Washington State Department of
Labor & Industries

Statutory Financial Information
Industrial Insurance Fund

For the Fiscal Year Ended June 30, 2007

December 2007

Report prepared by:

Department of Labor and Industries
Judy Schurke, Director

Insurance Services
Robert Malooly, Assistant Director

Actuarial Services
Bill Vasek, FCAS, Senior Actuary
Mark Mercier, ACAS, MAAA
Russell Frank, FCAS, MAAA
Joshua Ligosky, FCAS, MAAA

Administrative Services
Cynthia Harris, Assistant Director

Financial Services Program
Sharon Elias, Chief Accounting Officer
Christopher Carlile, CPA, CGFM,
Workers' Compensation Accounting Manager
Linda Tilson, Workers' Compensation Chief Accountant
Financial Services Program fiscal personnel

Additional assistance provided by:
Office of Financial Management
Washington State Investment Board

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Statutory Financial Information
For the Fiscal Year Ended June 30, 2007

Washington State Department of
Labor & Industries

Washington State
Department of Labor and Industries' Mission

We support the state's economic well-being by protecting the safety of Washington's workers, providing benefits to injured workers and ensuring fair wages and quality industry services.

Our Commitment

The Department of Labor and Industries (L&I) administers one of the best workers' compensation systems in the nation, one that's committed to meeting the needs and interests of injured workers and their employers. Our commitment:

- Work with employers and workers to prevent workplace injuries and illnesses.
- Provide prompt and certain relief to workers who suffer a work-related injury or illness.
- Administer the program and its finances in a way that is transparent and maximizes benefits and minimizes costs.
- Eliminate fraud and abuse by workers, employers, and health care providers.
- Listen to and respond to the needs of our customers.

Responsive Change

To fulfill this commitment, L&I will look for opportunities to improve the system and be open to new ideas and change. Our administration of the workers' compensation system will evolve as new proven technologies become available. We must closely monitor medical advancements, authorizing those that improve an injured worker's condition, and resisting those that provide little or no relief. We will manage claims effectively, encourage return-to-work options, and minimize the financial impact of a claim. No one benefits when a claim lasts longer than it should.

Finally, we will continue to partner with employers and workers to improve a vital and vigorous workers' compensation system.

December 2007

Message from the Director and Assistant Director, Insurance Services

December 2007

2007 highlighted by a 'rate holiday' and lower rates

In many ways, Fiscal Year (FY) 2007 was a banner year for Washington's workers' compensation system. Employers and workers benefited from lower rates and investment earnings laid the groundwork for a partial rate holiday in the first half of FY 2008.

Last December, we changed how we determine an employer's Experience Modification Factor (EMF) to ensure that employers and their workers are assessed the proper level of premiums. We listened to employers' concerns and delayed any increase associated with the change, giving employers with increased rates time to adjust. We also made decisions that ensure the workers' compensation system will maintain adequate reserves and stable rates.

Midway through the fiscal year, an independent auditor hired by the Washington State Auditor's Office gave the Department of Labor and Industries (L&I) a clean opinion of its rate-setting and reserving assumptions, and the new formula for calculating an employer's claims experience.

Controlling health-care costs

Health care inflation in our system is low at 5.9% compared with a 7.7% average annual increase for all workers' compensation insurers. L&I is managing costs in a number of ways.

We closely monitor prescription drug use and use financial incentives to encourage doctors to prescribe from the state's Preferred Drug List. Those two efforts alone saved the workers' compensation system over $8.5 million in FY 2007.

The safety of injured workers, including those whose injuries result in chronic pain, is a priority for L&I. This is why we are working with our treating physicians to ensure safe use of prescription narcotics.

L&I also saves money by offering financial incentives to doctors who use occupational health best practices. And while we pay for services that help an injured worker recover, we don't pay for unsafe treatments, or ineffective treatments that don't enhance a worker's chances for recovery and return to meaningful work.

In central and eastern Washington, L&I expanded its Center of Occupational Health and Education (COHE), which is training hundreds of doctors in occupational health best practices.

Together these efforts have reduced worker disability and saved the system millions of dollars in claim costs.

Anti-fraud program
In FY 2007, L&I recovered more than $139 million in unpaid premiums and overpayments to providers and workers (plus more than $4 million in avoided costs). This is up from $97.8 million in 2004. To help local prosecutors, we are funding an assistant attorney general who is dedicated to prosecuting fraud cases. L&I investigations resulted in 13 cases referred for criminal prosecution.

For a more complete look at fraud prevention accomplishments in 2007, go to L&I's website at www.Fraud.Lni.wa.gov.

Contributing to the state's business climate
Washington continued to offer high benefits (5th in the nation, according to the most recent study by the National Academy of Social Insurance) while maintaining base rates that were in the bottom third of all states. As a percentage of payroll, Washington's rates have dropped 25 percent since 1990. And with considerable help from the Washington State Investment Board, the workers' compensation system finished the fiscal year with nearly $750 million in realized investment income and gains. These earnings are used to lower the cost of workers' compensation insurance in Washington.

New customer-tested annual rate notice
L&I also overhauled the rate notice it sends to employers. Though it contains exactly the same information as before – plus more – we've tried to make it easier to read and understand, particularly for new businesses. A number of new and existing businesses helped test this document and told us what they wanted. Here are some examples of new features: It's easier to see if you have earned a claim-free discount. Instructions and ratemaking explanations are clearer. And, at your request, we created an extra

column so we could clearly show both your contribution and your workers' to the total premium you pay.

A partnership with Business and Labor

Considerable credit for our success goes to the vast majority of Washington employers and workers who focused on safety and avoided injuries, and to L&I's Division of Occupational Safety and Health, which provides workplace safety consultations to employers.

Our goal is to run one of the best workers' compensation systems in the nation. We are committed to working with our customers to achieve that goal and ensure mutual protection for workers and employers.

Sincerely,

Judy Schurke
Director

Robert Malooly
Assistant Director, Insurance Services

CPAs & BUSINESS ADVISORS

Judy Schurke, Director
The Washington Department of Labor and Industries
7273 Linderson Way SW
Tumwater, WA 98501

Independent Accountant's Report on Applying Agreed-Upon Procedures

We have performed the procedures enumerated below, which were agreed to by the Management of Washington Department of Labor and Industries (L&I), Industrial Insurance Fund, solely to assist you in connection with conducting a review and issuing a report on whether L&I's management discussion and analysis (MD&A) financial information, notes, and any other required supplementary information for the Industrial Insurance Fund are presented in substantial compliance with Statutory Accounting Principles (SAP) requirements as promulgated by the National Association of Insurance Commissioners (NAIC). This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA). The sufficiency of these procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures are as follows.

