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☞ Details: Public Hearing: Audit Report 7-10: An Evaluation: State of Wisconsin Investment Board

(FORM UPDATED: 08/11/2010)

WISCONSIN STATE LEGISLATURE ... PUBLIC HEARING - COMMITTEE RECORDS

2007-08

(session year)

Joint

(Assembly, Senate or Joint)

Committee on Audit...

COMMITTEE NOTICES ...

- Committee Reports ... **CR**
- Executive Sessions ... **ES**
- Public Hearings ... **PH**

INFORMATION COLLECTED BY COMMITTEE FOR AND AGAINST PROPOSAL

- Appointments ... **Appt** (w/Record of Comm. Proceedings)
- Clearinghouse Rules ... **CRule** (w/Record of Comm. Proceedings)
- Hearing Records ... bills and resolutions (w/Record of Comm. Proceedings)
(**ab** = Assembly Bill) (**ar** = Assembly Resolution) (**ajr** = Assembly Joint Resolution)
(**sb** = Senate Bill) (**sr** = Senate Resolution) (**sjr** = Senate Joint Resolution)
- Miscellaneous ... **Misc**

* Contents organized for archiving by: Stefanie Rose (LRB) (October 2012)

Presentation to Joint Legislative Audit Committee

October 31, 2007

State of Wisconsin Investment Board

Keith Bozarth

Executive Director

Variable Fund (VF) Performance

Recommendation: Review Asset Allocation for

VF – Agree

- Began review October 2007 – regular process
- Presents a benefit issue
- Verify current goals for VF
- Dialogue required – immediate and ongoing (initially with ETF)

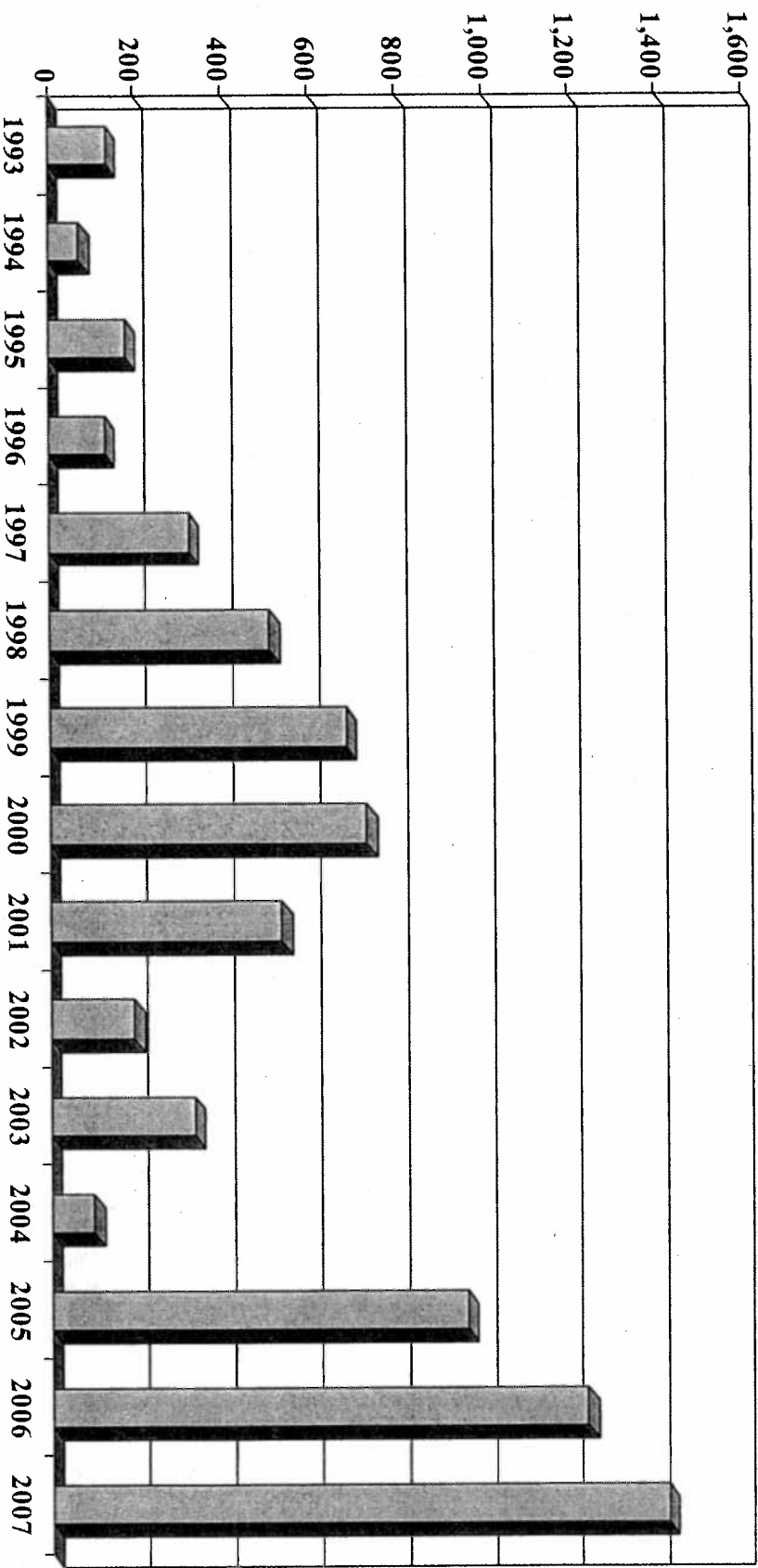


Private Markets (PM) Asset Increase

Recommendation: Report on progress in increasing PM investments – Agree

- Rapid pace of commitment in recent years
- Gaining on private equity goal
 - Ongoing challenge
- Achieved real estate goal recently

Investment Pace – Private Equity (SWIB Commitments in \$ millions)



As of August 31, 2007. 1993 – 2003 based on vintage date and 2004 – 2007 based on commitments. 4

Progress towards Meeting Allocation Target (\$ Millions)

