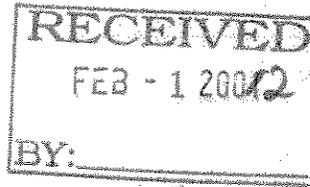




# State of Wisconsin Investment Board

MAILING ADDRESS  
PO BOX 7842  
MADISON, WI 53707-7842

121 EAST WILSON ST  
MADISON, WI 53702  
(608) 266-2381



January 31, 2002

Senator Brian Burke, Co-Chair  
Joint Committee on Finance  
P.O. Box 7882  
Madison, WI 53707-7882

Representative John Gard, Co-Chair  
Joint Committee on Finance  
P.O. Box 8952  
Madison, WI 53708-8952

Dear Senator Burke and Representative Gard:

In accordance with s. 25.17(17) of the Statutes, I am submitting to the Joint Committee on Finance, the State of Wisconsin Investment Board's (SWIB) annual report on credits, or "soft dollars," generated with security brokerage firms and the use of those credits to acquire investment research services. This report covers soft dollar credits and expenditures for calendar year 2001. Additional reports regarding SWIB's commission activities with other brokerage firms are available upon request.

## Background

When shares of stocks are bought or sold, a commission is paid to the brokerage firm handling the transaction. A portion of the commission represents compensation for the trading function, such as trade execution, clearing, settling and custody. Another portion of the commission serves to compensate the firm for investment research products and services it provides.

Occasionally, a brokerage firm will not have its own research staff. In such instances, the firm may offer to pay independent research vendors for services they provide to the investment manager. Credits made available to clients in this manner are termed "third-party" or "non-exclusive" soft dollar research credits.

Similarly, a broker, which does not have an in-house research staff, may enter into a contractual (exclusive) relationship with a research provider such that investors are only granted access to the research if a specified level of trading activity is executed with the broker. These types of soft dollar arrangements are termed "exclusive."

Soft dollar research services and practices evolved prior to 1975 when commission rates were fixed by rule. Since many stock trading functions are fairly generic, brokers had to compete for trading business with the research services and credits they offered. In this manner, research grew to be a major service provided by brokers. At the same time, since commission rates were fixed, investment managers relying on soft dollar research did not encounter any fiduciary conflicts with the practice.

A roughly comparable soft dollar research practice exists in trading public bonds. Large institutional investors receive research services directly from brokers or may, in certain situations involving new bond issues, be able to direct a portion of the "selling concession" to brokerage firms that can provide desired third-party research services. A key difference between stock soft dollar credits and bond soft dollar credits involves the type of transaction which generates the credit. Whereas an investment manager cannot receive a soft dollar research credit from the purchase of new issues of stock, a soft

Senator Brian Burke  
Representative John Gard  
January 31, 2002  
Page 2

dollar research credit for a bond transaction can, in some limited instances, be received on the new issue of a bond.

A significant difference also exists in the way that the research credit is generated. A "commission" is an amount paid on top of the selling price of a share of stock and represents a payment by the investor for both the transaction and research services. The "selling concession" received by a bond broker is taken from the proceeds of the bond issue. The seller rather than the bond purchaser therefore, pay it. The price paid by the bond buyer (SWIB) is the same, regardless of the soft dollar research arrangements offered by the broker.

***Legal Basis for "Soft Dollar" Transactions.*** The Securities Acts Amendments of 1975 to the Securities Exchange Act replaced fixed commission rates with negotiated rates, effective May 1, 1975. The Amendments also created the Section 28(e) safe harbor provisions regarding the use of "soft dollars" by investment managers. In effect, Section 28(e) defines allowable uses of soft dollars. If a person with "investment discretion" is in compliance with these provisions, he or she is protected against claims that receiving research services through the payment of brokerage commissions violates fiduciary responsibility. The person must determine that the "bundled" price of the services received is reasonable in relation to the value of the trading and research services received.

Rulings and interpretations by the Securities and Exchange Commission (SEC) provide the framework for applying Section 28(e). SEC determinations have covered diverse topics, such as the standards used to judge reasonableness of price, the relations between brokers and third-party vendors, and the definition of allowable research equipment and supplies.

Over the past years, several industry groups and regulatory agencies have issued reports which attempt to more closely define appropriate use, management and disclosure of soft dollar activity. SWIB has followed these discussions with interest and, in some cases, has helped to form broad industry guidelines. We believe that SWIB's existing soft dollar procedures continue to meet or exceed the recommended policies.

***Alternative Brokerage Arrangements.*** In lieu of soft dollar arrangements, some brokerage firms offer "commission recapture" programs. Under such programs, a commission is paid to a broker when a trade is executed and the broker later refunds some portion of the commission back to the investor.

Our understanding is that the use of commission recapture programs by internally managed state pension funds is limited and may be more common among funds which rely heavily on outside advisors to manage their investments. In such situations, oversight of trading activities by the pension fund is not as direct and the benefits from commissions may tend to flow more to the outside advisor than to the fund itself. For pension funds that depend upon outside management, recapture programs provide one way to access some of the benefits of trading activity that the pension fund would not otherwise receive.

SWIB believes that good value is being received for the commissions we pay and that there is little additional value to be "recaptured." Our concern would be that reduced commissions could potentially lead to a reduction in quality or quantity of trading services. In 2001, the Domestic Equities group reaffirmed this concern. For that reason, we have proceeded cautiously in our

consideration of commission recapture arrangements and do not presently participate in such programs.

**State of Wisconsin Investment Board CY2001 Soft Dollar Commissions**

In calendar year 2001, SWIB's internally managed domestic equity portfolios generated a total of \$11.5 million in commissions. This total does not include transactions where fees were implicit in the sale/purchase price of the investment (principal transactions) or where the fees are paid by the issuer (syndicate transactions). Also included in the information below are soft dollars generated from bond transactions, whereby selling concessions were permitted to be designated to soft dollar brokers.

*Third Party (non-exclusive) Soft Dollar Brokers.* The table below lists the six third-party soft dollar brokerage firms with which SWIB transacted business during calendar year 2001. This exhibit itemizes the commission amounts expended with each firm and the credits earned with each firm.

<b>Broker</b>	<b>Fixed Income &amp; Equity Soft Dollars CY 2001</b>	
	<b>Commissions Generated</b>	<b>Credits Earned</b>
BISI	\$4,300	\$2,867
Citation	18,300	11,091
Jeffries & Co.	143,905	89,941
Lehman Brothers	83,402	52,126
Pacific American	241,837	151,148
Standard & Poors	3,000	2,000
<b>TOTAL</b>	<b>\$494,744</b>	<b>\$309,173</b>

*Soft Dollar Expenditures – Calendar Year 2001.* Expenditures from third-party soft dollar credits in 2001 totaled \$499,458. These expenditures fell into the following categories:

<b>Research Service</b>	<b>Amount</b>	<b>Percent</b>
Electronic Research/Equipment	\$202,852	41%
Investment Publications	155,435	31%
Institutional Memberships	57,253	12%
Research Conference Registrations	55,404	11%
Professional Services	20,451	4%
Books and Miscellaneous Items	8,063	1%
<b>Total</b>	<b>\$499,458</b>	<b>100%</b>

Electronic data services comprised 41% of the total. Included in this category are on-line services that provide current market data and prices to the securities analysts and traders, on-line performance monitoring services and electronic information and news retrieval. Also included in this figure are computer software and hardware purchases for equipment needed to receive and distribute research and information services to investment staff within the agency.

Investment publications, totaling 31%, include printed investment materials and periodicals ranging from daily newspapers to highly specialized financial analyses and reports. The bulk of the services received in this category can be attributed to specialty trade publications, which provide economic forecasting, company research, and credit analysis for fixed income investing.

Professional services include research and consulting services provided on a variety of investment topics including: performance analysis of specific real estate investments, projections for upcoming market trends from leading technology experts, comparative cost measurement studies which specialize in public pension fund analysis, and general economic forecasting and research.

The category of institutional memberships includes payments for SWIB's participation in organizations such as the Association for Investment Management and Research and the Security Traders Association.

SEC rules allow use of third-party soft dollar credits for registration fees at professional conferences. Travel and other expenses are not allowed. Conferences funded in this manner provide training opportunities in industry and company analysis, investment analysis tools and techniques and portfolio and asset allocation strategies.

The category of books includes a wide range of financial and legal reference materials and textbooks.

*Directed Research (exclusive) Soft Dollar Brokers.* As described earlier in this report, "directed research" describes research services provided to SWIB under contractual relationships between the broker and the research provider. In general, these research services are "exclusive" or "directed" in that they are only available through one or, at most, a handful of brokers. In other words, SWIB's traders must trade directly with a specific broker or brokers in order to obtain these research products.

The table below shows the amount of commission business transacted with exclusive soft dollar brokers in 2001. The commission amounts have not been converted to soft dollar credits because the fee arrangements between the broker and research provider are not disclosed to investors. This exhibit also provides a brief description of the research products received and the minimum level of commission business required to procure the services described.