The SAP financial information is prepared by adjusting the generally accepted accounting principles (GAAP) financial statements. The adjustments are based on Statements of Statutory Accounting Principles (SSAP).

1. Review all adjustments to determine compliance with SSAP requirements.
2. Recommend additional adjustments, if any, that should be considered and/or recorded.
3. Determine if the presentation of the MD&A, combining financial statements, notes to financial information and supplemental schedules are in compliance with SAP reporting requirements as promulgated by the National Association of Insurance Commissioners (NAIC), and recommend changes to be made.
4. Express limited assurance in a report, including all recommendations referenced in the two previous bullets, that the SAP financial information requires no material modification to be in compliance with the SAP.

The associated findings are as follows:

1. L&I provided GAAP trial balances, adjustments from GAAP to SAP and adjusted SAP trial balances. Assurances were obtained by Eide that there were no material adjustments to the GAAP financial statements that had not already been made. Eide compared the adjustments to standards outlined in SSAP by obtaining specific detailed information from L&I, selecting samples of the detail and testing the accuracy of the SAP adjustment calculated for the sample items. Results of actuarial analyses from the independent actuaries were obtained by Eide from L&I, reviewed and compared to the assets and liabilities in the financial statements. Eide reviewed disclosures in the financial statements and compared them to SSAP guidelines and the financial information provided. Based on the procedures performed, we found no exceptions as a result of the procedures.
2. Eide does not recommend any additional adjustments or disclosures as a result of the procedures performed.

3. Eide reviewed the appropriate SSAP documentation and guidelines and did not note any material deviation therefrom in the MD&A, the combining financial statements or the notes to financial information. Therefore, we recommend no changes as a result of the reviews.

4. As a result of the procedures performed as defined by management, Eide did not note any additional required material modifications to the combining financial statements, disclosures to the notes to financial information or MD&A to be in compliance with SAP.

We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the materiality of the presentation of the financial statements and related disclosures on the basis of Statutory Accounting Principles. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. We also were not engaged to perform a review or compilation as defined by the AICPA standards and therefore do no present the financial s as either reviewed or compiled.

This report is intended solely for the information and use of the Director and Management of Washington Department of Labor and Industries, Industrial Insurance Fund, and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

Eide Bailly LLP
Fargo, North Dakota
December 13, 2007

Management's Discussion and Analysis

The state of Washington's Department of Labor and Industries administers the state Workers' Compensation Program, including the Industrial Insurance Fund.

This section of the Industrial Insurance Fund (also known as the State Fund) of the state of Washington Statutory Financial Information presents management's discussion and analysis of the financial performance of the Industrial Insurance Fund for the fiscal year that ended on June 30, 2007. This discussion should be read in conjunction with the accompanying statutory financial statements and notes. The statutory financial statements, notes, and this discussion are the responsibility of the Industrial Insurance Fund management.

Some history and things that make the Industrial Insurance Fund of the state of Washington unique:

The state of Washington's "Workmen's Compensation Act" established the industrial insurance system in 1911, covering only extremely hazardous work. In 1923, Washington became the only state where workers paid a significant portion of the insurance premiums. Washington remained an exclusive State Fund until 1971 when the system underwent a major overhaul. It was expanded to cover virtually all workers, and allowed large employers that met certain financial and safety criteria to self insure.

Washington State, through Title 51 of the Revised Code of Washington, requires all employers, unless exempted, to secure coverage for job-related injuries and illnesses either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Workplace Injuries:

During Fiscal Year 2007, Washington's workers' compensation system covered about 2.5 million workers employed by 168,000 employers. Over 140,000 claims were filed, though that figure is incomplete because workers have a year from the date of injury to file a claim. The vast majority of injured workers – 70 percent – were men, and nearly half of all injuries were to workers from 30 to 50 years of age. A total of 7,540,000 days were paid by the Industrial Insurance Fund for lost work. The most common injuries were to muscles, tendons, ligaments, and joints of back and legs, and to fingers and face. Fifty-four fatal pensions were awarded.

Using the Statutory Financial Statements:

The Combining Balance Sheet, Combining Statement of Income, and Combining Statement of Cash Flows have been prepared in conformity with the Statements of Statutory Accounting Principles (SSAP), as promulgated by the National Association of Insurance Commissioners, whereby the main purpose of SSAP-based information is to determine solvency. Solvency is defined as the availability of the Industrial Insurance Fund's assets to satisfy its obligations to injured workers and beneficiaries. The Notes to the Statutory Financial Statements provide additional information that is essential to a full understanding of the data provided in the Statutory Financial Statements.

The accompanying Statutory Financial Statements report the financial condition and results of operation for three out of the five Workers' Compensation Program funds including Accident, Medical Aid, and Pension Reserve Funds. These three funds represent the Workers' Compensation Program Basic Plan, also known as the Industrial Insurance Fund or State Fund.

Financial Highlights:

- The Industrial Insurance Fund total assets on June 30, 2007, were $11.57 billion, an increase of $920 million or 8.6% compared to June 30, 2006.
- The Industrial Insurance Fund total liabilities on June 30, 2007, were $9.48 billion, an increase of $536 million or 6.0% compared to June 30, 2006.
- The Industrial Insurance Fund revenues for Fiscal Year 2007 were $2.17 billion, an increase of $129 million or 6.3% compared with the prior fiscal year.
- The Industrial Insurance Fund program expenses for Fiscal Year 2007 were $2.04 billion, an increase of $364 million or 21.7% compared with the prior fiscal year.
- The Industrial Insurance Fund contingency reserve at June 30, 2007, was $2.09 billion, an increase of $384 million or 22.5% compared to June 30, 2006.

Financial Position:

Industrial Insurance Fund financial position at the end of the last two fiscal years is as follows:

Balance Sheet *(expressed in thousands)*	**June 30,2007**	**June 30, 2006**
Assets		
Fixed income securities	$ 8,266,702	$ 8,036,111
Treasury Inflation Protection Securities (TIPS)	510,267	-
Equities	2,057,449	1,906,029
Short-term investments	151,061	145,135
Trade receivables	4,371	42
Total Investments	10,989,850	10,087,317
Interest receivable	113,710	100,057
Cash (Treasury)	9,663	3,343
Premiums receivable	383,037	420,349
Other assets	75,948	40,926
Total Assets	$11,572,208	$10,651,992
Liabilities and Contingency Reserve		
Benefit (loss) liabilities	$ 8,794,375	$ 8,328,981
Claims administration (LAE) liabilities	414,332	399,578
Other liabilities	269,789	214,123
Total Liabilities	9,478,496	8,942,682
Contingency reserve	2,093,712	1,709,310
Total Liabilities and Contingency Reserve	$11,572,208	$10,651,992

The Industrial Insurance Fund had a strong year financially with a $384 million increase in contingency reserve, ending with a balance of $2.09 billion. This increase is mainly the result of better-than-expected investment earnings with unrealized investment gains of $272 million and realized investment gains of $219 million.