	<u>2005</u>	<u>2006</u>	<u>2007*</u>
Private Equity Assets	\$1,689	\$1,993	\$2,454
Core Trust Fund	\$67,514	\$76,033	\$79,500
% of Core Trust	2.5%	2.6%	3.1%
Uncalled Capital	\$1,389	\$2,169	\$2,631
Total Exposure	4.6%	5.5%	6.4%

Total Exposure = private Equity Assets + Uncalled Capital / Core Trust Fund

*Estimated August 31, 2007 Values

Wisconsin Investments

Recommendation: highlight performance of WI private equity portfolio – Agree

- Rationale – attractive opportunities overlooked by others
- Legislature encouraged approach, but reinforced fiduciary standard
- Implicit concern – restricted portfolio (limited opportunity set – lack of diversification)
- Must apply same standard with any investment

WI Private Equity – 9/30/07

Portfolio Return

Benchmark

YTD	50.1%	13.4%
1 Year	46.0%	16.4%
3 Year	15.4%	10.0%
5 Year	4.3%	15.0%



Real Estate Benchmark

Recommendation: Frequent review of benchmark in light of international exposure
– *Agree*

- Review benchmarks on annual basis
- Considered RE benchmark early in 2007
- Will revisit periodically

Transition Portfolios

Recommendation: Closely monitor construction of transition portfolios – Agree

- Issue in private markets, not public markets
- Occurs with strategy or portfolio manager change
- New portfolios based on portfolio goals and guidelines
- Legacy portfolios still require ongoing management and measurement
- Will carefully consider whenever a new transition portfolio required



Broader Issues

1. Ongoing challenge in attracting and retaining investment staff
2. Keeping up with evolution of investment ^{competition} world
3. Crafting optimal use of internal and external portfolios

Attracting and Retaining Staff

- Pending staff request — increased budget
 - ↳ domestic equity issues mentioned in audit
 - ↳ current analyst handle the work
- Careful use of incentive compensation latitude — current peer group
- Dynamic marketplace increases the challenge
- Also targeting expanded opportunities for professional growth

↳



Keeping Up with Changes

- Investment modernization bill
- Changes in equity management
- Enhanced use of risk management tools
- Recent private equity changes

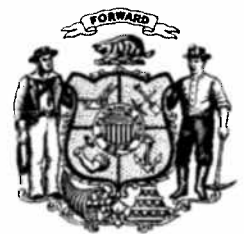


Optimal Use of Internal and External

- Targeting most efficient use of external managers
- Current statutory constraints part of calculation
- Additional discussion likely



WISCONSIN STATE LEGISLATURE



SLIDE 1 - Introduction (JAN)

In addition to our annual financial audit work at the Investment Board, statutes require the Audit Bureau to perform a biennial management audit. The biennial management audit requirement was implemented in 1999. This report represents our fourth management audit under this requirement.

The 2007 audit focuses on three areas: investment performance, the private markets group, and Wisconsin investments.

SLIDE 2 – Wisconsin Retirement System

With assets of over **\$83 billion**, the Wisconsin Retirement System is the **ninth** largest public pension fund in the United States. It represents the pension funds of over **540,000** current and former employees of the State, school districts, and local governments.

The Retirement System's investments are managed in two funds. The larger of the two funds is the **Core Fund**, which is a **diversified** fund that provides the basic retirement benefits available to participants. Until **April 2006**, this fund was referred to as the **Fixed Fund**.

*10%
Variable Fund*

The **Variable Fund** is an all **stock** fund that was reopened in **2001** to participants interested in increasing their exposure to stocks.

Approximately **91** percent of the Retirement System's investments are in the Core Fund and **9** percent in the Variable Fund.

SLIDE 3 – Wisconsin Retirement System Annual Returns

As we have done in all four management audits of the Investment Board, we reviewed overall investment performance of the retirement funds.

A market **downturn** beginning in **2000** resulted in **negative** returns for both funds from **2000 through 2002**. A **rebound** in investment markets during **2003** brought **double-digit returns** that were among their **highest** in the preceding **20** years. As shown on the slide, positive returns have continued. During 2006, the **Core Fund** had a **15.8%** return and the **Variable Fund** had a **17.6%** return.

SLIDE 4 - Investment Performance Comparison to Benchmarks

We **evaluate** the relative effectiveness of the Investment Board's performance in **two** ways.

First, we compare performance to the **benchmarks** established by the Investment Board. The **Core Fund met or exceeded** its benchmarks for all periods at the end of **2005 and 2006**. It also continued to exceed the **actuarial** expected investment returns of **7.8%** in the long term.

The **Variable Fund met or exceeded** its benchmarks at the end of **2005**, but **lagged** its **3- and 5-year** benchmarks at the end of **2006**.

SLIDE 5 – Investment Performance – Strong and Weak Performers

As part of our review of the Investment Board's success in meeting its benchmarks, we highlight asset classes or portfolios that have been particularly successful, as well as those that did not meet their benchmark.

Real estate, private equity, and international equity were particularly **strong performing** asset classes in 2005 and 2006. For example, **private equity** investments provided a **44.2 %** return in **2005**, compared to a benchmark of **30.4%**.

Domestic equities was the most notable **underperforming** asset class during this period. It missed its **1-, 3-, and 5-year** benchmarks at the end of **2006** and provided a **five-year** average annual return of **6.5%** compared to a benchmark of **7.2%**.

Among the more notable underperforming domestic equity portfolios were some of the **internally managed portfolios**. **Two** internally managed **large cap** stock portfolios **missed** their one-year benchmarks for **three straight years**.

The Investment Board is taking steps to address the underperformance, including undertaking a **major reorganization** of its equity portfolios and staff. We will continue to **monitor** this area closely and anticipate that it will be an area of **focus** during **future management audits**.

SLIDE 6 - Comparison of Five-year Return Rankings

A **second** way we evaluate performance is by comparing the Core Fund's performance to the performance of **nine** other **large** public pension funds.

We recognize that such comparisons are **not perfect** measures because of differences between pension plans. However, we believe the comparisons provide some measure of the **relative effectiveness** of the Investment Board's **overall** investment **strategies** and **asset allocation** decisions.