<b>Broker</b>	<b>Commissions Generated 2001</b>	<b>Research Service Received</b>
Bridge Trading Co.	\$527,006	Electronic data service
Hoening Group	25,000	Energy research
Howard Weil Labouiss	12,000	Energy research
ISI Group, Inc.	76,725	Daily economic reports
Mamis	27,000	Technical analysis
O'Neil (WM) & Co.	173,465	Electronic data service
Weeden/Leuthold	39,032	Equity/Bond research service
<b>TOTAL</b>	<b>\$880,228</b>	

Senator Brian Burke  
Representative John Gard  
January 31, 2002  
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### **Investment Board Procedures Governing the Use of Soft Dollar Credits**

The primary policy concern about the generation and use of soft dollar research credits is that dependence upon these credits to pay for services will lead to choosing brokers offering the credits rather than choosing the broker who can provide the best execution of the trade. SWIB's trading philosophy requires that each trade be performed with the broker that provides "best execution." If this requirement can be met with any number of brokerage firms, the trade may be executed with a broker that provides beneficial research services to SWIB, such as a soft dollar firm.

Over the last several years SWIB has reduced its dependence on soft dollars. This is due to the reduction in the size of our internally managed stock portfolios and the corresponding reduction in the level of ongoing trading activity. Thus, SWIB's use of soft dollar credits is being limited to research services that are deemed to be less critical to essential investment operations. This serves the purpose of ensuring that SWIB's fiduciary duty of attaining "best execution" on all trades is not compromised. Services that are deemed to be of vital importance to the investment process are procured through more certain sources of funding. Our third-party soft dollar credit expenditures in 2001 dropped by 29% compared to 2000 and have decreased by 66% over the last five years.

I hope you will find this information responsive to the statutory reporting requirements. Please feel free to contact me with any questions you might have about this report or other Investment Board matters.

Sincerely,



Patricia Lipton  
Executive Director

cc: Members, Joint Committee on Finance  
Robert Lang, Legislative Fiscal Bureau



## State of Wisconsin Investment Board

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February 14, 2002

Senator Brian Burke, Co-Chair  
Joint Committee on Finance  
P.O. Box 7882  
Madison, WI 53707-7882

Representative John Gard, Co-Chair  
Joint Committee on Finance  
P.O. Box 8952  
Madison, WI 53708-8952

Mr. George Lightbourn, Secretary  
Department of Administration  
101 East Wilson Street  
P.O. Box 7864  
Madison, WI 53707-7864

Dear Senator Burke, Representative Gard and Secretary Lightbourn:

Attached is our quarterly report of charges to funds managed by the Investment Board for expenses incurred under ss. 25.18 (1)(a) and (m), Stats. This report includes payments made during the quarter ending December 31, 2001. Section 25.17 (13m), Stats., requires that we provide this report on a quarterly basis.

Under s. 25.18 (1)(a), Stats., the Board may employ special legal or investment counsel in any matter arising out of the scope of our investment authority. S. 25.18 (1)(m), Stats., authorizes the Board to employ professionals, contractors or agents to evaluate or operate any property in which the Board has an interest. Expenses for these services are charged to the current income of the fund for which the services were furnished.

Because the report represents actual payments made during the quarter, significant fluctuations in amounts reported for each vendor will occur from quarter to quarter. This makes it difficult to draw conclusions from quarter-to-quarter comparisons of the data.

Please contact me if you have any questions or comments about the report.

Sincerely,

A handwritten signature in black ink, appearing to read "Patricia Lipton".

Patricia Lipton  
Executive Director

cc: Members, Joint Committee on Finance  
Robert Lang, Legislative Fiscal Bureau

STATE OF WISCONSIN INVESTMENT BOARD  
Direct Charges Under ss. 25.18 (1) (a) or (m)

10/1/01 to 12/31/01

**Custodial and Banking Fees**

Bank of New York	\$141,737	
Bankers Bank	\$2,500	
Firststar	\$2,157	
Mellon Financial Services	<u>\$935,443</u>	
<b>Total Custodial and Banking Fees</b>		\$1,081,837

**Legal Fees, Services and Expenses**

Allf & Associates	\$20	
Alston & Bird	\$228	
Bryan Cave LLP	\$2,848	
Foley & Lardner	\$4,631	
Godfrey & Kahn SC	\$2,820	
Grant & Eisenhofer PA	\$12,000	
Jeffer, Mangels, Butler & Marmaro	\$670	
Jones, Day, Reavis & Pogue	\$88,050	
Mallon & Johnson P.C.	\$4,956	
Michael Best & Friedrich	\$24,192	
Quarles & Brady	\$90	
Solheim, Billing & Grimker SC	\$11,167	
Stafford Rosenbaum Attorneys	<u>\$139</u>	
<b>Total Legal Fees, Services and Expenses</b>		\$151,811

**Investment Counsel**

AG Risk Management	\$10,000	
American Stock Exchange	\$3,854	
Bloomberg, LP	\$116,465	
Board of Regents UW System	\$5,042	
Bridgewater Associates	\$3,750	
CFRA Inc	\$18,000	
Council of Institutional Investors	\$30,000	
Data Broadcasting Corporation	\$21,330	
Dow Jones & Co	\$6,795	
Factset Data Systems	\$21,591	
First Call	\$29,067	
Fitch Info., Inc.	\$1,500	
Gordon, Haskett & Co.	\$11,600	
H C Wainwright & Co Economics Inc	\$10,000	
IDC Portfolio Mgmt, Inc.	\$6,250	
Instinet	\$380	

STATE OF WISCONSIN INVESTMENT BOARD  
Direct Charges Under ss. 25.18 (1) (a) or (m)

10/1/01 to 12/31/01

International Financing Review	\$7,020	
Investor Group Services	\$40,000	
IRRC	\$27,000	
Korn/Ferry International	(\$31,933)*	
Kudlow & Co.	\$15,000	
Maria Fiorini Ramirez	\$1,950	
McKinsey & Company, Inc.	\$250,000	
McLagan Partners	\$29,873	
Multex Company	\$900	
NASDAQ Stock Market	\$600	
New York Stock Exchange	\$7,642	
Pathway Capital Management	\$248,000	
Pension Fund Data Exchange	\$1,000	
Property & Portfolio Research	\$25,000	
Reuters America Inc.	\$93,897	
RiskMetrics	\$25,000	
Russell/Mellon Analytical Services	\$2,500	
Salomon Analytics Yield Book	\$15,000	
Standard & Poor's	\$22,180	
Stone & McCarthy Research	\$1,400	
Strategic Investment Solutions, Inc.	\$57,500	
Thomson Trading Services	\$4,800	
Toronto Stock Exchange	\$975	
Trade Web	\$2,400	
William F. Pridmore, Ltd.	\$5,354	
William M. Mercer, Inc	\$25,000	
Wilshire Associates	\$66,542	
<b>Total Investment Counsel</b>		\$1,240,224

**Real Estate Advisory Fees**

AETNA PMSA Fund	\$50,153
Apollo Advisors II & LP	\$156,250
Bristol Group, Inc.	\$154,452
Churchill Mortgage Corporation	\$3,533
Cornerstone Real Estate Advisors	\$8,668
Fortress Investment Corp	\$156,250
Goldman Sachs & Co.	\$1,009,587
Heitman Capital Management Corp.	\$45,481
Hudson Advisors (Lonestar Funds)	\$415,920
Invesco Realty Advisors, Inc.	\$54,680
Jones, Lang, Wootton Realty Advisors	\$59,328
Kensington Realty Advisors	\$169,395

\*Includes a refund of professional services expense.

STATE OF WISCONSIN INVESTMENT BOARD  
Direct Charges Under ss. 25.18 (1) (a) or (m)

10/1/01 to 12/31/01

Koff Bren Realty Advisors	\$230,436	
Landmark Realty Advisors	\$100,256	
Lazard Freres	\$156,250	
Lend Lease Real Estate Investment	\$100,346	
New England Mutual	\$46	
PM Realty Advisors, Inc.	\$113,173	
PRICOA Trans European	\$56,987	
Prudential (Senior Housing)	\$42,369	
Security Capital	\$577,120	
Westbrook Real Estate	\$590,809	
Yarmouth Capital Partners	<u>\$131,287</u>	
<b>Total Real Estate Advisory Fees</b>		\$4,382,776
<b><u>Index Fund Fees</u></b>		
Barclays Global Investors	<u>\$3,293,325</u>	
<b>Total Index Fund Fees</b>		<u>\$3,293,325</u>
<b>Total</b>		<u>\$10,149,973</u>



## State of Wisconsin Investment Board

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February 14, 2002

Senator Brian Burke, Co-Chair  
Joint Committee on Finance  
316 South, State Capitol  
Madison, WI 53707-7882

Representative John Gard, Co-Chair  
Joint Committee on Finance  
315 North, State Capitol  
Madison, WI 53708-8952

Senator Gary George, Co-Chair  
Joint Committee on Audit  
118 South, State Capitol  
Madison WI 53707-7882

Representative Joseph Leibham, Co-Chair  
Joint Committee on Audit  
103 West, State Capitol  
Madison WI 53708-8952

Senator Robert Wirsch, Co-Chair  
Joint Survey Committee on  
Retirement Systems  
310 South, State Capitol  
Madison WI 53707-7882

Representative Daniel Vrakas, Co-Chair  
Joint Survey Committee on  
Retirement Systems  
119 West, State Capitol  
Madison WI 53708-8902

Subject: 2001 Annual Fiscal Report

Dear Senators and Representatives:

I have enclosed a copy of the FY 2001 Annual Fiscal Report for the State of Wisconsin Investment Board. The report contains Independent Auditor's Reports, prepared by the Legislative Fiscal Bureau, for the funds that we manage. They include the Fixed Fund and Variable Fund of the Wisconsin Retirement System, the State Investment Fund and the various smaller funds.