Total assets increased from Fiscal Year 2006 to Fiscal Year 2007 by $920 million. $491 million of this increase is from realized and unrealized investment gains.

Total benefit liabilities increased by $465 million during Fiscal Year 2007. This is a result of the Accident, Medical Aid, and Pension Reserve Fund benefit liabilities increasing by $41 million, $217 million, and $207 million, respectively. Non-pension benefit liabilities are discounted at 2.5 percent, while pension benefit liabilities are discounted at 6.5 percent.

The Claims Administration liability for the Industrial Insurance Fund increased by $15 million. This is in line with increases in Accident and Medical Aid Fund liabilities.

Results of Operations:

Industrial Insurance Fund operating results and certain key financial ratios are presented in the following table:

Statement of Income *(expressed in thousands)*	**FY 2007**	**FY 2006**
Net premiums earned	$1,294,870	$1,338,983
Net investment income earned and realized gains	749,065	574,383
Other reimbursements and income	126,546	128,229
Total Revenue Earned	**2,170,481**	**2,041,595**
Benefits (loss) incurred	1,770,168	1,413,139
Claims administration expenses (LAE) incurred	138,252	141,835
Premium administration expenses incurred	32,250	39,222
Other administration expenses	101,187	83,953
Total Expenses Incurred	**2,041,857**	**1,678,149**
Net Income	**$ 128,624**	**$ 363,446**
Loss ratio	136.7%	105.6%
Loss adjustment expense (LAE) ratio	16.2%	16.2%
Loss and LAE ratio	152.9%	121.8%
Underwriting expense ratio	4.8%	3.5%
Combined Ratio	**157.7%**	**125.3%**
Less: Net Investment Income ratio	40.9%	37.3%
Operating Ratio	**116.8%**	**88.0%**

Net premiums earned during Fiscal Year 2007 of $1.29 billion decreased by $44 million or 3.3 percent over Fiscal Year 2006. This decrease is mainly the result of higher retrospective rating adjustments earned during Fiscal Year 2007.

Net investment income increased from Fiscal Year 2006 to Fiscal Year 2007 by $30 million. This increase is the result of a higher fixed income asset balance. Net fixed income and equity investment realized gains increased by $145 million mainly due to the rebalancing of the equity portfolio when the equity percentage went above the upper limit in the equity allocation policy range. Finally investment unrealized gains, which includes equities and Treasury Inflation Protected Securities (TIPS) increased by $123 million due to favorable stock market conditions.

Benefits incurred during Fiscal Year 2007 totaled $1.77 billion, an increase of $357 million from Fiscal Year 2006 due to the 2006 results having considerable favorable reserve development.

The combined ratio of 157.7% expresses the total sum of costs, which includes benefits incurred, claims administration expenses incurred, and premium administration expenses, as a percentage of net premiums earned. The ratio is a recognized industry measure of underwriting performance. The Industrial Insurance Fund is expected to have a combined ratio above 100% because the rate setting process recognizes that significant investment income will be earned. The operating ratio of 116.8%, which is the combined ratio less the net investment income ratio, is another industry measure of overall financial performance. Ratios above 100% indicate that expenses are greater than premium and net investment income revenue. The operating ratio increased due to the tremendous financial performance in the previous year and reduction in premium rate levels. The LAE ratio and underwriting expense ratio both continue to remain far below industry levels.

Cash Flows and Liquidity

Cash Flows - The primary sources of cash were from premiums collected and investment income and gains. The primary uses of cash were for payments of benefits and administration expenses, and purchases of investments.

Cash flows of the Industrial Insurance Fund are summarized as follows:

Statement of Cash Flows *(expressed in thousands)*	**FY 2007**	**FY 2006**
Operations		
Net premiums collected	$1,335,337	$1,298,709
Other reimbursements and income	113,631	145,050
Benefits (loss) paid	(1,304,775)	(1,251,364)
Administration expenses paid	(249,159)	(226,613)
Cash provided by (used in) operations	(104,966)	(34,218)
Investment Activities		
Investment income	589,023	553,731
Net realized gains	219,079	74,573
Sales (purchases), net	(624,835)	(538,829)
Investment management expenses	(71,981)	(52,543)
Cash provided by (used in) investment activities	111,286	36,932
Change in Cash		
Net increase in cash	$ 6,320	$ 2,714

During Fiscal Year 2007, cash out-flow from operations increased $71 million compared to Fiscal Year 2006. This is the result of increases in benefit payments and administration expenses.

Cash provided from investment activities increased by $74 million in Fiscal Year 2007 over the prior period. Proceeds from investment income exceeded the cost of investments acquired and investment management expenses by $111 million. Investment income from bonds and equities was $589 million. Realized gains for fixed income securities were high due to the rebalancing of the equity portfolio which occurred when the equity percentage went above the upper limit in the equity allocation policy range.

Liquidity - The Industrial Insurance Fund's operations require liquidity sufficient to meet both short-term and long-term requirements. Short-term liquidity requirements come from four basic elements. First, the department may reduce rates in order to reduce its contingency reserve resulting in negative cash flow. Second, workers' compensation claims are subject to some variation. Third, premiums are paid to the department once every three months. Finally, retrospective premium returns require an increased degree of liquidity.

The Industrial Insurance Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. The Industrial Insurance Fund has the financial capacity to hold its fixed income portfolio to maturity and to match projected cash inflows from premiums and investment income from this portfolio with projected cash outflows for payment of benefits.

Future Plan:

The Industrial Insurance Fund's current contingency reserve amount is over $2 billion. In order to reduce the contingency reserve, the agency has implemented a rate holiday and will be issuing dividends to policyholders (employers).

Rate Holiday - The Department of Labor and Industries has temporarily suspended the hourly rate employers and workers pay into the Medical Aid Fund for work performed from July 1 to December 31, 2007. The Medical Aid Fund pays for health care benefits for work-related injuries. The total estimated reduction of premiums collected for Fiscal Year 2008 is $315 million.

Dividend – The Department of Labor and Industries strives to make sure that no individual or group pays more than it should for workers' compensation insurance. Because of the way the rate holiday was structured, non-retro employers will pay for a slightly larger percentage of their expected claim benefits. The dividend will balance out what retro and non-retro employers pay for their insurance. Dividends will be based on the Accident Fund premiums non-retro employers paid in the second half of 2007. Dividends will be issued during Fiscal Year 2009 for a total estimated amount of $30 million.