We found that the Core Fund's rankings were in the **middle** of the pack for all of the periods reviewed. As shown on the slide, the Core Fund ranked **5th** in its average **five-year returns** at 12/31/06. In comparison, the Fund's five-year returns **ranked first** among the same ten funds at the end of **2003** and last at the end of 2001.

At least one factor that may have contributed to the middle rankings at the end of 2006 was the **underperformance** of the Investment Board's **domestic equities**.

SLIDE 7 – Variable Fund

As part of our review of investment performance during this audit, we looked more closely at the performance of the Variable Fund. We note that the Variable Fund's equity investments **no longer mirror** those of the Core Fund. **Since 2000**, various allocation and strategic decisions made by the Investment Board have moved the Variable Fund's allocation **away from a proportionate mix** of equity investments.

One of the **key strategic decisions** was to reduce the Variable Fund's **exposure to international** equities in an effort to temper the Fund's volatility. At the end of 2006, **23.1%** of the Variable Fund's equity investments were in international equities, compared to **39.7%** of the Core Fund's. At the same time, **international equity** investments have provided **strong returns** in recent years.

These decisions have **affected** the Variable Fund's **performance**. The Variable Fund's performance was **less than the composite** performance of the retirement funds' equity portfolios for **all periods** ending 12/31/06.

Consequently, we **recommended** the Investment Board **re-evaluate** its policies and procedures for making allocation and investment decisions that affect the Variable Fund.

SLIDE 8 – Private Markets Investments

The **second major area** of review during our audit was the Investment Board's **private markets investments**. Private markets investments include real estate, private equity, and private debt.

The Investment Board's **real estate** investments can include properties directly owned by the Investment Board, investments in real estate joint ventures and partnerships, and commercial real estate mortgages.

Private equity includes equity investments in companies whose stock is not registered with the SEC and not available to the general public. The Investment Board's private equity largely includes leveraged buyouts and some venture capital investments. Most private equity investments are held through funds and partnerships.

Private debt consists of privately negotiated loans. Most of the Investment Board's private debt is with Wisconsin companies.

At the end of 2006, the Investment Board's private markets investments totaled **\$5.5 billion** and represented **7.2%** of the Core Fund.

Overall, private markets investments often offer the **potential for higher returns**, although at a **higher risk**.

SLIDE 9 – Management of Private Markets Investments

The Investment Board encountered **difficulties** in the management of its private equity investments in past years because it did not have an adequate structure, resources, and controls in place to support their success. We noted concerns in our **2001 audit** of the Investment Board, including a large troubled private equity investment in South Korea. A **management consulting firm** hired by the Investment Board also noted several issues in the same year.

During our current audit, we found the Investment Board has undertaken several **organizational, staffing, strategic, and procedural changes** to address concerns noted in 2001. One of the **major changes** was to establish a **private markets group** to manage all of its private markets investments. It also established **tighter limits** on private equity investments in **emerging markets** and improved its **due-diligence** and **monitoring** procedures. We believe these changes have ultimately helped to **improve the management** of the private markets investments.

SLIDE 10 – Performance of Private Markets Investments

In addition to the management improvements, we also highlight the **strong returns** in the private equity and real estate asset classes during 2005 and 2006. As you can see from the slide, **private equity** provided returns of **44.2%** in 2005 and **28.7%** in 2006, while **real estate** provided returns of **28.2%** and **30.1%** in those 2 years.

SLIDE 11 – Areas Needing Continued Attention

While the Investment Board has come a long ways in improving the management of its private markets investments since our review in 2001, there are several areas needing continued attention.

The Investment Board faces **increased competition** for private markets investments. It is implementing or considering several options for **increasing its access** to the private markets investments. We recommend that the Investment Board **report** on these efforts in its annual report to the Legislature.

An ongoing challenge is the ability to **hire and retain staff** with the skills to develop and monitor the complex and higher-risk investment strategies in the private equity investments. The Investment Board lost a **private equity portfolio manager** in both 2005 and 2006 to other employers.

During our audit, we also identified **two other fairly technical areas** for the Investment Board to consider in its management of private markets investments. **First**, we **recommend** the Investment Board review closely the process and decisions made in the placement of investments into **transition portfolios**. The Investment Board established transition portfolios as they made staffing and strategic changes for its private markets investments. Our **concern** is that the Investment Board **ensures** that staff **cannot unduly influence** their **bonuses** by the placement of investments in these portfolios.

Second, we recommend the Investment Board **regularly analyze** whether the **real estate benchmarks** continue to be **appropriate** based on the strategies and investments included in the real estate portfolios. For example, one of the benchmarks did not consider the portfolio's large balance of **international investments**, which contributed significantly to the portfolio's performance. As a result, the portfolio was able to easily exceed its benchmarks.

SLIDE 12 – Wisconsin Investments

The final chapter of our report is primarily an informational piece on Wisconsin investments. The Investment Board has invested almost **\$1.4 billion** in companies headquartered or with a significant presence in Wisconsin. As the Investment Board makes these investments, it needs to **balance the public policy goal** of investing in Wisconsin with its **fiduciary responsibilities**.

As shown in the slide, the **State Investment Fund** held almost **\$709 million** in Wisconsin investments that were primarily CDs issued by Wisconsin banks and thrifts through the Investment Board's **Wisconsin CD program**. The Investment Board also held Wisconsin investments in most asset classes in the retirement funds.

As part of our audit of the private markets investments, we focused our review on the **private equity and private debt** investments in Wisconsin, which totaled almost **\$390 million**.

SLIDE 13 – Wisconsin Private Debt Portfolio

The Wisconsin private debt portfolio consists of **privately negotiated loans** with Wisconsin companies. The objective of the portfolio is to invest in loans that provide **market-rate returns**. The Investment Board first began to **officially track** these loans in **1983**.

The portfolio was valued at almost **\$353 million** at 12/31/06, which represented loans with **31** different **Wisconsin companies**. The portfolio has had steady performance. It has provided an average annual return of **7.8%** over the **last 10 years**.

SLIDE 14 – Wisconsin Private Equity Portfolio

The Wisconsin Private Equity Portfolio was established in **2000** to **focus on venture capital** funds active in **Wisconsin** and the **Midwest**. Through 2006, the Investment Board has **committed \$180 million** to various funds and direct investments that focus largely on **start-up and early-stage companies**. Of that amount almost **\$78 million** has been **invested**, including **\$33 million in Wisconsin companies**.