Additional copies of the report are available by contacting our office or by going to our website, which is [www.swib.state.wi.us](http://www.swib.state.wi.us). More recent returns as of December 31, 2001 are also available on the website. Thank you.

Sincerely,

Patricia Lipton  
Executive Director

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State of Wisconsin  
Investment Board

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*Schedule of Investments for the  
fiscal year ending June 30, 2001  
is also available on the website or  
by contacting SWIB.*

Annual Report  
2001



# About SWIB . . .

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

## Vision

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

## Investment Guidelines at a Glance ...

Investments must be within guidelines established for each specific fund.

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

## SWIB Seeks to ...

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

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

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

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

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

## Assets Under Management - June 30, 2001

<u>Fund</u>	<u>\$ in Millions</u>	<u>% of Total</u>
Wisconsin Retirement System	\$ 60,174	91%
<i>Fixed Retirement Trust Fund</i>	53,414	81
<i>Variable Retirement Trust Fund</i>	6,760	10
State Investment Fund*	5,374	8
Various Funds		
Patients Compensation Fund	576	1
State Life Insurance Fund	71	-
Local Gov't Property Insurance Fund	31	-
Historical Society Trust Fund	12	-
Tuition Trust Fund	10	-
<b>Total</b>	<b>\$ 66,248</b>	<b>100%</b>

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

# Executive Director's Message

I am pleased to present the Annual Financial Report of the State of Wisconsin Investment Board (SWIB) for the fiscal year ending June 30, 2001. This year SWIB proudly recognized the many people involved in creating and shaping the Investment Board, as we marked our 50th anniversary. The visionaries who sought to ensure that the state would optimize its earnings on state funds and provide public servants with a solid future after retirement could scarcely have imagined the growth that has occurred.

The Wisconsin Retirement System (WRS) was one of the first public pension systems to invest in stocks and remains one of the few state pension funds in the nation in which retirees share in investment gains. Over 85% of the cost of benefits paid to WRS participants comes from investment returns.

In June 2001, the Wisconsin Supreme Court found 1999 Wisconsin Act 11 constitutional. As a result, active employees again have the option of placing half of their future pension contributions into an all stock fund (the Variable Trust Fund). The WRS is one of the only state public pension funds in the nation to offer this option.

The markets continue to be volatile, experiencing a significant downturn during the last half of the fiscal year. While returns continued to be in negative territory, SWIB did outperform benchmarks for both the Fixed and Variable Retirement Trust Funds. The one-year return for the Fixed Fund was -5.4% versus the benchmark return of -5.9%. The Variable Fund return was -13.5%, ahead of the benchmark of -15.7%. The 10-year return for the Fixed Fund was 11.4%, still ahead of the 8% long-term benefit funding goal.

This report consists of an overview of SWIB, the financial statements and independent auditors' opinions on the Wisconsin Retirement System, the State Investment Fund and five various funds managed for the state.

SWIB continues to be committed to rising to the new challenges that lie ahead utilizing our best assets — the visionary leadership of our Board and the work of our dedicated staff.



*Patricia Lipton  
Executive Director*

A handwritten signature in black ink that reads "Pat Lipton". The signature is fluid and cursive, with the first name "Pat" being more prominent than the last name "Lipton".

Patricia Lipton  
Executive Director  
June 30, 2001

# Board of Trustees

## Board Members...

- Six public members appointed by the Governor and confirmed by the State Senate including:
  - *Four with at least 10 years investment experience.*
  - *One with at least 10 years financial experience and who works for a local government in the LGIP.*
- Teacher participant in the WRS appointed by the Teacher Retirement Board.
- Non teacher participant in WRS appointed by the Wisconsin Retirement Board.
- Secretary of the Department of Administration or designee.

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

## Board Responsibilities...

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

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

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

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

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

**George Lightbourn**  
Secretary, Department of Administration

**Wayne McCaffery** (*Wisconsin Retirement System, Teacher Retirement Board Member*)  
Teacher, Stevens Point

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

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

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

# Agency Management

## Senior Management

Executive Director - Patricia Lipton

Assistant Executive Director - James M. Gannon

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

Chief Investment Officer - Public Equities - Joseph E. Gorman

Chief Operating Officer - Kenneth W. Johnson

Chief Legal Officer - Keith L. Johnson

Director of Human Resources - Ledell Zellers

Director of Internal Audit - James W. Kaellner

## Senior Investment Managers

### Domestic Equities

Steven F. Hilmer

William A. McCorkle

John F. Nelson

Trisha L. Reopelle

### International Equities

Charles D. Saunders

### Private Equity

Jon R. Vanderploeg

### Opportunity Portfolio

Michael A. Wagner

### Public Fixed Income

Sally J. Lee

Laurel A. Butler

John J. Zwadzich

### Global Fixed Income

J. Alain Hung

### Private Placements

James M. Gannon

### Real Estate

Robert H. Severance

## SWIB Staff at a Glance...

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

# WRS Investment Results

## WRS at a Glance...

- The Wisconsin Retirement System includes about 478,000 participants.
- Participants are current and former employees of state agencies and local governments.
- Most receive a pension annuity initially set by a formula using years of service, salary and job type.
- WRS is comprised of the Fixed Trust Fund, a balanced fund, and the Variable Trust Fund, a stock fund.

## Annualized Performance Ending 6/30/01

Retirement Funds	1-year return	5-year return	10-year return
<b>Fixed Fund</b>	<b>-5.4%</b>	<b>10.3%</b>	<b>11.4%</b>
<i>Benchmark</i>	-5.9	9.6	10.6
<b>Variable Fund</b>	<b>-13.5%</b>	<b>12.1%</b>	<b>13.3%</b>
<i>Equity Benchmark</i>	-15.7	10.3	12.6
<i>S&amp;P 500</i>	-14.8	14.5	15.1

## Total Rate of Return -As of June 30, 2001

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

<u>Fiscal Year</u>	<u>Fixed Trust Fund</u>	<u>Variable Trust Fund</u>
1992	13.2%	13.0%
1993	14.2	15.0
1994	3.8	6.1
1995	16.7	19.6
1996	14.8	20.1
1997	18.9	25.0
1998	17.6	20.6
1999	9.8	15.1
2000	12.5	17.8
2001	-5.4	-13.5
10 Yr. Avg.	11.4%	13.3%

## Annual Income Credits

- Income credit consists of income plus capital gains and losses.
- Credit or income paid at the end of each year, is a percentage of the participant's beginning balance.
- The Fixed Trust Fund capital gains and losses are spread over several years to smooth account returns.
- Fixed Trust Fund income credit is based on an established formula.

## Annual Income Credits

<u>Year (Ended 12/31)</u>	<u>Fixed Trust Fund*</u>	<u>Variable Trust Fund</u>
1991	12.1%	28.0%
1992	10.2	11.0
1993	11.0	17.0
1994	7.7	0.0
1995	11.3	27.0
1996	12.5	20.0
1997	12.8	23.0
1998	13.1	18.0
1999	24.1**	28.0
2000	10.9**	-7.0

\*Historical data based upon results for the Wisconsin Retirement System.

\*\*Results impacted by the 1999 Wisconsin Act 11 benefit improvements.

# Management Costs

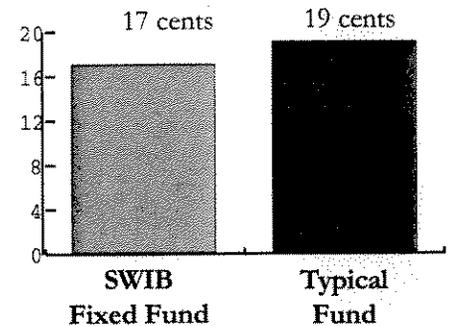
Total costs of the State of Wisconsin Investment Board include agency operating expenses as well as fees paid to outside suppliers of investment services. In fiscal year 2001, agency operating expenses for staff compensation overhead and equipment were \$19.3 million. Compared to the average value of assets managed, the cost per \$100 of securities managed was 2.75 cents.