Requests for Information:

This report is designed to provide a general overview of the Industrial Insurance Fund and to illustrate the Fund’s financial condition to interested parties. If you have questions about this report or need additional financial information, please contact the Chief Accounting Officer at the Department of Labor and Industries, P.O. Box 44833, Olympia, Washington 98504-4833.

Statutory Financial Statements

State of Washington Industrial Insurance Fund
Combining Balance Sheet - Statutory Basis
As of June 30, 2007, and 2006
(amounts rounded to the nearest $1,000)

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total June 30, 2007	Total June 30, 2006
Assets					
Cash and Investments					
Investments, net (note 1):					
Fixed income @ amortized cost	$ 3,366,774,000	$ 2,720,361,000	$ 2,179,567,000	$ 8,266,702,000	$ 8,036,111,000
Treasury Inflation Protection Securities @ par	229,099,000	145,791,000	135,377,000	510,267,000	-
Equities @ fair value	455,154,000	1,314,768,000	287,527,000	2,057,449,000	1,906,029,000
Short term @ fair value	38,712,000	57,855,000	54,494,000	151,061,000	145,135,000
Trade receivables, net	11,000	3,915,000	445,000	4,371,000	42,000
Total investments	4,089,750,000	4,242,690,000	2,657,410,000	10,989,850,000	10,087,317,000
Interest receivable	48,170,000	33,917,000	31,623,000	113,710,000	100,057,000
Cash	6,595,000	1,971,000	1,097,000	9,663,000	3,343,000
Total Cash and Investments	4,144,515,000	4,278,578,000	2,690,130,000	11,113,223,000	10,190,717,000
Other Assets					
Premiums receivable, net	234,524,000	148,513,000	-	383,037,000	420,349,000
Land, buildings, and improvements, net (note 2)	6,843,000	6,842,000	-	13,685,000	10,946,000
Self Insurance receivables, net	3,154,000	3,037,000	2,332,000	8,523,000	7,114,000
Miscellaneous	51,699,000	1,161,000	880,000	53,740,000	22,866,000
Total Other Assets	296,220,000	159,553,000	3,212,000	458,985,000	461,275,000
Total Assets	$ 4,440,735,000	$ 4,438,131,000	$ 2,693,342,000	$ 11,572,208,000	$ 10,651,992,000
Liabilities and Contingency Reserve					
Liabilities					
Benefits (note 3)	$ 3,254,334,000	$ 2,911,256,000	$ 2,628,785,000	$ 8,794,375,000	$ 8,328,981,000
Other Liabilities					
Claims administration	164,617,000	249,715,000	-	414,332,000	399,578,000
Retrospective rating adjustments	159,748,000	-	-	159,748,000	156,593,000
Accrued liabilities	19,941,000	23,507,000	64,557,000	108,005,000	56,041,000
Deferred revenue	1,091,000	945,000	-	2,036,000	1,489,000
Total Other Liabilities	345,397,000	274,167,000	64,557,000	684,121,000	613,701,000
Total Liabilities	3,599,731,000	3,185,423,000	2,693,342,000	9,478,496,000	8,942,682,000
Contingency Reserve (note 4)	841,004,000	1,252,708,000	-	2,093,712,000	1,709,310,000
Total Liabilities and Contingency Reserve	$ 4,440,735,000	$ 4,438,131,000	$ 2,693,342,000	$ 11,572,208,000	$ 10,651,992,000

The Notes to the Statutory Financial Statements are an integral part of this statement.
The source of this financial information is the Washington State Agency Financial Reporting System (AFRS) with adjustments for insurance reporting.

State of Washington Industrial Insurance Fund
Combining Statement of Income - Statutory Basis
For the Fiscal Years Ended June 30, 2007, and 2006
(amounts rounded to the nearest $1,000)

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total June 30, 2007	Total June 30, 2006
Revenues					
Net standard premiums earned	$ 910,382,000	$ 579,506,000	$ -	$ 1,489,888,000	$ 1,501,272,000
Less retrospective rating adjustments	(195,018,000)	-	-	(195,018,000)	(162,289,000)
Net premiums earned	715,364,000	579,506,000	-	1,294,870,000	1,338,983,000
Net investment income earned	221,507,000	171,858,000	136,622,000	529,987,000	499,810,000
Net fixed income investment realized gains (losses)	82,025,000	3,163,000	25,554,000	110,742,000	28,530,000
Net equity investment realized gains	8,277,000	94,829,000	5,230,000	108,336,000	46,043,000
Self-insured administration expense reimbursements	12,662,000	12,797,000	-	25,459,000	18,055,000
2nd injury pension reserve reimbursement	-	-	38,025,000	38,025,000	62,123,000
Self-insured pension reimbursements	-	-	4,607,000	4,607,000	17,018,000
Fines, penalties, and interest	47,825,000	2,116,000	319,000	50,260,000	15,505,000
Other income	6,508,000	1,633,000	54,000	8,195,000	15,528,000
Total Revenues Earned	1,094,168,000	865,902,000	210,411,000	2,170,481,000	2,041,595,000
Expenses					
Net benefits incurred	597,960,000	750,117,000	422,091,000	1,770,168,000	1,413,139,000
Claims administration expenses incurred	56,200,000	82,052,000	-	138,252,000	141,835,000
Premium administration expenses incurred	24,098,000	8,152,000	-	32,250,000	39,222,000
General insurance administration expenses incurred	9,949,000	6,510,000	-	16,459,000	14,922,000
Self-insured administration expenses incurred	11,049,000	11,952,000	-	23,001,000	21,210,000
Other administration expenses incurred	40,336,000	20,955,000	436,000	61,727,000	47,821,000
Total Expenses Incurred	739,592,000	879,738,000	422,527,000	2,041,857,000	1,678,149,000
Net Income Before Transfers	354,576,000	(13,836,000)	(212,116,000)	128,624,000	363,446,000
Contributions and Transfers In (Out)					
Pension funding transfer	(211,712,000)	-	211,712,000	-	-
Catastrophe injury account transfer	(782,000)	-	782,000	-	-
Pension funding actuarial adjustment	50,665,000	-	(50,665,000)	-	-
Net Contributions and Transfers	(161,829,000)	-	161,829,000	-	-
Net Income (Loss)	192,747,000	(13,836,000)	(50,287,000)	128,624,000	363,446,000
Other Changes In Contingency Reserve					
Equities unrealized gains	63,482,000	148,547,000	40,100,000	252,129,000	149,153,000
Treasury Inflation Protection Securities unrealized gains	9,099,000	5,791,000	5,377,000	20,267,000	-
Change in nonadmitted assets	(8,523,000)	(10,350,000)	2,255,000	(16,618,000)	3,845,000
Change in contingency reserve, net	256,805,000	130,152,000	(2,555,000)	384,402,000	516,444,000
Beginning contingency reserve, July 1	584,199,000	1,122,556,000	2,555,000	1,709,310,000	1,192,866,000
Ending contingency reserve, June 30	$ 841,004,000	$ 1,252,708,000	$ -	$ 2,093,712,000	$ 1,709,310,000

The Notes to the Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System (AFRS) with adjustments for insurance reporting.