As part of these investments, the Investment Board has made **direct investments in nine Wisconsin companies**, seven of which are medical technology or biotechnology companies. At **least two** of these investments have already been **sold at a gain**.

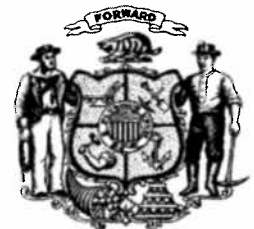
SLIDE 15 – Performance of Wisconsin Private Equity Portfolio

The Wisconsin private equity portfolio had **negative returns** and significantly **underperformed** its benchmarks for all periods at the end of 2005 and 2006. The Investment Board attributes the underperformance to the fact the portfolio is **relatively new** and early-stage private-equity investments typically **earn below benchmark** returns until some time has passed.

The Investment Board **expects improved returns** as more of the companies in the portfolio's funds mature and are sold. We **recommend** the Investment Board **highlight** the **performance** of its Wisconsin private equity portfolio in its **annual report** to the Legislature.



WISCONSIN STATE LEGISLATURE





State of Wisconsin Investment Board

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November 15, 2007

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

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

Senator Jim Sullivan, Co-Chair
Joint Committee on Audit
P.O. Box 7882
Madison WI 53707-7882

Representative Suzanne Jeskewitz, Co-Chair
Joint Committee on Audit
P.O. Box 8952
Madison WI 53708-8952

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

Dear Senator Decker, Senator Sullivan, Representative Rhoades, Representative Jeskewitz and Secretary Morgan:

Attached is our quarterly report of all expenses that were charged directly to funds managed by the Investment Board (Attachment A). This report includes expenses incurred during the quarter ending September 30, 2007. Wisconsin statute sec. 25.17 (13m) requires that we provide this report on a quarterly basis.

The statutes authorize the Board to employ special legal or investment counsel in any matter arising from the scope of our investment authority and to employ professionals, contractors or agents to evaluate or operate any property in which the Board has an interest. The Board may also contract with external advisers to manage various types of investments. Expenses for these services are directly charged to the current income of the fund for which the services are furnished.

The expenses in this report are reflected on an accrual basis, which lists costs when they are incurred rather than paid. Providing the information on an accrual basis gives a better picture of quarter to quarter trends in our use of services that are directly charged to the funds. A negative charge typically indicates a downward adjustment to expenses accrued in a prior quarter or a refund of expenses that were prepaid and subsequently adjusted.

Attachment A lists all expenses by category. Expenses increased by \$10.6 million from the prior quarter, primarily due to the following:

- The most significant change between this report and the second quarter report occurred with the "Total Private Equity Management" expenses, which increased approximately \$13 million

from the prior quarter. During the second quarter, SWIB had enhanced its accounting procedures to more accurately categorize the management fees for private equity as an expense or a reduction in the asset value. With the enhanced procedures, SWIB recalculated the costs and made all adjustments at the end of the second quarter for private equity limited partnership management fees for FY 2007. That resulted in lower than normal expenses for the second quarter and is the reason for the disparity between the two quarters.

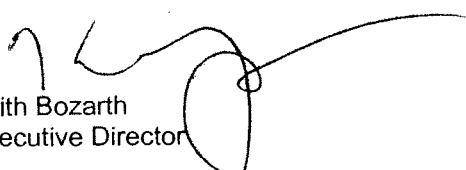
- Earlier this year, SWIB re-negotiated the contract with BNY Mellon for bank custody services, and the lower negotiated fees are first reflected in this report. As a result of the new contract, the "Custodial and Banking Fees" decreased over \$600,000 from the prior quarter.
- The equity markets were very volatile during the third quarter and particularly affected the enhanced index funds. The fees that SWIB pays the managers for those funds are primarily performance based. As a result of lower performance, the fees dropped nearly \$2.8 million from the prior quarter.
- In an effort to reach the asset allocation target, SWIB increased its real estate commitments in the last few months. This resulted in fees for real estate management services increasing by \$830,000.

Attachment B provides further explanation about the various expenditure categories. Attachment C includes legal expenses that are capitalized at the time of acquisition or directly associated with the ongoing activity of an asset, such as appraisals or bankruptcy costs. Unlike other expenses listed in this report, these expenses are reflected in the value of the asset or are netted from gross returns of the asset, consistent with standard industry practices.

Attachment D shows the amount and percent of Wisconsin Retirement System (WRS) assets managed internally and externally over the last four quarters. In the third quarter of 2007, dedicated externally managed assets increased primarily due to the funding of two global real estate investment trusts (REIT). Commingled externally managed assets decreased one percent, which was due primarily to funding the REIT portfolios. Most other changes were a result of market movements and capital calls for private market investments.

We hope this report gives you a clear picture of expenditures and how funds are managed. Please contact me, however, if you have any questions or comments about the report.

Sincerely,



Keith Bozarth
Executive Director

Attachments

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

STATE OF WISCONSIN INVESTMENT BOARD
Direct Charges to All Funds Under Management - Accrual Basis
Quarter Ending September 30, 2007

Custodial and Banking Fees

Bankers' Bank	Wisconsin CD Program	\$2,500
BNY Mellon	Retirement System Custodial Services	507,090
US Bank	State Banking Services	1,014

Legal Fees, Services and Expenses

Foley & Lardner	Private Markets Investment Transactions	<u>\$22,693</u>
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Investment Counsel