	Fiscal Year Ended <u>June 30, 2001</u>	Fiscal Year Ended <u>June 30, 2000</u>
<b>PROGRAM REVENUE AVAILABLE</b>		
Prior Year Balance	\$ 2,726,800	\$ 1,287,200
<b>RECEIPTS FROM:</b>		
State Investment Fund	\$ 1,286,900	\$ 776,600
Fixed Retirement Trust Fund	15,949,800	12,146,300
Variable Retirement Trust Fund	1,840,900	1,358,800
Local Gov't Property Ins. Fund	48,300	25,100
State Life Insurance Fund	67,500	64,500
Historical Society Trust Fund	25,700	16,400
Patients Compensation	23,700	112,900
Tuition Trust Fund	66,400	18,400
Miscellaneous	11,400	23,500
<b>Total Receipts</b>	<u>\$ 19,320,600</u>	<u>\$ 14,542,500</u>
<b>TOTAL REVENUE AVAILABLE</b>	\$ 22,047,400	\$ 15,829,700
<b>DISBURSEMENTS:</b>		
Salaries	\$ 12,845,900	\$ 7,030,700
Fringe Benefits	2,607,300	2,036,200
Supplies & Equipment	3,854,700	4,036,000
<b>AGENCY OPERATING EXPENSES</b>	<u>\$ 19,307,900</u>	<u>\$ 13,102,900</u>
<b>CLOSING BALANCE</b>	<u>\$ 2,739,500</u>	<u>\$ 2,726,800</u>

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

Annually, SWIB participates in an independent review of costs compared to other investment managers with similar objectives. An analysis by Cost Effectiveness Measurement, Inc. concluded that SWIB's total cost to manage the Fixed Fund in calendar year 2000 was 17 cents per \$100 managed compared to 19 cents for managers with a similar mix of assets.

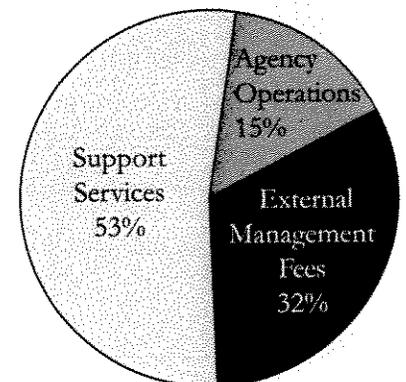
**Total Costs  
per \$100 Managed**  
Calendar Year 2000



## Management Costs at a Glance ...

- Total costs for all funds were about 15.0¢ per \$100 managed.
- All management costs are funded with earnings of the funds managed.

**Calendar Year 2000**  
Total Costs = \$102.9 million



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# Financial Statements

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## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Assets for the State Investment Fund of the State of Wisconsin, as of June 30, 2001 and 2000, and the related Statements of Operations and Changes in Net Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the State Investment Fund as of June 30, 2001 and 2000, and the results of its investment operations and changes in net assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the financial statements of the State Investment Fund of the State of Wisconsin. The accompanying financial information included in the introduction of the annual report is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements referred to in the first paragraph and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the State of Wisconsin Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations. That report, which will be included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

August 23, 2001

by   
Janice Mueller  
State Auditor

**STATE INVESTMENT FUND**  
**Statement of Net Assets**  
**As of June 30, 2001 and June 30, 2000**

	<u>June 30, 2001</u>	<u>June 30, 2000</u>
<b>Assets</b>		
Investments (At fair value):		
Repurchase Agreements	\$ 798,000,000	\$ 806,000,000
Government and Agency	5,196,239,080	3,890,321,070
Commercial Paper	0	40,868,882
Certificates of Deposit (CDs)	400,000,000	398,000,000
Asset Backed Securities	10,700,341	21,320,027
Mortgage Backed Securities	2,593,857	3,330,444
Yankee/Euro Issues	0	0
Swap(s)	<u>(25,889,413)</u>	<u>(21,231,211)</u>
Total Net Investments (At fair value)	\$ 6,381,643,865	\$ 5,138,609,212
Other Assets:		
Accrued Interest Receivable	<u>19,593,885</u>	<u>21,028,658</u>
Total Assets	<u>\$ 6,401,237,750</u>	<u>\$ 5,159,637,870</u>
Liabilities		
Check Float Invested	\$ 336,941,395	\$ 349,751,578
Earnings Distribution Payable	23,045,876	28,106,873
Accrued Swap Payments	315,933	222,678
Accrued Expenses	<u>71,000</u>	<u>62,000</u>
Total Liabilities	<u>\$ 360,374,204</u>	<u>\$ 378,143,129</u>
NET ASSETS	<u>\$ 6,040,863,546</u>	<u>\$ 4,781,494,741</u>
Net Assets consist of:		
Participating Shares	\$ 6,052,869,000	\$ 4,798,299,000
Undistributed Unrealized Gains (Losses)	<u>(12,005,454)</u>	<u>(16,804,259)</u>
NET ASSETS	<u>\$ 6,040,863,546</u>	<u>\$ 4,781,494,741</u>

*The accompanying notes, on pages 14 through 18, are an integral part of this document.*

**STATE INVESTMENT FUND**  
**Statement of Operations and Changes in Net Assets**  
**For the Fiscal Years Ended June 30, 2001 and 2000**

	<u>June 30, 2001</u>	<u>June 30, 2000</u>
<b>Investment Revenue</b>		
Investment Income	\$ 356,589,287	\$ 353,757,468
Net Swaps Revenue (Expense)	(6,843,454)	(17,100,343)
<b>Total Investment Revenue</b>	<u>\$ 349,745,833</u>	<u>\$ 336,657,125</u>
<b>Expenses</b>		
Management Operating Expense Allocation	\$ 1,286,852	\$ 776,572
Custodial Bank Charges	205,795	203,711
State Treasurer Costs	35,609	34,347
Electronic Services	129,032	85,253
Legal and Consulting Fees	44,340	47,376
<b>Total Expenses</b>	<u>\$ 1,701,628</u>	<u>\$ 1,147,259</u>
<b>NET INVESTMENT REVENUE</b>	<u>\$ 348,044,205</u>	<u>\$ 335,509,866</u>
State Working Bank Charges Allocation	<u>3,692,978</u>	<u>3,756,456</u>
<b>Net Investment Income</b>	<u>\$ 344,351,227</u>	<u>\$ 331,753,410</u>
Distributions Paid and Payable	<u>339,552,422</u>	<u>312,831,508</u>
Change in Undistributed Unrealized Gains (Losses)	\$ 4,798,805	\$ 18,921,902
Beginning of Period Undistributed Unrealized Gains (Losses)	<u>(16,804,259)</u>	<u>(35,726,161)</u>
End of Period Undistributed Unrealized Gains (Losses)	<u>\$ (12,005,454)</u>	<u>\$ (16,804,259)</u>
Participant Transactions		
Receipts by Transfer to Fund	\$ 23,224,238,000	\$ 22,189,474,000
Disbursements by Transfer from Fund	<u>(21,969,668,000)</u>	<u>(23,668,616,000)</u>
Net Change in Participating Shares	\$ 1,254,570,000	\$ (1,479,142,000)
Beginning of Period Participating Shares	<u>4,798,299,000</u>	<u>6,277,441,000</u>
End of Period Participating Shares	<u>\$ 6,052,869,000</u>	<u>\$ 4,798,299,000</u>
<b>Net Assets</b>	<u>\$ 6,040,863,546</u>	<u>\$ 4,781,494,741</u>

*The accompanying notes, on pages 14 through 18, are an integral part of this document.*

## 1. Description of Fund

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

Wisconsin Statutes 25.17(3)(b), (ba) and (bd) enumerate the various types of securities that can be invested in, which include direct obligations of the United States and Canada, securities guaranteed by the United States, securities of federally chartered corporations such as the African Development Bank, the unsecured notes of financial and industrial issuers, Yankee/Euro issues, certificates of deposit issued by banks in the United States and solvent financial institutions in this state and bankers acceptances. The Board of Trustees may approve other prudent investments. The Board of Trustees has given standing authority to SWIB staff to invest in resale agreements, financial futures contracts, options and interest rate swaps on behalf of the SIF.

## 2. Significant Accounting Policies

### A. Basis of Presentation

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

### B. Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting using the economic resources measurement focus.

### C. Valuation of Securities

Investments are valued at fair value for financial statement purposes and amortized cost for purposes of calculating income to participants (See Footnote 3). The Bank of New York, as custodial bank, has compiled fair value information for all securities by utilizing third party pricing services. Government and agency securities and commercial paper are priced using matrix pricing. This method estimates a security's fair value by using quoted market prices for securities with similar interest rates, maturities, and credit ratings. Repurchase agreements and certificates of deposit are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. Swaps are valued at the net present value of estimated expected future cash flows using discount rates commensurate with the risk involved. In addition, two bonds issued by other Wisconsin State agencies having a combined par value at June 30, 2001 of \$2.8 million, are valued at par, which management believes approximates fair value. The fair value of investments is determined at the end of each month.

## Summary Information by Investment Classification

	Interest Rates	Maturity Dates	June 30, 2001		June 30, 2000	
			Fair Value	Book Value (Amort. Cost)	Fair Value	Book Value (Amort. Cost)
Repurchase Agreements	3.93-4.11	07/02/01-07/02/01	\$ 798,000,000	\$ 798,000,000	\$ 806,000,000	\$ 806,000,000
Government and Agency Commercial Paper	3.52-7.02	07/02/01-02/15/05	5,196,239,080	5,182,359,295	3,890,321,070	3,885,830,354
Certificates of Deposit	N/A	N/A	0	0	40,868,882	40,875,186
Asset Backed Securities	3.80-7.42	07/16/01-05/17/04	400,000,000	400,000,000	398,000,000	398,000,000
Mortgage Backed Securities	3.96-4.20	07/25/01-04/01/03	10,700,341	10,696,167	21,320,027	21,377,487
Yankee/Euro Issues	4.75-4.75	04/27/02-04/27/02	2,593,857	2,593,857	3,330,444	3,330,444
Swap(s)	N/A	N/A	0	0	0	0
	N/A	03/16/05-03/16/05	(25,889,413)	0	(21,231,211)	0
<b>Total Investments</b>			<b>\$ 6,381,643,865</b>	<b>\$ 6,393,649,319</b>	<b>\$ 5,138,609,212</b>	<b>\$ 5,155,413,471</b>
<b>Ratio of Fair Value to Book Value</b>				<b>99.8122%</b>		<b>99.6740%</b>

*D. Management Operating Expenses*

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

**3. Pool Earnings and Pool Shares**

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

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

#### 4. Deposits and Investments

*Deposits* – As of June 30, 2001, the SIF held certificates of deposit with an estimated fair value of \$400 million invested pursuant to the Wisconsin Certificate of Deposit Program implemented in July 1987. Banks that are accepted into this program must be located in Wisconsin and meet credit screening criteria designed to assure the safety of the deposits.