State of Washington Industrial Insurance Fund
Combining Statement of Cash Flows - Statutory Basis
For the Fiscal Years Ended June 30, 2007, and 2006
(amounts rounded to the nearest $1,000)

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total June 30, 2007	Total June 30, 2006
Standard premiums collected	$ 939,456,000	$ 587,744,000	$ -	$ 1,527,200,000	$ 1,450,166,000
Less retrospective rating adjustments	(191,863,000)	-	-	(191,863,000)	(151,457,000)
Net premiums collected	747,593,000	587,744,000	-	1,335,337,000	1,298,709,000
Self-insured expense reimbursements	12,381,000	11,677,000	-	24,058,000	17,074,000
Self-insured pension reimbursements	-	-	12,890,000	12,890,000	17,605,000
Fines, penalties, and interest	22,186,000	4,211,000	-	26,397,000	50,699,000
Other income (expense)	11,585,000	(1,372,000)	(9,068,000)	1,145,000	(3,052,000)
Fund transfers in (out)	(243,168,000)	-	292,309,000	49,141,000	62,724,000
Cash Flow In	550,577,000	602,260,000	296,131,000	1,448,968,000	1,443,759,000
Benefits paid	525,688,000	532,831,000	246,256,000	1,304,775,000	1,251,364,000
Claims administration expenses	52,485,000	71,013,000	-	123,498,000	114,105,000
Premium administration expenses	12,574,000	12,825,000	-	25,399,000	22,734,000
General insurance administration expenses	9,847,000	6,419,000	-	16,266,000	14,193,000
Self-Insured administration expenses	10,825,000	11,682,000	-	22,507,000	20,169,000
Other administration expenses	40,375,000	21,114,000	-	61,489,000	55,412,000
Total administration expenses paid	126,106,000	123,053,000	-	249,159,000	226,613,000
Cash Flow Out	651,794,000	655,884,000	246,256,000	1,553,934,000	1,477,977,000
Operating Cash Flow	(101,217,000)	(53,624,000)	49,875,000	(104,966,000)	(34,218,000)
Investment income - bonds	250,579,000	160,324,000	146,437,000	557,340,000	524,388,000
Investment income - equities	6,503,000	21,071,000	4,109,000	31,683,000	29,343,000
Realized gains (losses)	90,303,000	97,993,000	30,783,000	219,079,000	74,573,000
(Purchases) Sales	(202,360,000)	(209,255,000)	(213,220,000)	(624,835,000)	(538,829,000)
Expenses - fund managers & WSIB	(40,061,000)	(14,295,000)	(17,625,000)	(71,981,000)	(52,543,000)
Net Cash Flow	3,747,000	2,214,000	359,000	6,320,000	2,714,000
Beginning cash, July 1	2,848,000	(243,000)	738,000	3,343,000	629,000
Ending cash, June 30	$ 6,595,000	$ 1,971,000	$ 1,097,000	$ 9,663,000	$ 3,343,000

The Notes to the Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System (AFRS) with adjustments for insurance reporting.

Notes to the Statutory Financial Statements

For the Fiscal Year ended June 30, 2007

Index to the Notes to the Combining Financial Statements

Note 1 - Summary of Significant Accounting Policies

1.A. Nature of Operations

The state of Washington's Department of Labor and Industries (L&I) administers the state Workers' Compensation Program. The agency is the exclusive writer of workers' compensation in the state of Washington for all businesses except the self-insured.

Washington's "Workers' Compensation Act" established the industrial insurance system in 1911. Initially it only covered workers in hazardous jobs. In 1923, Washington became the only state where workers paid a significant portion of the insurance premiums. Washington remained an exclusive state industrial insurance provider, also known as the State Fund, until 1971 when the system underwent a major overhaul. It was expanded to cover almost all workers, and allowed large employers that met certain financial and safety criteria to self insure.

In Fiscal Year 2007, 168,000 employers were insured and an estimated 2.5 million workers were covered by the Workers' Compensation Program. Employers have reported 3,287 million hours worked.

1.B. Basis of Presentation

The accompanying statutory financial statements are based on Statements of Statutory Accounting Principles (SSAP) as promulgated by the National Association of Insurance Commissioners. These standards are required to be used by property and casualty insurance enterprises in the United States when reporting its financial condition to state insurance regulators. The SSAP are very conservative in nature and are designed to protect injured workers and policyholders to ensure that, in the event of liquidation, sufficient amounts have been set aside to provide for outstanding claims of injured workers. This accounting basis is used to present insurance solvency and the adequacy of premium rates.

L&I prepares a Comprehensive Annual Financial Report (CAFR) from data recorded in the Washington State Agency Financial Reporting System. The CAFR is prepared in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Governmental Accounting Standards Board. Peterson Sullivan, PLLC audited the Fiscal Year 2007 CAFR for the period ended June 30, 2007, and issued an unqualified (clean) opinion. The audited GAAP financial report and underlying data serve as the source for the accompanying SSAP-based Statutory Financial Statements for the Industrial Insurance Fund.

The principal SSAP followed by the Industrial Insurance Fund varies in some respects from GAAP. Some of the most significant differences between the SSAP and GAAP are as follows:

- SSAP investment securities are principally carried at amortized cost, whereas GAAP carries such securities at the estimated fair value with changes in fair value reflected in net income.
- SSAP assets designated as "nonadmitted assets" are excluded from total assets. These assets consist primarily of premiums in collections that have been outstanding for over 90 days, office furniture and equipment, and prepaid expenses - the changes of which are credited or charged directly to the contingency reserve (or surplus). Under GAAP, these assets are included in total assets.
- According to SSAP, computer equipment purchases are expensed. Under GAAP, computer equipment purchases meeting the state's capitalization criteria are recorded as assets less accumulated depreciation.
- The Statutory Balance Sheet presents assets available to cover benefit liabilities. Under GAAP, assets and liabilities are presented in order of liquidity and classified as current and noncurrent.
- The Statutory Statement of Income presents premiums earned and investment income as the primary revenue sources, and expenses are presented as activities. GAAP presentations separate operating income from investment income since investment activity is not normally a primary revenue source. GAAP also presents expenses by object rather than by activity, and the net effect of revenues and expenses as a change in fund equity.
- The Statutory Statement of Cash Flows differs in certain aspects from the presentation required by GAAP. On the SSAP Statement of Cash Flows, *Cash Flows In* includes operating transfers and other income. *Cash Flows Out* is categorized by losses and administration expenses.
- The aggregate effects of the foregoing differences between GAAP and SSAP have not been determined on the accompanying Statutory Financial Statements.