Abel/Noser Corp.	Trade Analysis	\$25,000
Alvin Stroyny	Quantitative Analysis Consulting	3,850
American Stock Exchange	American Stock Exchange Data	3,231
Analysis Group Economics	Investment Management Consultant-Equity Exposure Reporting	(3,333)
BCA Publications	Global & Domestic Fixed Income Strategy Research	12,333
BioCentury Publications	Biotech Stock News	500
Bloomberg, LP	Market, Company, Industry & Benchmark Information	173,544
Call Street Transcript Service	Credit Analysis	1,800
CanDeal.ca Inc.	Canadian Government Bond Trading Service	900
Charles River Systems, Inc.	Portfolio Management Software	82,678
CEM Benchmarking Inc.	Comparative Cost Analysis	20,000
Council of Institutional Investors	Corporate Governance	7,500
Courtland Partners	Performance Monitor Reporting	63,750
Credit Sights	Credit Assessments	17,250
Data Broadcasting Corporation - CMS Bond Edge	Pricing Service	10,725
Davis Mendel & Regenstein, Inc.	Online Investment Reports	8,750
Dominion Bond Rating Service (DBRS)	Credit Ratings & Research Reports for Corporate Bond Issuers	1,326
Dow Jones & Co	Company and Industry News Service	11,415
Dr. Harm de Blij	Board Presentation and Counsel	12,000
Economy.com	Economic, Currency & Bond Analysis	349
Ennis, Knupp & Associates	Fiduciary & Governance Consulting	48,838
Factset Data Systems	Financial & Economic Database	73,800
Financial Engineering Assoc Inc.	Value at Risk Calculation	3,309
Fitch Info., Inc.	Credit Rating Service	1,600
FX Alliance LLC	Electronic Platform for Trading Foreign Currencies	3,667
Gimme Credit	Credit Research	4,749
Global Investment Research Inc.	Technology and Telecom Research	2,499
Hamilton Lane Advisors, LLC	Private Equity Consulting/Reporting Services	362,500
iMoneyNet, Inc	Money Market Fund Database	10,168
Instinet	Equity Trading Service	882
Institutional Investor	Global Fixed Income Institute Membership	3,000
Institutional Shareholder Services, Inc	Proxy Voting Analysis	29,894
Investor Responsibility & Support Services, Inc	Securities Class Action Support	8,751
Lombard Street Research	Global Economic Analysis	11,100
London Stock Exchange PLC	License to Use Foreign Security Numbers	7,050
Maria Fiorini Ramirez	Economic Analysis	1,200
Market Axxess Corporation	Bond and Yield Pricing	1,200
McLagan Partners	Compensation Comparison	2,500
Moody's Investor Service	Corporate Bond Credit Quality Screening	33,846
Morgan Stanley Capital International	Developed Markets Security Data	21,748

NASDAQ Stock Market	NASDAQ Stock Exchange Data	600
New York Stock Exchange	New York Stock Exchange Data	3,952
Options Price Reporting Authority (OPRA)	Quote System for Options Market	1,540
Peter L. Bernstein	Economic & Portfolio Strategy	462
Property & Portfolio Research	Real Estate Consulting & Electronic Services	27,500
Quantitative Services Group LLC	Access to Quantitative Data	20,001
Reuters America Inc.	News, Economic & Company Research & Analytics	128,759
RiskMetrics	Volatility and Correlation Data for Value	6,876
Russell/Mellon Analytical Services	Fundamental and Quantitative Risk & Performance Analysis	8,750
S.R. Battiboi & Company	Tax Compliance Services Required by Government of India	(7,029)
Salomon Analytics Yield Book	Fixed Income Portfolio Risk & Optimization Modeling/Analysis	15,000
Sheshunoff Info. Services	Government Financial Management Report	120
SNL Financial	Customized Analysis of Bank Investments	8,625
Standard & Poor's	Industry & Corporate Research	50,164
Strategic Economic Decisions	Research Reports	6,249
Strategic Investment Solutions, Inc.	Asset Allocation & Benchmark Consulting	70,000
Thomson Financial Services	Electronic Research Pricing (Autex, StreetEvents, FirstCall)	84,204
Toronto Stock Exchange	Market Data/Traders	1,134
Trade Web	On-Line Fixed Income Trading Service	7,800
William O'Neil & Co.	Equity & Analytics Technical Research	21,250
Wilshire Associates	Performance Measurement, Portfolio Management & Analytics	89,625

Real Estate Investment Management Services

Apollo Advisors II & LP	Real Estate Management Services	\$30,334
Archstone - Smith Trust	Real Estate Management Service	430,149
Berkshire Property Advisors, LLC	Real Estate Management Services	44,163
Bristol Group, Inc.	Real Estate Management Services	1,217,724
BVP Managers, LLC	Real Estate Management Services	375,000
Callahan Capital	Real Estate Management Services	268,200
Capital Trust	Real Estate Management Services	75,429
Centerline Capital Group	Real Estate Management Services	107,705
Comerstone Real Estate Advisors	Real Estate Management Services	135,026
Essex VFGP	Real Estate Management Services	96,192
Fortress Investment Corp.	Real Estate Management Services	1,548,022
Goldman Sachs & Co.	Real Estate Management Services	125,182
Guggenheim Structured Real Estate Advisors, LLC	Real Estate Management Services	224,785
Hawkeye Partners LP	Real Estate Management Services	125,000
Heitman Capital Management, LLC	Real Estate Management Services	(12,903)
Henderson Global Investors (North America) Inc.	Real Estate Management Services	276,412
Hudson Advisors	Real Estate Management Services	379,084
Invesco Realty Advisors, Inc.	Real Estate Management Services	279,682
JP Morgan Investment Management	Real Estate Management Services	955,983
Kensington Realty Advisors	Real Estate Management Services	76,895
Koll Bren Realty Advisors	Real Estate Management Services	149,951
KTR Capital Partners	Real Estate Management Services	125,000
Landmark Realty Advisors	Real Estate Management Services	18,530
Lazard Freres	Real Estate Management Services	99,082
Mesa West Capital LLC	Real Estate Management Services	243,750
MMA Realty Capital	Real Estate Management Services	8,085
Morgan Stanley	Real Estate Management Services	122,066
Northwestern Mutual Life	Real Estate Management Services	26,173
Prudential (senior housing)	Real Estate Management Services	157,535
Rockpoint Group LLC	Real Estate Management Services	371,331
Rockspring Property Investment Managers	Real Estate Management Services	220,830
RREEF	Real Estate Management Services	541,190
Sentinel Realty Advisors Corp.	Real Estate Management Services	28,016

The Blackstone Group	Real Estate Management Services	328,125
UBS Realty Investors	Real Estate Management Services	60,777
Westbrook Real Estate	Real Estate Management Services	502,704