The GASB Statement No. 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed by the SIF as defined in GASB Statement No. 3. Category 1 consists of deposits that are insured or collateralized with securities held by the State or by its agent in the State's name. Approximately \$378.5 million falls under this category through FDIC insurance, the Wisconsin State Deposit Guarantee Fund, and Financial Securities Assurance Corporation insurance. The remaining \$21.5 million are considered Category 3 uncollateralized deposits. The actual coverage of these deposits fluctuates daily based on the allocable share of participants' accounts.

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

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

#### Securities Categorized by Level of Risk

	Category			Fair and Carrying Value
	1	2	3	
<b>Deposits:</b>				
CDs (Nonnegotiable)	\$ 378,487,736	\$ 0	\$ 21,512,264	\$ 400,000,000
<b>Investments:</b>				
Repurchase Agreements	\$ 798,000,000	\$ 0	\$ 0	\$ 798,000,000
Government and Agency	5,196,239,080	0	0	5,196,239,080
Commercial Paper	0	0	0	0
CDs (Negotiable)	0	0	0	0
Asset Backed Securities	10,700,341	0	0	10,700,341
Mortgage Backed Securities	2,593,857	0	0	2,593,857
Yankee/Euro Issues	0	0	0	0
Subtotal	<u>\$ 6,007,533,278</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 6,007,533,278</u>
<b>Not Categorized:</b>				
Swap				\$ (25,889,413)
Total Investments				<u>\$ 6,381,643,865</u>

## 5. Derivative Financial Instruments

As of June 30, 2001, the only derivative financial instrument held by the SIF was the March 16, 1995 restructured interest rate swap which required periodic payments over ten years, as discussed in detail in Footnote 6. Each swap transaction involves the exchange of interest rate payment obligations without the exchange of underlying principal amounts. The notional amounts used to express the volume of these transactions do not represent the amounts subject to risk, but represent the amount on which both parties calculate interest rate obligations. The settlement of the interest rate exchange occurs at predetermined dates, with the net difference between the interest paid and interest received reflected as an increase in income. Entering into interest rate swap agreements subjects the investor to the possibility of financial loss in the event of adverse changes in market rates or nonperformance by the counterparty to the swap agreement. Selecting creditworthy counterparties mitigates credit risks arising from derivative transactions.

During fiscal year 2000, seven derivative financial instruments held by the SIF reached maturity and expired. The following schedule summarizes the cash flows for all derivative financial instruments for fiscal years 2001 and 2000.

Category:	Cash Flows for Derivative Financial Instruments			
	Fiscal Year 2001		Fiscal Year 2000	
	Cash Flows	Termination Costs	Cash Flows	Termination Costs
Interest Rate Swaps-Restructured	\$ (6,750,199)	\$ 0	\$ (12,233,269)	\$ 0
Structured Bonds-Restructured	0	0	(5,973,818)	0
Total	\$ (6,750,199)	\$ 0	\$ (18,207,087)	\$ 0

## 6. Restructured Investments – March 16, 1995

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

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

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

## Restructured Investments Analysis

	Fair Value		
	June 30, 2001	June 30, 2000	March 16, 1995
<b>Restructured Interest Rate Mirror Swaps</b>			
USD Libor Swap	\$ 0	\$ 0	\$ (1,380,000)
ESP Libor Swap	0	0	(2,960,000)
ITL Libor versus ESP Libor Swap	0	0	(1,537,000)
SWK CMS Swap	0	0	(4,160,000)
CMT Two-Year Spread Swap	0	0	(889,000)
Ten-Year Swap Spread Swap	0	0	(4,720,000)
DEM Libor Swap	0	0	(6,570,000)
FFR Pibor Swap	0	0	(5,710,000)
Subtotal	\$ 0	\$ 0	\$ (27,926,000)
<b>Restructured Asset Amortizing Swaps</b>			
SLMA Currency Linked NZ\$ vs. Yen	\$ 0	\$ 0	\$ (4,995,000)
Grantor Trust Currency Linked C\$ vs. Lira vs. Yen	0	0	(27,400,000)
Subtotal	\$ 0	\$ 0	\$ (32,395,000)
<b>Mexican - Spread Restructuring Swap</b>			
10.74% - 1m USD Libor	\$ (25,889,413)	\$ (21,231,211)	\$ (35,000,000)
US Treas. 7.50% 2/15/05 Hedge-Unreal. Gain	10,921,881	4,981,097	0
Subtotal	\$ (14,967,532)	\$ (16,250,114)	\$ (35,000,000)
Total Fair Value	\$ (14,967,532)	\$ (16,250,114)	\$ (95,321,000)

## Deferred Loss Cash Requirements

Fiscal Year Ended:	Principal	Interest	Total
June 30, 2002	\$ 3,952,561	\$ 1,369,072	\$ 5,321,633
June 30, 2003	4,326,704	994,930	5,321,634
June 30, 2004	4,778,983	584,417	5,363,400
June 30, 2005	3,816,569	143,331	3,959,900
June 30, 2006	0	0	0
Thereafter	0	0	0
Total	\$ 16,874,817	\$ 3,091,750	\$ 19,966,567

## 7. Related Party Transactions

The SIF held two bonds issued by other State of Wisconsin agencies with remaining par and carrying values totaling \$2.8 million at June 30, 2001. Management believes the rates of interest received are comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.

## 8. State Investment Fund Additional Information

Fiscal Year Ended	Average Daily Cash Values	Net Investment Income	Time Weighted Annual Yield
June 30, 2001	\$ 6,003,803,646	\$ 348,044,205	5.96%
June 30, 2000	\$ 5,892,342,320	\$ 335,509,866	5.49%

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## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for the Retirement Trust Funds (Fixed Retirement Trust Fund and Variable Retirement Trust Fund) of the State of Wisconsin, as of June 30, 2001 and 2000, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the investment activity of the Retirement Trust Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements are not intended to present the financial activity of the Retirement Trust Funds attributable to the Department of Employee Trust Funds, nor are they intended to present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2, the accompanying statements are prepared in conformity with accounting principles generally accepted in the United States, while prior financial statements of the investment activity of the Retirement Trust Funds were prepared in conformity with an other comprehensive basis of accounting to demonstrate compliance with the statutes of the State of Wisconsin. In conjunction with changes resulting from the passage of 1999 Wisconsin Act 11, the State of Wisconsin Investment Board no longer presents information related to income accumulation or distributions made in accordance with s. 40.04(3), Wis. Stats. Fiscal year 1999-2000 financial statements have been restated in conformity with accounting principles generally accepted in the United States. The restatements consisted of changes in presentation and classification and had no effect on the results of operations as previously reported.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net investment assets of the Retirement Trust Funds as of June 30, 2001 and 2000, and the changes in net investment assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

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

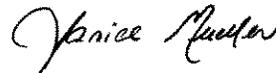
Our audits were made for the purpose of forming an opinion on the financial statements of the Retirement Trust Funds of the State of Wisconsin. The accompanying financial information included in the introduction of the annual report is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements referred to in the first paragraph and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the State of Wisconsin Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

January 9, 2002

by



Janice Mueller  
State Auditor

**RETIREMENT FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2001**

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

*The accompanying notes, on pages 26 through 32, are an integral part of this statement.*

## RETIREMENT FUNDS

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

	<u>Fixed Retirement Trust Fund</u>	<u>Variable Retirement Trust Fund</u>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in Fair Value of Investments	\$ (4,920,664,857)	\$ (1,200,100,846)
Interest	1,290,534,754	6,845,584
Dividends	420,738,892	88,546,658
Securities Lending Commissions	200,246,448	12,090,391
Other Income	127,519,426	0
Less:		
Investment Expense	(112,676,966)	(9,013,649)
Securities Lending Rebates	(173,263,527)	(8,585,881)
Securities Lending Fees	(4,651,186)	(680,568)
Total Investment Income (Loss)	\$ (3,172,217,016)	\$ (1,110,898,311)
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	<u>(705,855,125)</u>	<u>(455,400,608)</u>
<b>Net Increase (Decrease)</b>	<b>\$ (3,878,072,141)</b>	<b>\$ (1,566,298,919)</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<u>57,291,980,861</u>	<u>8,326,495,505</u>
<b>End of Year</b>	<u>\$ 53,413,908,720</u>	<u>\$ 6,760,196,586</u>