1.C. Description of the Industrial Insurance Fund

Washington State, through Title 51 of the Revised Code of Washington (RCW), requires all employers, unless exempted, to secure coverage for job-related injuries and illnesses either by paying insurance premiums to the Industrial Insurance Fund or by self insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

The statute provides five benefit funds to make compensation payments to injured workers or to medical providers for rehabilitation services to injured workers. The Accident, Medical Aid, and Pension Reserve Funds are required to be self-sustaining by insurance premiums. The accompanying Statutory Financial Information statements report on the financial condition and results of operations of these three funds known collectively as the Industrial Insurance Fund.

The Accident Fund pays compensation directly to injured workers for lost wages during temporary disability and for permanent partial disability awards. The Accident Fund also pays to the Pension Reserve Fund the present value of pensions awarded to survivors of fatally injured workers and to workers adjudged to be permanently and totally disabled. Accident Fund claim liabilities are discounted for Fiscal Year 2007 to the present value assuming a 2.5 percent annual interest rate.

Revenues for this fund are provided by employer paid premiums and are calculated on the basis of hours worked. However, employers may elect to have their premiums retrospectively rated with an adjustment for actual losses incurred. This may result in either a rebate of premiums paid or an assessment of additional premiums due. All retrospective premium adjustments are financed entirely through the Accident Fund. The adjustment calculation considers both the Accident and Medical Aid Funds' experience and premiums together; however, no retrospective premium adjustments are made through the Medical Aid Fund.

The Medical Aid Fund pays for the cost of medical and vocational rehabilitation services to injured workers. Revenues for this fund are usually provided by equal contributions from employers and employees. Employers are required to withhold half of the medical aid premium from their employees' wages. Medical Aid Fund liabilities are discounted to the present value assuming a 2.5 percent annual interest rate.

The Pension Reserve Fund pays benefits to all permanently disabled pensioners including disabled employees of self-insured employers. These liabilities are discounted to the present value assuming a 6.5 percent annual interest rate. Revenues to fund pension payments are provided with transfers from the Accident Fund and reimbursement payments from self-insured employers that are invested in securities selected to cover payments for the expected life of the injured worker or survivor.

The above three funds are maintained on an actuarially solvent basis, except that a cash-flow basis is authorized for the components of the Pension Reserve Fund when self-insured employers guarantee related benefits with a surety bond.

The Supplemental Pension Fund and the Second Injury Fund are a part of the Workers' Compensation Program; however income, expenses, assets, or future claim liabilities related to these two funds are not part of the Industrial Insurance Fund and are not included in this report.

1.D. Use of Estimates in Preparation of Financial Information

The preparation of financial information in conformity with SSAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingency assets and liabilities at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Future premium income is not offset against claims liabilities because the claims liabilities come from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay claims expenses and claims administration liabilities is not contingent upon any future premiums for future coverage periods. Although management records its best estimate of its liability for claims and settlement expenses, actual results could differ materially from those estimates.

Management's estimates are based on subjective as well as objective factors and, as a result, judgment is required to estimate amounts, particularly loss and loss adjustment expense liabilities, at the date of the financial information. Management's judgment is based on its knowledge and experience about past and current events and circumstances and its assumptions about conditions it expects to exist in the future. Factors relevant to the estimation of loss and loss adjustment expense liabilities include the estimation of the ultimate frequency and severity of losses, the level of inflation to future medical costs over long periods of time, the future legal environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed after the fiscal year end by a nationally recognized qualified consulting actuarial firm. The statement of the independent actuarial firm's opinion is included in the Supplementary Information section of this report.

Note 2 - Investments

2.A. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship over the Industrial Insurance Fund's investments is vested in the Washington State Investment Board (WSIB). The Legislature established a standard of care for investment of these funds in RCW 43.33A.140. The WSIB must also comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes investment decisions and seeks to meet its investment objectives.

In accordance with state laws, Industrial Insurance Fund investments are to be managed to limit fluctuations in industrial insurance premiums and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the order of the objectives is to:

- Maintain solvency of the funds.
- Maintain premium rate stability.
- Ensure sufficient assets are available to fund the expected liability payments.
- Subject to those above, achieve a maximum return at a prudent level of risk.

Eligible Investments – Eligible investments include:

- U.S. Equities.
- International Equities.
- U.S. Treasuries and Government Agencies.
- Credit Bonds.
- Mortgage-Backed Securities rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's Investor's Service (Moody's).
- Asset-Backed Securities rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's.
- Commercial Mortgage-Backed Securities rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's.
- Investment Grade Non-U.S. Dollar Bonds.

Investment Restrictions - To meet stated objectives, investments of the Industrial Insurance Fund are subject to the following constraints:

- Asset allocation between equity and fixed income investments must fall within prescribed limits as shown below and are to be reviewed every three to four years, sooner if there are significant changes in funding levels or liability durations.

Fund	Fixed Income Target	Equity Target	Equity Range
Accident	90%	10%	8% - 12%
Medical Aid	70%	30%	24% - 36%
Pension Reserve	90%	10%	8% - 12%

- No corporate fixed income issue cost shall exceed 3 percent of the fund's market value at the time of purchase, nor shall its market value exceed 6 percent of the investment's market value at any time.
- The equity investments are allocated 85% to U.S. and 15% to international equities. The benchmark and structure for U.S. equities is the broad U.S. stock market as defined by the Dow Jones-Wilshire 5000. The benchmark and structure for international equities is the Morgan Stanley Capital Indexes Europe, Australia, Far East (MSCI EAFE) index. Both portfolios are passively managed 100 percent in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.

- The fixed income portfolios' structure varies depending upon the required duration target. The duration targets are reviewed every three years, or sooner, if there are significant changes in the funding levels or the liability durations. The target durations and ranges per fund are:

Fund	Target Duration	Duration Range
Accident	9 Years	7.2 to 10.8
Medical Aid	6 Years	4.8 to 7.2
Pension Reserve	9 Years	7.2 to 10.8

- Sector allocation of fixed income investments must be managed within the prescribed ranges. These targets are long term in nature. Deviations may occur in the short term as a result of interim market conditions. However, if a range is exceeded, the portfolios must be rebalanced as soon as it is practical to the target allocations. Total holdings of below investment grade credit bonds (rated BB+ or below by Standard & Poor's or rated Ba1 or below by Moody's) should not exceed five percent of total fixed income holdings.