Private Equity Management

3I Europe Investment Partners	Private Equity Management	\$257,500
ACI Capital Investors II	Private Equity Management	214,700
Alchemy Partners	Private Equity Management	82,600
Alta Communications IX, LP	Private Equity Management	181,900
American Securities Distressed Partners, L.P.	Private Equity Management	2,500
Ampersand Ltd Partnership	Private Equity Management	121,200
Apollo Investment Fund IV LP	Private Equity Management	24,200
Apollo Investment Fund VII, L.P.	Private Equity Management	250,000
Ares Corporate Opportunities Fund II, LP	Private Equity Management	169,000
Ares Corporate Opportunities Fund, LP	Private Equity Management	52,000
Asia Recovery Fund	Private Equity Management	(100,500)
Avenue Special Situation Fund, L.P.	Private Equity Management	307,600
Baird Capital Partners II	Private Equity Management	5,500
Baird Venture Partners	Private Equity Management	123,800
BC European Capital	Private Equity Management	99,000
Bear Stearns	Private Equity Management	(79,000)
Bear Stearns Merchant Capital	Private Equity Management	203,700
Birch Hill Equity II	Private Equity Management	(400)
Blackstone Management Partners V LLC	Private Equity Management	116,900
Boston Millennia	Private Equity Management	230,900
Bridgepoint Europe III A LP	Private Equity Management	386,600
Capital International Global	Private Equity Management	13,400
Capital Res Partners IV LP	Private Equity Management	114,300
Capital Resource Lenders III	Private Equity Management	28,300
Carlyle Asia Ltd.	Private Equity Management	40,500
Carlyle Partners IV, LP	Private Equity Management	7,100
Carlyle Partners V, L.P.	Private Equity Management	330,300
Cerberus Institutional Partners LP	Private Equity Management	375,000
Charterhouse	Private Equity Management	77,100
Charterhouse VIII	Private Equity Management	312,000
Coller International	Private Equity Management	108,400
Coller International V LP	Private Equity Management	187,500
Comerstone Equity IV LP	Private Equity Management	6,500
CVC European Equity Partners IV	Private Equity Management	106,600
CVC European Equity Partners Tandem Fund	Private Equity Management	110,400
Cypress Advisors, LP	Private Equity Management	(3,000)
Davis Tuttle Venture Prtns LP	Private Equity Management	100
Doll Technology Invt Fd II LP	Private Equity Management	32,500
El Dorado Ventures	Private Equity Management	778,600
EQT V, L.P.	Private Equity Management	196,600
Essex Woodlands Hlth Venture V	Private Equity Management	111,200
Facilitator Fund LP	Private Equity Management	50,800
FFC Partners II, LP	Private Equity Management	75,200
Fortress Invest Fund II LLC	Private Equity Management	14,600
Fortress Invest Fund IV (Coinvestment Fund A) LP	Private Equity Management	84,400
Fortress Invest Fund IV (Fund A) LP	Private Equity Management	190,300
Fortress RIC	Private Equity Management	73,100
Fortress V	Private Equity Management	200,000
Fortress V Coinvestment	Private Equity Management	(11,400)
Frazier	Private Equity Management	353,300

Frontenac	Private Equity Management	(280,400)
Gores Capital Partners II, LP	Private Equity Management	318,900
Graphite	Private Equity Management	(177,000)
Green Equity Partners V	Private Equity Management	250,000
GS Special Oppty Asia Fd LP	Private Equity Management	6,100
GTCR	Private Equity Management	179,400
Harbourvest International	Private Equity Management	350,200
Hellman & Friedman Capital VI	Private Equity Management	35,200
Horizon Partners, Ltd	Private Equity Management	(15,600)
IGP II	Private Equity Management	29,900
Industrial Growth Partners	Private Equity Management	(17,300)
Joseph, Little, John & Levy, Inc.	Private Equity Management	(1,500)
Kelso Investment Assoc III	Private Equity Management	(58,700)
Kelso Investment VII LP	Private Equity Management	156,000
Kelso VIII	Private Equity Management	375,000
KKR 2006 Fund LP	Private Equity Management	625,600
KKR European II	Private Equity Management	269,000
Kohlberg Investors VI, LP	Private Equity Management	246,000
Kohlberg Kravis Roberts & CO	Private Equity Management	117,300
Lake Pacific I Gladson, LLC	Private Equity Management	125,000
Lake Pacific Partners, LLC	Private Equity Management	250,000
Latin America Ent Fund Manager	Private Equity Management	50,000
Lindsay Goldberg and Bessemer II	Private Equity Management	438,200
Lone Star Fund IV LP	Private Equity Management	26,600
Mason Wells Partners I, LLC	Private Equity Management	(14,100)
Mayfield XI LP	Private Equity Management	203,200
New Mountain III	Private Equite Management	(205,600)
New Mountain Partners III, L.P.	Private Equity Management	705,600
Oak Investment Partners XII, LP	Private Equity Management	150,000
OCM Opportunities Fund VII	Private Equity Management	158,100
Old Lane India Opportunities Fund-T, LP	Private Equity Management	126,000
Peninsula Fund IV LP	Private Equity Management	250,000
Pennisula Fund	Private Equity Management	111,000
Pioneer Poland US LP SWIB	Private Equity Management	(2,400)
Pomona Capital	Private Equity Management	183,500
Providence Equity Partners VI, LP	Private Equity Management	186,400
Recovery Equity	Private Equity Management	22,800
Seaport Capital Partners II	Private Equity Management	47,500
SKM Equity Fund III, LP	Private Equity Management	107,100
Sprout	Private Equity Management	61,300
Stonington Partners	Private Equity Management	119,500
TA X	Private Equity Management	40,500
Thomas Lee VI	Private Equity Management	328,100
TPG Partners V, LP	Private Equity Management	509,800
Venture Investors	Private Equity Management	87,900
Venture Investors Early Stage Fund IV	Private Equity Management	154,300
Vista Equity Partners Fund III, L.P.	Private Equity Management	259,000
Warburg Pincus Private Equity IX, L.P.	Private Equity Management	185,200
Windpoint Partners II	Private Equity Management	(14,400)
Windpoint Partners IV LP	Private Equity Management	89,700
Windpoint Partners V LP	Private Equity Management	86,000
Windpoint Partners VI LP	Private Equity Management	57,400
Windward Capital Partners II LP	Private Equity Management	(57,900)
WLR Recovery Fund L P	Private Equity Management	(28,300)
Total Private Equity Management		2,519,500