*The accompanying notes, on pages 26 through 32, are an integral part of this statement.*

**RETIREMENT FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2000**

	<b>Fixed Retirement Trust Fund</b>	<b>Variable Retirement Trust Fund</b>
<b>Assets</b>		
Cash and Cash Equivalents	\$ 740,718,736	\$ 130,507,405
Receivable:		
State Investment Fund Earnings	1,455,456	272,907
Accrued Interest & Dividends Receivables	232,122,051	4,659,782
Sales Receivables	589,378,799	53,443,500
Foreign Currency Contracts	8,078,428	1,666,252
Due From Other Funds	3	0
Securities Lending Collateral	3,534,520,628	192,750,636
Other Assets	1,411,337	0
Investments (at fair value):		
Bonds	15,242,944,452	833,355
Private Placements	3,282,710,750	0
Stocks	33,844,976,177	8,157,469,950
Limited Partnerships	2,943,723,671	0
Mortgages	396,258,331	0
Real Estate Owned	456,796,698	0
Financial Futures Contracts	43,044	5,739
<b>Total Investment Assets</b>	<b>\$ 61,275,138,561</b>	<b>\$ 8,541,609,526</b>
<b>Liabilities</b>		
Due to Other Funds	\$ 0	\$ 3
Purchases Payable	439,859,398	21,367,028
Mortgage Escrow Account	99,356	0
Vouchers Payable	8,678,318	996,354
Securities Lending Collateral Liability	3,534,520,628	192,750,636
<b>Total Investment Liabilities</b>	<b>\$ 3,983,157,700</b>	<b>\$ 215,114,021</b>
<b>Net Investment Assets Held in Trust</b>	<b>\$ 57,291,980,861</b>	<b>\$ 8,326,495,505</b>

*The accompanying notes, on pages 26 through 32, are an integral part of this statement.*

## RETIREMENT FUNDS

### Statement of Changes in Net Investment Assets For the Fiscal Year Ended June 30, 2000

	<u>Fixed Retirement Trust Fund</u>	<u>Variable Retirement Trust Fund</u>
<b>Additions:</b>		
Investment Income:		
Net Increase (Decrease) in Fair Value of Investments	\$ 4,586,182,721	\$ 1,169,917,033
Interest	1,244,543,964	8,213,406
Dividends	468,908,905	106,869,957
Securities Lending Commissions	185,672,837	11,299,871
Other Income	122,135,463	0
Less:		
Investment Expense	(84,754,676)	(6,853,793)
Securities Lending Rebates	(163,757,069)	(8,328,963)
Securities Lending Fees	(4,273,895)	(572,487)
Total Investment Income (Loss)	\$ 6,354,658,250	\$ 1,280,545,024
<b>Deductions:</b>		
Net Receipts (Disbursements) - Department of Employee Trust Funds	(581,646,924)	(369,107,545)
<b>Net Increase (Decrease)</b>	<b>\$ 5,773,011,326</b>	<b>\$ 911,437,479</b>
<b>Net Investment Assets Held in Trust:</b>		
<b>Beginning of Year</b>	<u>51,518,969,535</u>	<u>7,415,058,026</u>
<b>End of Year</b>	<u>\$ 57,291,980,861</u>	<u>\$ 8,326,495,505</u>

*The accompanying notes, on pages 26 through 32, are an integral part of this statement.*

## 1. Description of Funds

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

### A. Fixed Retirement Trust Fund

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

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

Special Death Benefits	\$ 1,317,411
Police and Firefighters	152,401,739
Accumulated Sick Leave	672,505,818
Milwaukee Retirement System	73,198,828
Duty Disability	91,901,170
Income Continuation Insurance	87,270,118
Long Term Disability Insurance	<u>250,390,361</u>
Total	<u>\$ 1,328,985,445</u>

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

### B. Variable Retirement Trust Fund

The Variable Retirement Trust Fund also consists of retirement contributions for the participants in the WRS. Participation in this fund is at the option of the employee. Participants have elected to credit up to one-half of their retirement contributions and matching amounts of employer contributions to this fund, and have the remainder credited to the Fixed Retirement Trust Fund. Individual participants in the variable program may elect to terminate their variable participation and transfer their account to the Fixed Retirement Trust Fund. The variable program was closed to further enrollment in April 1980 but new legislation has reopened the Variable Retirement Trust Fund to new participants. See Note 7.

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

## 2. Significant Accounting Policies

### A. Basis of Presentation

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

Prior audited financial statements were prepared in conformity with statutory provisions. The principal difference between the statutory requirements and GAAP for governments is that Wisconsin statutes require all investment gains and losses in the Fixed Retirement Trust Fund be distributed in accordance with s. 40.04(3) Wis. Stat. This section of Wisconsin statute prescribes holding gains and losses in the Transaction Amortization Account and distributing it as current income over five years, which is not in accordance with GAAP. In conjunction with changes resulting from the passage of Wisconsin 1999 Act 11 (See Note 7), SWIB will no longer present information related to income accumulation or distributions made in accordance with s. 40.04(3) Wis. Stat., allowing presentation in conformity with GAAP. Presenting the financial statements in accordance with GAAP is preferred because it allows for better comparison between entities and it is consistent with the State of Wisconsin financial reports. Fiscal year 2000 information, presented for comparative purposes, has been restated in conformity with GAAP. The restatements consisted of changes in presentation and classification and had no effect on the results of operations as previously reported.

### B. Basis of Accounting

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

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

### C. Valuation of Securities

The investments of the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund are valued at fair value, per s. 25.17(14), Wis. Stats. Monthly, the investments are adjusted to fair value, with unrealized gains and losses reflected in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments".

Generally, fair value is based on quoted market prices but a number of other pricing methods are used for various types of investments.

Private Placements and 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.

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

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

Index options are priced on the Black-Scholes model which is based on strike prices, present value prices, implied volatility, time to maturity, style, type of option and interest rates. Currency options are priced by an independent pricing source specializing in the valuation of options based on the Garman Khol-Hargen model.

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

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

#### D. Use of Estimates

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

### 3. Deposits, Investments, and Securities Lending Transactions

*Deposits* — GASB Statement 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed. Deposits as of June 30, 2001 included \$1,302 deposited in two financial institutions. Federal depository insurance covers \$832 of the deposits, while the remainder is uninsured. In addition, SWIB held a number of nonnegotiable short-term certificates of deposit. The fair value of these certificates of deposit was approximately \$62.3 million, all of which was uncollateralized.

*Investments* — The following tables present the investments held by SWIB as of June 30, 2001, categorized to give an indication of the level of risk assumed by SWIB at year end. The categories are:

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

June 30, 2001	Fixed Retirement Trust Fund			Fair and Carrying Value
	Category			
	1	2	3	
Stocks	\$ 15,160,552,798	\$ -	\$ -	\$ 15,160,552,798
Bonds	7,261,307,094	-	-	7,261,307,094
Repurchase Agreements	465,633,687	-	-	465,633,687
Bankers Acceptances	366,871,289	-	-	366,871,289
Total	<u>\$ 23,254,364,868</u>	<u>\$ -</u>	<u>\$ -</u>	\$ 23,254,364,868
Private Placements				3,757,794,140
Limited Partnerships				2,772,892,081
Pooled Equities				14,679,316,234
Pooled Bonds				5,747,883,414
Mortgages				667,941,865
Real Estate Owned				501,079,814
Financial Futures Contracts				12,873
State Investment Fund				565,073,795
Pooled Cash and Cash Equivalents				581,282,693
Investments held by broker dealers under securities loans				
Bonds				1,894,879,985
Equities				939,390,062
Securities lending cash collateral pooled investments				645,142,460
Total				<u>\$ 56,007,054,284</u>

June 30, 2001	Variable Retirement Trust Fund			Fair and Carrying Value
	Category			
	1	2	3	
Stocks	\$ 3,270,420,157	\$ -	\$ -	\$ 3,270,420,157
Bonds	95,315,363	-	-	95,315,363
Repurchase Agreements	29,353,735	-	-	29,353,735
Bankers Acceptances	23,127,714	-	-	23,127,714
Total	<u>\$ 3,418,216,969</u>	<u>\$ -</u>	<u>\$ -</u>	\$ 3,418,216,969
Pooled Equities				3,146,366,642
Financial Futures Contracts				3,518
State Investment Fund				77,919,392
Pooled Cash and Cash Equivalents				83,738,597
Investments held by broker dealers under securities loans				
Equities				178,486,235
Securities lending cash collateral pooled investments				<u>40,670,040</u>
Total				<u>\$ 6,945,401,393</u>

Fair value information represents actual bid prices or the quoted yield equivalent at the end of the fiscal year for securities of comparable maturity, quality and type as obtained from one or more major investment brokers. If quoted market prices are not available, a variety of third party pricing methods are used, including appraisals, certifications, pricing models and other methods deemed acceptable by industry standards. See Note 2(C).