  The target allocations for fixed income sectors are as follows:

U.S. Treasuries and Government Agencies	5 – 25%
Credit Bonds	20 – 70%
Asset-Backed Securities	0 – 10%
Commercial Mortgage-Backed Securities	0 – 10%
Mortgage-Backed Securities	0 – 25%

2.B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Industrial Insurance Fund's fixed income investments are actively managed to not be significantly different in the long run from the return of a hypothetical basket of indices that are similar in duration, and asset mix for each fund according to the investment guidelines. As of June 30, 2007, the durations of the various fixed income classes were within the duration targets of the investment guidelines.

The Industrial Insurance Fund's investments include U.S. Treasuries, government agencies, corporate debt, and mortgage-backed securities. The latter resets periodically to the market interest rate. The bond durations are laddered, and bond durations targets are long and are close to the liability durations, both of which help reduce interest rate risk to the contingency reserve.

The following schedule presents the Industrial Insurance Fund's investments by type and provides information about the interest rate risks associated with the investments as of June 30, 2007. The schedule displays various asset classes held by maturity in years and credit ratings. Variable-rate securities are presented according to the length of time until the next reset date rather than the stated maturity.

(expressed in thousands)

		Maturity				
Investment Type	**Fair Value**	Less than 1 year	1-5 years	6-10 years	More than 10 years	**Credit Rating**
Mortgages:						
Collateralized Mortgage Obligations	$ 1,720,253	$ -	$ 158,435	$ 280,229	$ 1,281,589	Aaa
Pass Throughs	2,045	135	1,621	289	-	Aaa
Non-Standard Mortgages	11,091	-	9,381	-	1,710	Multiple
Commercial Mortgage Backed Securities	640,287	13,958	230,567	395,762	-	Multiple
Corporate Bonds - Domestic	4,732,794	202,091	882,666	1,388,602	2,259,435	Multiple
Government Securities-Domestic:						
US Government Treasuries	948,232	16,974	259,815	-	671,443	Aaa
US Government Agencies	209,807	-	-	-	209,807	Aaa
Treasury Inflation Protected Securities	472,661	-	-	227,350	245,311	Aaa
	8,737,170	$ 233,158	$ 1,542,485	$ 2,292,232	$ 4,669,295	
Commingled Index Funds-Domestic	1,740,566					
Commingled Index Funds-Foreign	316,883					
Money Market Funds	188,793					
Total	$ 10,983,412					

Investments with multiple credit ratings are presented using the Moody's rating scale as follows:

(expressed in thousands)

	Investment Type			
Moody's Equivalent Credit Rating	Corporate Bonds - Domestic	Non-Standard Mortgages	Commercial Mortgage Backed Securities	**Total**
Aaa	$ 494,086	$ 11,062	$ 582,341	$ 1,087,489
Aa1	83,022	-	57,946	140,968
Aa2	193,679	29	-	193,708
Aa3	718,821	-	-	718,821
A1	553,968	-	-	553,968
A2	494,673	-	-	494,673
A3	614,322	-	-	614,322
Baa1	407,075	-	-	407,075
Baa2	821,683	-	-	821,683
Baa3	351,465	-	-	351,465
Total	$ 4,732,794	$ 11,091	$ 640,287	$ 5,384,172

(NOTE: The preceding two investment schedules were prepared by the WSIB on a GAAP basis for the Workers' Compensation Program as a whole and include the Supplemental Pension Fund which is not part of the Industrial Insurance Fund. Investments of the Supplemental Pension Fund account for only 0.8% of the Workers' Compensation Program total investments. These investment schedules are not available for the Industrial Insurance Fund prepared on a SSAP basis.)

2.C. Credit Risk

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The WSIB investment policy mitigates credit risk by limiting holdings of below investment grade fixed income securities. The rated debt investments of the Industrial Insurance Fund as of June 30, 2007, were rated by Moody's and/or an equivalent national rating organization.

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The WSIB policy states that the cost of no corporate fixed income issue shall exceed 3 percent of the fund's market value at the time of purchase, nor shall its market value exceed 6 percent of the fund's market value at any time. There was no concentration of credit risk as of June 30, 2007.

Custodial Credit Risk – Custodial credit risk is the risk that, in the event of failure of the custodian, the WSIB would not be able to recover its investment securities or collateral securities that are in the possession of the custodian. The WSIB has no formal policy regarding custodial credit risk. However, as all of the Industrial Insurance Fund assets are registered and held in the state of Washington's name, they are not subject to custodial credit risk.

2.D. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The WSIB does not have a formal policy to limit foreign currency risk. The Industrial Insurance Fund had $316.9 million invested in an international commingled equity index fund. As such, no currency denomination is presented.

2.E. Accounting for Investments in Accordance with SSAP Requirements

- Short-term investments and investments in money market funds are carried at cost, which approximates market. Bonds are principally carried at amortized cost.
- Realized gains and losses on sales or maturity of investments are determined on the basis of specific identification and are included in net income.

- Declines in fair value of investments that are deemed to be other than temporary are included in investment income as a realized loss. Subsequent recoveries in value are reflected as increases in unrealized gains and included as a component of contingency reserve.
- All equity holdings are in the form of index funds. Securities are divided with 85 percent held in US Equity Market Fund B and 15 percent held in MSCI EAFE Index SL CTF for International equities as of the fiscal year that ended on June 30, 2007. Equities are carried and reported at fair or market value.
- Fixed income securities are reported at amortized cost which adjusts for any premiums or discounts with the respective interest payment or when traded. Unrealized gains or losses on these securities are not recognized until matured or traded. Generally, these securities are purchased to provide income and are held until maturity. Carrying the value at amortized cost avoids wide swings in value because of changing interest rates.

Note 3 –Cash

Cash consists of cash in banks, cash on deposit with the State Treasurer, and cash on hand. L&I has a cash management agreement with the Washington State Treasurer's Office, the WSIB, and the Office of Financial Management. Cash balances at the end of each day are invested.

Note 4 – Premiums Receivable, Net

All employers in Washington State are subject to Title 51 of the Revised Code of Washington and are required to provide workers' compensation insurance by paying premiums to the Industrial Insurance Fund, or by electing and qualifying to be self insured. Premiums are normally calculated using each employer's reported payroll hours and insurance rates based on the employer's risk classification(s) and past employee injury experience.

In addition to its regular premium plans, the Industrial Insurance Fund offers a retrospective premium rating plan under which an employer's premiums are adjusted annually for up to three years following the plan year based on the employer's loss experience. The first of the three annual adjustments to the original premiums is paid or collected from the associations and employers approximately 10 months after the end of each plan year they are enrolled.