Index, Enhanced and Commingled Fund Fees

Barclays Global Investors (BGI)	Quantitative/Enhanced & Index Fund Management	\$7,672,899
Boston Company, The	Equity Emerging Market Management	1,143,754
Capital Guardian Trust Company	Global High Yield Fixed Income Management	490,969
Goldman Sachs Asset Management	Quantitative/Enhanced & Index Fund Management	441,159
Grantham, Mayo, Van Otterloo	Equity and Fixed Income Emerging Market Management	611,400
Janus Institutional Asset Management	Quantitative/Enhanced & Index Fund Management	366,186
LSV Asset Management	Quantitative/Enhanced & Index Fund Management	334,768
T. Rowe Price Trust Company	International Emerging Market Management	1,793,268
UBS Global Asset Management	Multi-Asset Management	869,590

Public Market Active Management Fees

Aberdeen Asset Management	Global Fixed Income/Emerging Active Management	\$613,856
Acadian Asset Management	International Equity Active Management	1,199,421
AEW	Real Estate Investment Trusts	107,505
Alliance Bernstein	International Equity Active Management	1,995,354
American Century Investments	International Equity Active Management	437,436
Brandywine Asset Management	Global Fixed Income Active Management	467,733
Bridgewater Associates	Global Fixed Income Active Management	635,753
EII Realty Services, Inc.	Real Estate Investment Trusts	17,700
Grantham, Mayo, Van Otterloo	Large Cap Quantitative Management	64,506
Heitman Real Estate Securities, LLC	Real Estate Investment Trusts	103,790
Loomis, Sayles & Co.	High Yield Fixed Income Active Management	513,936
LSV Asset Management	International Equity Active Management	1,898,508
Morgan Stanley Asset Management	International Equity Active Management	980,858
Pyramis Global Advisors Trust Company	International Equity Active Management	1,016,040
RREEF America LLC	Real Estate Investment Trusts	15,797
Standish Mellon Asset Management LLC	Cash Management Service	26,967
Stone Harbor Asset Management	Emerging Market Fixed Income Active Management	478,741
UBS Global Asset Management	Global Fixed Income Management	253,892

Total Public Market Active Management Fees**\$5,082,792****Total Quarterly Charges to Funds****\$50,296,238**

**Fees paid to fund managers are established as a percentage of the capital committed. As assets in a fund are sold, the management fees paid are typically reimbursed from the profits of the fund.*

***Expenses for private equity management fees are estimated and adjusted annually based upon committed capital or assets under management, determined by management contract terms. Total committed capital includes management fees. All capital contributions to the limited partnership must first be returned to the limited partners before any incentive fees are paid to the general partner.*

Explanations of Direct Charges

Custodial & Banking Fees

Wisconsin Certificate of Deposit Program: Under a contract with SWIB, Bankers' Bank administers the program under which SIF purchases certificates of deposit from Wisconsin-based banks and thrifts. Most administrative costs are paid by the participating banks. SWIB's expenses are \$2,500 per quarter to help underwrite other administrative costs, such as insurance that SWIB requires to be purchased.

BNY Mellon: Provides master custody services (safekeeping of assets, income collection, valuations and accounting) for public and private domestic and foreign securities in the Wisconsin Retirement System (WRS) and smaller funds. In addition, SWIB receives performance measurement and analytical services from BNY Mellon Analytical Solutions through its custodial contract with BNY Mellon, which serves as the official book of record for SWIB's accounting and performance measurement functions. BNY Mellon provides the data and analytical tools used by SWIB for compliance and risk management. Fees for these services are established by contract.

US Bank: The State of Wisconsin has contracted with US Bank to be the state's working bank. The fees paid to US Bank by SIF reflect bank service charges that are not directly applicable to the fund participants. These fees are distributed to the fund participants through the monthly SIF earnings process.

Legal Fees, Services and Expenses

Under authority delegated by the Attorney General, pursuant to s. 25.18 (1) (a) Statutes, SWIB may employ legal counsel for any matters arising out of the scope of its investment authority. This includes legal services relating to bankruptcies, class actions, private markets transactions, fiduciary advice, securities law, investment litigation, and other similar matters. Capitalized fees incurred during the asset acquisition process are reported separately as a charge against the value of the asset. The Attorney General annually reviews and approves a list of law firms to provide investment legal services for SWIB and reviews related legal fees.

Investment Counsel

Current law gives SWIB the authority to employ investment counsel in any matters arising out of the scope of its investment authority. Investment research and services provided include global market, industry, economic and company information, financial and performance analytics, news information, pricing and exchange data, credit ratings, financial modeling, economic forecasting, trading services and a variety of Board consultations. These services enable SWIB to perform due diligence on current and future holdings and assist in monitoring investments.

Real Estate Investment Management Services

SWIB hires real estate advisors to assist with sourcing analysis, due diligence and management of real estate investments. SWIB also invests in funds, typically limited partnerships. Each fund either has a general partner or engages a fund manager with delegated authority to make real estate investments for the fund. Real estate advisory fees are usually based on a percentage of assets under management. Fees paid to fund managers are established as a percentage of the capital committed. As assets in a fund are sold, the management fees paid are typically reimbursed from the profits of the fund.

Private Equity Management Fees

SWIB invests in private equity funds, typically limited partnerships that in turn make individual private equity investments. Each fund is managed by its general partner or fund manager with delegated authority. Fees are established as a percentage of the capital committed to each fund or partnership. As assets in a fund are sold, the management fees are typically reimbursed from the profits of the fund.

Public Market Active Management Fees

Within broad guidelines established by SWIB, these managers have been delegated authority to determine strategy and purchase securities in SWIB's name under a separate and distinct account. This relationship is used primarily in the management of international equity and fixed income investments. Fees are typically assessed as a percentage of the market value of assets under management and may include other factors.