#### 4. Securities Lending Transactions

State statutes and board policies permit SWIB to use investments of the two funds to enter into securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities for collateral, in the form of cash or securities, with the simultaneous agreement to return the collateral for the same securities in the future. SWIB's securities custodian is an agent in lending the funds' domestic and international securities for collateral of 102 percent and 105 percent, respectively, of the loaned securities' fair value. The cash collateral is reinvested by the lending agent in accordance with contractual investment guidelines which are designed to insure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

Securities on loan at June 30, 2001 are presented as unclassified in the preceding schedule of custodial risk. At year end, SWIB had no credit risk exposure to borrowers because the amounts SWIB owed the borrowers exceeded the amounts the borrowers owed SWIB. The contract with the lending agent requires them to indemnify SWIB if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

The majority of securities loans can be terminated on demand by SWIB or the borrower, although the average term of the loans is approximately one week. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short-term investments with a weighted average maturity of 25 days.

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

#### 5. Derivative Financial Instruments

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

SWIB's derivative activities primarily involve forward contracts and foreign currency options. Generally foreign currency forwards and options are held to hedge foreign exchange risk. Market risk is controlled by

holding substantially offsetting purchase and sell positions. At June 30, 2001 the fair value of foreign currency forward contract assets totaled \$1.17 billion, while the liabilities totaled \$1.19 billion.

Forward commitments represent obligations to purchase or sell foreign currencies, with the seller agreeing to make delivery at a specified future date and a specified price. Options on foreign currencies provide the holder the right, but not the obligation, to purchase or sell foreign currencies on a certain date at a specified price. The seller (writer) 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.

During the periods presented in these financial statements, SWIB held one foreign currency option. This yield enhancing security expired in February 2000, realizing a gain of \$25.7 million. Market risk was limited to the \$11.9 million cost of this option, as there were offsetting positions in place while the security was held. No foreign currency options were held at June 30, 2001 or June 30, 2000.

#### *B. Other Options*

SWIB held equity option contracts for trading purposes during the periods presented in the financial statements. These option contracts give the purchaser of the contract the right to buy (call) or sell (put) the equity security or index underlying the contract at an agreed upon price (strike price) during or at the conclusion of a specified period of time. The seller (writer) 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.

SWIB held two other options that expired during fiscal year 2000. The counterparties to these option contracts were highly rated institutions resulting in minimal credit risk. The market risk for both contracts was limited to the initial cost of the contract. The first option was a portfolio hedging S&P 500 Index put costing \$20.5 million which expired with negligible value. Volatility in the price of the option was offset by the corresponding inverse relationship in the value of the underlying securities. The other option was a yield enhancing outperformance call which cost \$11.5 million and realized a \$5.8 million gain at expiration. SWIB held no other options at June 30, 2001 or June 30, 2000.

#### *C. Futures Contracts*

One outside investment manager uses futures contracts to manage its exposure to the stock market. This manager is authorized to utilize futures up to 25% of the fair value of the portfolio. Upon entering into a futures contract, the outside manager is required to deposit with the broker, in SWIB's name, an amount of U.S. government obligations in accordance with the initial margin requirements of the broker. Futures contracts are marked to market daily with gains and losses being recognized. The variation margin is settled daily until the contracts expire or are closed. Futures contracts involve, to varying degrees, risk of loss in excess of the variation margin disclosed in the Statement of Net Investment Assets. Losses may arise from the changes in the value of the underlying instrument, illiquidity in the secondary market for the contracts, or if the counterparties do not perform under the terms of the contract. Futures contracts are valued each day at the settlement price established by the board of trade or exchange on which they are traded. As of June 30, 2001 SWIB held S&P 500 index futures with a face value of \$1.9 million, which are set to expire on September 20, 2001. There was no initial cost upon entering into the contracts, but a net accumulated loss of \$106,195 has been realized on these contracts from contract date to the fiscal year end.

#### *D. Collateralized Mortgage Obligations*

Collateralized mortgage obligations (CMOs) are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes or tranches in accordance with each CMO's established payment order. Some CMO tranches have more stable cash flows relative to changes in interest rates while others are significantly more sensitive to interest rate fluctuations. In a declining interest rate environment, some CMOs may be subject to a reduction in interest payments as a result of prepayments of mortgages which make up the collateral pool. A reduction in interest payments causes a decline in cash flows and thus a decline in the fair value of the security.

Rising interest rates may cause an increase in interest payments, thus an increase in fair value of the security. CMOs are held to maximize yields and in part to hedge against a rise in interest rates.

At June 30, 2001 and June 30, 2000, SWIB held CMOs valued at \$387 million and \$402 million, respectively. SWIB holds only high quality, senior tranches, resulting in minimal risks of default and prepayment.

#### *E. Principal Only Strips*

Principal only strips are securities that derive cash flow from the payment of principal on underlying debt securities. SWIB holds several principal only strips for yield enhancing purposes. The underlying securities are United States Treasury obligations, therefore the credit risk is low. On the other hand, principal only strips are more volatile in terms of pricing, and thus the market risk is higher than traditional United States Treasury obligations. During fiscal year 2000, principal only strips with a combined total cost of \$234 million were sold for a net gain of \$25 million. As of June 30, 2001 and June 30, 2000, SWIB held 4 principal only strips valued at \$414 million and \$371 million, respectively.

### **6. Milwaukee Retirement Systems**

The Milwaukee Retirement Systems (MRS), consisting of the City of Milwaukee Retirement System and the Milwaukee Public School Retirement System, invests in the Fixed and Variable Retirement Trust Funds through the WRS. Since the MRS is a separate legal entity from the WRS, both the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund qualify as external investment trust funds. Participation by the MRS in the Fixed and Variable Retirement Trust Fund is described in the DETF Administrative Code, Chapter 10.12. MRS provides assets to DETF for investment in the Fixed and Variable Retirement Trust Funds which are managed by SWIB. Each month the DETF distributes the pro-rata share of the total Fixed Retirement Trust Fund's earnings less administrative expenses as well as, the Variable Retirement Trust Fund's earnings less administrative expenses. The MRS accounts are adjusted to fair value and gains/losses are recorded directly in the accounts per DETF Administrative Code 10.12(2). The fair value of the MRS position in the Fixed Retirement Trust Fund and the Variable Retirement Trust Fund is the same as the value of the pool shares. Neither State statute, a legal provision, nor a legally binding guarantee exist to support the value of MRS's portion of the Fixed Retirement Trust Fund or the Variable Retirement Trust Fund.

As of June 30, 2001, the Fixed Retirement Trust Fund held \$51,878.2 million of investments, as well as \$2,939.6 million of securities lending collateral, and the Variable Retirement Trust Fund held \$6,595.7 million of investments, as well as \$185.3 million of securities lending collateral. The tables included in Note 3 present investments of the Fixed and Variable Retirement Trust Funds at June 30, 2001, categorized in accordance with the level of risk requirements of GASB Statement 3.

The following schedules provide summary information by investment classification for the Fixed and Variable Retirement Trust Funds at June 30, 2001.

<b>Fixed Retirement Trust Fund</b>				
<b>June 30, 2001</b>				
<b>Classification</b>	<b>Interest/Coupon Rates</b>	<b>Maturity Dates</b>	<b>Cost</b>	<b>Fair Value</b>
Bonds	Variable and .01 to 13.625	7/01 to 7/49	\$ 13,215,477,021	\$ 13,399,255,713
Common and Preferred Stock	N/A	N/A	33,744,813,503	30,779,259,094
Limited Partnerships	N/A	N/A	2,786,338,468	2,772,892,081
Mortgages	6.77 to 12.25	08/04 to 01/22	647,658,204	667,941,865
Real Estate	N/A	N/A	437,902,443	501,079,814
Financial Futures Contracts	N/A	N/A	0	12,873
Private Placements	Variable and 5.95 to 14.75	7/01 to 5/30	3,551,766,109	3,757,794,140
			<u>\$ 54,383,955,748</u>	<u>\$ 51,878,235,580</u>

## Variable Retirement Trust Fund

June 30, 2001

Classification	Interest/Coupon Rates	Maturity Dates	Cost	Fair Value
Bonds	N/A	12/01 to 8/14	\$ 454,196	\$ 451,233
Common and Preferred Stock	N/A	N/A	7,275,268,033	6,595,273,034
Financial Futures Contracts	N/A	N/A	0	3,518
			<u>\$ 7,275,722,229</u>	<u>\$ 6,595,727,785</u>

**7. Benefit Improvement Legislation**

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

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

The Wisconsin Education Association Council, the State Engineers Association and the Wisconsin Professional Police Association petitioned the Court to be allowed to intervene in the Wisconsin Act 11 lawsuit, asserting that they represent interest of participants in the Wisconsin Retirement System (WRS) who will be directly affected by the outcome. The Court allowed these parties to intervene and appointed a reserve judge to determine any factual issues and present his findings to the Court. On June 12, 2001 the justices ruled that the provisions of the pension and benefit improvement law were legal and could be implemented.

Act 11 has made a number of changes to the funding of and benefits provided by the WRS. These changes include reopening the Variable Retirement Trust Fund for new participants, immediate recognition of \$4 billion from the Transaction Amortization Account and creation of a Market Recognition Account to replace the Transaction Amortization Account.

**8. Unfunded Capital Commitments**

Partnership agreements generally set a limit on the total dollar amount that limited partners must commit to funding when entering the partnership. Over the life of the partnership, the general partner will request capital contributions totaling the agreed upon limit. As of June 30, 2001, unfunded capital commitments totaled \$1.4 billion.

