21,133,667	27.1%	154,173,784	25.9%	0	0.0%	407,988	4.0%
BBB	0	0.0%	7,595,294	9.7%	68,284,178	11.5%	0	0.0%	461,457	4.6%
BB	0	0.0%	0	0.0%	4,792,950	0.8%	0	0.0%	0	0.0%
B	0	0.0%	850,000	1.1%	7,650,000	1.3%	0	0.0%	0	0.0%
CCC	0	0.0%	707,380	0.9%	3,750,000	0.6%	0	0.0%	81,500	0.8%
Not Rated	0	0.0%	2,021,550	2.6%	0	0.0%	0	0.0%	0	0.0%
Subtotal	\$3,964,260	7.5%	\$75,850,140	97.2%	\$580,496,575	97.7%	\$2,558,965	91.8%	\$9,694,356	95.8%
SIF (unrated)	48,932,000	92.5%	2,181,000	2.8%	13,615,000	2.3%	230,000	8.2%	428,000	4.2%
Totals	\$52,896,260	100.0%	\$78,031,140	100.0%	\$594,111,575	100.0%	\$2,788,965	100.0%	\$10,122,356	100.0%

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

B. Custodial Credit Risk

Deposits — Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Various Funds will not be able to recover deposits that are in possession of an outside party. The Various Funds do not have a deposit policy specifically for custodial credit risk. As of June 30, 2006 the Various Funds had \$5,678 deposited in a bank account covered by federal depository insurance.

Investments — Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Various Funds will not be able to recover the value of investments that are in the possession

of an outside party. The Various Funds do not have an investment policy specifically for custodial credit risk. As of June 30, 2006 the Various Funds did not have any investment securities exposed to custodial credit risk.

C. Concentration of Credit Risk

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

As of June 30, 2006 no Various Fund had more than five percent of their total investments (including the SIF) in a single issuer.

D. Interest Rate Risk

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

Duration for Fixed Income Securities (in years)										
	LGPIF		Life Fund		IPFCF		Historical Society		EdVest	
	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration
Govt/Agcy	\$3,964,260	0.42	\$33,576,809	10.41	\$241,064,779	4.81	\$0	0.00	\$8,130,013	4.94
Corporate	0	0.00	42,273,331	9.15	339,431,796	5.04	0	0.00	1,564,343	4.08
Bond Funds	0	0.00	0	0.00	0	0.00	2,558,965	4.98	0	0.00
Subtotal/Ave	\$3,964,260	0.42	\$75,850,140	9.71	\$580,496,575	4.94	\$2,558,965	4.98	\$9,694,356	4.80
SIF	48,932,000	0.06	2,181,000	0.06	13,615,000	0.06	230,000	0.06	428,000	0.06
Total/Ave	\$52,896,260	0.09	\$78,031,140	9.44	\$594,111,575	4.83	\$2,788,965	4.57	\$10,122,356	4.60

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The Various Fund investment guidelines do not specifically address foreign currency risk with the exception that Life Fund only allows investments in U.S. dollar denominated instruments. As of June 30, 2006 the Various Funds did not own any issues denominated in a foreign currency.

4. Derivative Financial Instruments

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

As of June 30, 2006 and 2005, the EdVest Tuition Trust Fund held interest only strips valued at \$8.0 and \$8.8 million, representing approximately 78.8% and 77.2% of portfolio investments, respectively.

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