Standish BNY Mellon invests the cash from the externally managed portfolios and internally managed international equity portfolios that have yet to be invested in stocks or bonds. Due to settlement times around the globe, these funds cannot be effectively managed in the State Investment Fund. The fees are negotiated as part of the custodial contract.

Indexed, Enhanced and Commingled Fees

SWIB has investments in a number of externally managed funds that seek to replicate the returns of a particular public market index (such as the Russell 3000) or seek to enhance the return from a particular public market index through the use of quantitative models or other strategies. SWIB's investments are commingled with other investors, and the underlying securities are owned in the name of the fund manager. Fees are typically based on a percentage of assets under management and may include other factors, such as performance.

Asset Specific Charges

Asset specific charges include expenses that are directly associated with the ongoing activity of an asset such as appraisals or bankruptcy costs. Unlike other expenses reflected in this report, these expenses are netted in gross returns of the asset, consistent with standard industry practices.

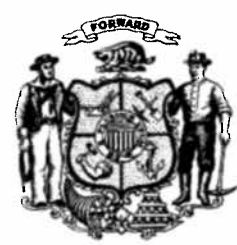
STATE OF WISCONSIN INVESTMENT BOARD
Report of Asset Specific Charges and Capitalized Legal Fees - Accrual Basis
Quarter Ending September 30, 2007

Legal Fees, Services and Expenses		
Cox, Castle & Nicholson	Real Estate Investment Transactions	(\$92)
Law Office of Walter S. Cowger	Private Markets Investment Transactions	4,878
Quarles & Brady	Litigation & Private Markets Investment Transactions	(15,236)
Reinhart Boerner Van Dueren	Private Markets Investment Transactions	(3,169)
Solheim, Billing & Grimmer SC	Private Markets Investment Transactions	348
Total Legal Fees, Services and Expenses		<u>(13,271)</u>
Investment Counsel		
Warshaw, Kirk M.		3,550
Total Investment Counsel		<u>3,550</u>
Total Asset Specific Charges		<u>(\$9,721)</u>
Capitalized Legal Fees		
Quarles & Brady	Litigation & Private Markets Investment Transactions	10,407
Reinhart Boerner Van Dueren	Private Markets Investment Transactions	50,005
Solheim, Billing & Grimmer SC	Private Markets Investment Transactions	7,575
Total Capitalized Legal Fees		<u>\$67,986</u>
Total Capitalized Legal Fees		<u>\$67,986</u>

This table includes expenses that are capitalized at the time of acquisition or directly associated with the ongoing activity of an asset such as appraisals or bankruptcy costs. Unlike other expenses reflected in this report, these expenses are reflected in the value of the asset or netted in gross returns of the asset, consistent with standard industry practices.

**INTERNAL AND EXTERNAL MANAGEMENT
QUARTER TO QUARTER COMPARISON**

	12/31/2006		3/31/2007		6/30/2007		9/30/2007	
	Amount (in millions)	Percent	Amount (in millions)	Percent	Amount (in millions)	Percent	Amount (in millions)	Percent
Internally Managed	\$17,064	20.5%	\$17,233	20.4%	\$17,694	20.1%	\$18,406	20.6%
Externally Managed Dedicated Accounts	12,912	15.5%	13,384	15.8%	14,072	16.0%	14,865	16.6%
Externally Managed Commingled Accounts	53,200	64.0%	53,858	63.8%	56,056	63.8%	56,057	62.8%
1. Passive Index Funds	24,199	29.1%	24,500	29.0%	27,369	31.2%	27,347	30.6%
2. Enhanced Index Commingled Funds	22,045	26.5%	21,843	25.9%	20,395	23.2%	19,800	22.2%
3. Limited Partnerships	3,990	4.8%	4,490	5.3%	5,001	5.7%	5,414	6.1%
4. Actively Managed Commingled Accounts	2,966	3.6%	3,025	3.6%	3,291	3.7%	3,496	3.9%
TOTAL WRS Assets	\$83,176	100.0%	\$84,475	100.0%	\$87,822	100.0%	\$89,328	100.0%





STATE OF WISCONSIN
Legislative Audit Bureau

22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703
(608) 266-2818
Fax (608) 267-0410
leg.audit.info@legis.wisconsin.gov

Janice Mueller
State Auditor

November 21, 2007

Mr. Keith S. Bozarth, Executive Director, and
Members of the Investment Board Audit Committee
121 East Wilson Street
Madison, Wisconsin 53702

Dear Mr. Bozarth and Members of the Investment Board Audit Committee:

We have completed a financial audit of the investments and investment activity of the Retirement Investment Trust Funds, the State Investment Fund, and the Various Funds managed by the State of Wisconsin Investment Board as of and for the year ended June 30, 2007. We issued unqualified auditor's reports on the fair presentation of the financial statements. These financial statements and related opinions are included in the Investment Board's annual report for 2007.

As provided for in *Government Auditing Standards*, we also are furnishing you with the auditor's report on internal control over financial reporting and on compliance and other matters. We did not identify any control or compliance concerns required to be reported under these standards.

We appreciate the courtesy and cooperation extended to us by Investment Board staff during the audit.

Sincerely,

Janice Mueller
State Auditor

JM/DA/ss

Enclosure



STATE OF WISCONSIN

Legislative Audit Bureau

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Janice Mueller
State Auditor

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

We have audited the financial statements of the Retirement Investment Trust Funds managed by the State of Wisconsin Investment Board as of and for the year ended June 30, 2007, and the financial statements of the State Investment Fund and the Various Funds managed by the State of Wisconsin Investment Board as of and for the years ended June 30, 2007 and 2006, and have issued our reports thereon dated August 22, 2007, and November 21, 2007. The financial statements and related auditor's opinions are included in the State of Wisconsin Investment Board's annual report for 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Investment Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Investment Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Investment Board's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purposes described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined in the preceding paragraph.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Investment Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This independent auditor's report is intended for the information and use of the Investment Board's management and audit committee, and the Wisconsin Legislature. This report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Investment Board's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

November 21, 2007

by



Diann Allsen
Audit Director