**9. Subsequent Events**

As of the balance sheet date, SWIB was contingently liable for \$39 million in notes issued by SWR Investments Limited (SWR) as set forth in the Note Purchase and Exchange Agreement. This agreement between Bank of America (BOA), SWIB, and SWR gave BOA the right to require SWIB to purchase the outstanding notes held by BOA at any time. SWIB had the option of converting the purchased notes into common shares of SWR under this agreement.

In October 2001, SWR paid off the notes issued to BOA and the Note Purchase and Exchange Agreement was terminated effectively eliminating SWIB's contingent liability. This was accomplished when SWIB entered into a subscription agreement with SWR. SWIB purchased 41,786 common shares of SWR in exchange for the \$39 million that was forwarded to SWR for settlement of the principal amount on the notes issued to Bank of America.

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JANICE MUELLER  
STATE AUDITOR

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## INDEPENDENT AUDITOR'S REPORT

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

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

We have audited the accompanying Statements of Net Investment Assets for Various Funds (Local Government Property Insurance Fund, State Life Insurance Fund, Patients Compensation Fund, Historical Society Trust Fund, and Tuition Trust Fund) of the State of Wisconsin as of June 30, 2001 and 2000, and the related Statements of Changes in Net Investment Assets for the years then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the investment activity of the Various Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements are not intended to present the financial activity of the Various Funds attributable to other state agencies, nor are they intended to fairly present the financial position and results of operations of the Investment Board or of the State of Wisconsin, in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net investment assets of the Various Funds as of June 30, 2001 and 2000, and the changes in net investment assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

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

of the inherent uncertainty of valuation, those estimated values may differ from the values that would have been used had a ready market for the investments existed.

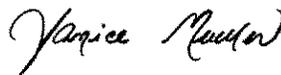
Our audits were made for the purpose of forming an opinion on the financial statements of the Various Funds of the State of Wisconsin. The accompanying financial information included in the introduction of the annual report is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements referred to in the first paragraph and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the State of Wisconsin Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

January 9, 2002

by



Janice Mueller  
State Auditor

**VARIOUS FUNDS**  
**Statement of Net Investment Assets**  
**June 30, 2001**

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

*The accompanying notes, on pages 38 through 40, are an integral part of this document.*

**VARIOUS FUNDS**  
**Statement of Investment Assets**  
**June 30, 2000**

	<b>Local Gov't. Property Ins. Fund</b>	<b>State Life Insurance Fund</b>	<b>Patients Compensation Fund</b>	<b>Historical Society Trust Fund</b>	<b>Tuition Trust Fund</b>
<b>Assets</b>					
Cash and Cash Equivalents	\$ 16,484,695	\$ 5,366,767	\$ 16,137,345	\$ 561,891	\$ 261,709
Receivables					
Investment Income Receivable	218,179	1,177,905	9,665,272	63,532	49,193
Investment Sales Receivable	0	9,167	0	0	0
Investments					
Bonds	11,876,176	44,081,318	472,247,533	3,958,498	5,843,287
Stocks	0	0	44,122,571	8,721,698	0
Private Placements	0	17,199,354	0	0	0
<b>Total Investment Assets</b>	<b>\$ 28,579,050</b>	<b>\$ 67,834,511</b>	<b>\$ 542,172,721</b>	<b>\$ 13,305,619</b>	<b>\$ 6,154,189</b>
<b>Liabilities</b>					
Payables	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
<b>Net Investment Assets</b>	<b>\$ 28,579,050</b>	<b>\$ 67,834,511</b>	<b>\$ 542,172,721</b>	<b>\$ 13,305,619</b>	<b>\$ 6,154,189</b>

*The accompanying notes, on pages 38 through 40, are an integral part of this document.*

## VARIOUS FUNDS

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

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

The accompanying notes, on pages 38 through 40, are an integral part of this document.

## VARIOUS FUNDS

### Statement of Changes in Net Investment Assets For the Fiscal Year Ended June 30, 2000

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Patients Compensation Fund	Historical Society Trust Fund	Tuition Trust Fund
<b>From Investment Activities:</b>					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ (88,750)	\$ (1,886,063)	\$ (15,941,747)	\$ 1,091,446	\$ (139,524)
Interest	1,519,877	4,827,503	35,897,217	307,158	394,274
Dividends	0	0	135,161	82,597	0
Securities Lending Net Income	0	0	2,695	0	0
Investment Expenses	(4,466)	(8,033)	(19,464)	(18,018)	0
Increase (Decrease) in Net Investments Derived from Investment Activities	\$ 1,426,661	\$ 2,933,407	\$ 20,073,862	\$ 1,463,183	\$ 254,750
<b>From Participant Transactions:</b>					
Net Receipts (Disbursements) - Non-Investment Activity	5,377,287	(2,521,825)	21,742,975	(278,658)	1,920,175
Net Increase (Decrease) in Net Investment Assets	\$ 6,803,948	\$ 411,582	\$ 41,816,837	\$ 1,184,525	\$ 2,174,925
<b>Net Investment Assets</b>					
Beginning of Period	21,775,102	67,422,929	500,355,884	12,121,094	3,979,264
End of Period	\$ 28,579,050	\$ 67,834,511	\$ 542,172,721	\$ 13,305,619	\$ 6,154,189

The accompanying notes, on pages 38 through 40, are an integral part of this document.

## 1. Description of Funds

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

The State Investment Fund (SIF) is used by the various funds to invest idle cash of the funds. The SIF is managed by the State of Wisconsin Investment Board (SWIB) with oversight by a Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. It is not registered with the SEC as an investment company.

### A. Local Government Property Insurance Fund

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

### B. State Life Insurance Fund

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

### C. Patients Compensation Fund

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

### D. Historical Society Trust Fund

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

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

#### E. Tuition Trust Fund

The EdVest Wisconsin program offers families a new way to prepare for future higher education costs through the purchase of tuition units. These units, plus investment earnings, are expected to equal one percent of the projected average annual cost of tuition at University of Wisconsin campuses in the year of their use. The Department of Administration is responsible for the management of the EdVest Wisconsin program. SWIB is responsible for investment of program funds in excess of short-term liabilities. Wisconsin Statutes 16.24(10)(b) directs SWIB to invest monies in investments with maturities and liquidity that are appropriate to the needs of the program, as reported quarterly by the Department of Administration. Investment guidelines further focus the fund on high quality fixed income instruments which include unlimited securities of the U.S. Treasury and government agencies. Fixed income securities are permitted in the fund, provided that no more than 5% of the fund is invested in issues of a single corporation or municipality. The State does not guarantee the principal of the securities.

## 2. Significant Accounting Policies

### A. Basis of Presentation

The accompanying financial statements of the investment activity of the Local Government Property Insurance Fund, the State Life Insurance Fund, the Patients Compensation Fund, the Historical Society Trust Fund, and Tuition Trust Fund are prepared in accordance with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The Local Government Property Insurance Fund (LGPIF), the State Life Insurance Fund (SLIF), and the Patients Compensation Fund (PCF) operate similar to insurance enterprises and are reported by the State as proprietary funds. In reporting the investment activity of proprietary funds, SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 which do not conflict with or contradict GASB pronouncements.

### B. Basis of Accounting

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

### C. Valuation of Securities

The investments of the Local Government Property Insurance Fund, the State Life Insurance Fund, the Patients Compensation Fund, the Historical Society Trust Fund and EdVest Tuition Trust Fund are valued at fair value. Monthly, the investments are adjusted to fair value, with unrealized gains and losses reflected in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in Fair Value of Investments."

Generally, fair value is based on quoted market prices. Private placements are priced via a 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.

D. Use of Estimates

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

3. Deposits and Investments

Deposits — Governmental Accounting Standards Board (GASB) Statement 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed. Deposits, as of June 30, 2001, included \$4,306 deposited in a single financial institution in the State Treasury account covered by federal depository insurance.

Investments — The following table presents investments held as of June 30, 2001, categorized to give an indication of the level of risk assumed by the Funds at year end. The categories are as follows:

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

	CATEGORY			Fair and Carrying Value
	1	2	3	
Bonds	\$ 567,229,378	--	--	\$ 567,229,378
Stocks	79,261,434	--	--	79,261,434
<b>Subtotal</b>	<b>\$ 646,490,812</b>	<b>--</b>	<b>--</b>	<b>\$ 646,490,812</b>
Private Placements				18,970,202
Pooled Cash & Cash Equivalents				1,280,181
State Investment Fund				22,676,333
<b>Total</b>				<b>\$ 689,417,528</b>

4. Derivative Financial Instruments

Principal Only Strips — Principal only strips are securities that derive cash flow from the payment of principal on underlying debt securities. SWIB holds principal only strips for yield enhancing purposes. The underlying securities are United States Treasury obligations, therefore the credit risk is low. On the other hand, principal only strips are more volatile in terms of pricing, and thus the market risk is higher than traditional United States Treasury obligations.

As of June 30, 2001 and June 30, 2000, principal only strips valued at \$20.7 million and \$16.0 million, respectively, were held in the EdVest and Patients Compensation portfolios. As of June 30, 2001 and June 30, 2000, approximately 70% and 60%, respectively, of EdVest's portfolios are invested in principal only strips.