Employers' workers' compensation insurance premiums are due within 30 days following each calendar quarter in which payroll hours are reported. A premium receivable is established for each employer not fully paying or not reporting its payroll hours as of the due date set each quarter. Additionally, an allowance for uncollectible premiums is established based on an evaluation of outstanding premium receivables. Further, for reporting in accordance with SSAP, all premium receivables exceeding 90 days in age are adjusted as nonadmitted assets in the current period.

However, collection efforts are continued until the premiums are collected or all legal means are exhausted.

Note 5 - Land, Buildings, and Improvements, Net

Purchased or constructed assets with a value of $5,000 or greater are capitalized and depreciated over the estimated useful lives of the assets in accordance with the state of Washington's State Administrative and Accounting Manual. However, for insurance reporting, not all capitalized assets are admitted for reporting purposes. These nonadmitted assets are adjusted from the respective fund's contingency reserve and current purchases are immediately expensed. For Fiscal Year 2007, the Accident and Medical Aid Funds admitted only the investment in land, buildings, and improvements other than buildings, net of accumulated depreciation.

Additionally, per SSAP No. 40 (4) & (6), buildings are reported net of encumbrances, which, for the Industrial Insurance Fund, are the general obligation bonds issued for the construction of the building housing most of the Industrial Insurance Fund's employees.

Reconciliation of GAAP Capital Assets to SSAP Financial Information Admitted Capital Assets
(amounts in thousands)

Capital Asset	**Accident Fund**			
	GAAP Book Value	Nonadmitted	Encumbrance	SSAP Admitted
Land	$ 1,602	$ -	$ -	$ 1,602
Art	18	(18)	-	-
Building, net	21,418	-	(16,540)	4,878
Improvements other than buildings, net	363	-	-	363
Leasehold improvements, net	132	(132)	-	-
Equipment and software, net	13,715	(13,715)	-	-
Library resources, net	5	(5)	-	-
Subtotal	37,253	(13,870)	(16,540)	6,843
	Medical Aid Fund			
	GAAP Book Value	Nonadmitted	Encumbrance	SSAP Admitted
Land	1,602	-	-	1,602
Art	18	(18)	-	-
Building, net	21,419	-	(16,540)	4,879
Improvements other than buildings, net	361	-	-	361
Leasehold improvements, net	132	(132)	-	-
Equipment and software, net	12,203	(12,203)	-	-
Library resources, net	5	(5)	-	-
Subtotal	35,740	(12,358)	(16,540)	6,842
Total Capital Assets	$ 72,993	$ (26,228)	$ (33,080)	$ 13,685

Note 6 – Operating Leases

The Industrial Insurance Fund leases land, office facilities, office and computer equipment, and other assets under a variety of operating lease agreements. Although lease terms vary, most leases are subject to appropriation from the state Legislature to continue the obligation. If the possibility of not receiving funding from the Legislature is remote, leases are considered noncancelable for financial reporting purposes. Certain operating leases are renewable for specified periods. In most cases, management expects that the leases will be renewed or replaced by other leases.

The following schedule presents future minimum payments for operating leases as of June 30, 2007:

Operating Leases (by Fiscal Year)	Accident Fund	Medical Aid Fund	Total
2008	$ 2,422,010	$ 2,404,286	$ 4,826,296
2009	2,026,218	2,015,922	4,042,140
2010	2,067,426	2,052,794	4,120,220
2011	1,636,842	1,632,209	3,269,051
2012	785,856	785,856	1,571,712
2013-2017	96,087	96,088	192,175
Total Future Minimum Lease Payments	$ 9,034,439	$ 8,987,155	$ 18,021,594

The total operating lease rental expenses for Fiscal Year 2007 was $8,322,262.

Note 7 – Estimated Future Benefits

Liabilities for unpaid benefits and claims administration expenses in the Accident and Medical Aid Funds are provided based primarily on the development patterns of paid-to-date losses for older accident periods. For more recent accident periods, selections of several common actuarial techniques are used. These estimates are continually under review, and as changes to these liabilities become necessary, such adjustments are reflected in current income.

For insurance reporting purposes under SSAP requirements, these estimates are calculated and presented net of all recoveries. Reporting under GAAP requirements, these estimates are presented at the discounted present value without an adjustment for recoveries. Recoveries include overpayments and successful subrogation against third parties. Recoveries may be in the form of cash or a deduction against continuing benefits.

The benefit liability in the Pension Reserve Fund is determined from individual claims transferred to this fund using actuarial pension annuity tables. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.

Claims Liability Development by Program
(expressed in thousands)

Program/ Category	Undiscounted Liabilities	Discount Rate	SSAP Liabilities	Overpayment Adjustments	GAAP Liabilities
Accident	$ 5,515,464	2.5%	$3,254,334	$18,893	$3,273,227
Medical Aid	4,382,758	2.5%	2,911,256	1,924	2,913,180
Pensions	5,313,482	6.5%	2,628,785	3,242	2,632,027
Subtotal Benefit Liability	15,211,704		8,794,375	24,059	8,818,434
Claims Admin. Expense (CAE)	476,499	2.5%	414,332	-	414,332
Total Benefits and CAE Liabilities	$15,688,203		$9,208,707	$24,059	$9,232,766

Note 8 - Claims

The following schedule, expressed in thousands, presents the changes in claims liabilities for the past two fiscal years for the workers' compensation basic benefit plan (representing the Accident Fund, Medical Aid Fund, and Pension Reserve Fund):

	Basic Plan	
	FY 2007	FY 2006
Unpaid claims and claim adjustment expenses at beginning of fiscal year	$ 8,728,559	$ 8,538,938
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year	1,643,249	1,823,328
Decrease in provision for insured events of prior years	265,167	(268,238)
Total incurred claims and claim adjustment expenses	1,908,416	1,555,090
Payments:		
Claims and claim adjustment expenses attributable:		
To events of the current year	294,879	277,626
To insured events of prior years	1,133,389	1,087,843
Total payments	1,428,268	1,365,469
Total unpaid claims and claim adjustment expenses at fiscal year end	$ 9,208,707	$ 8,728,559
Current portion	$ 1,415,608	
Long-term portion	$ 7,793,099	

A description of the risks to which the Industrial Insurance Fund is exposed and the ways risks are handled is presented in Note 7. At June 30, 2007, $15.7 billion of unpaid claims and claim adjustment expenses are presented at their net present and settlement value of $9.2 billion. These claims are discounted at assumed interest rates of 2.5 percent (Accident Fund and Medical Aid Fund) and 6.5 percent (Pension Reserve Fund) to arrive at a settlement value that is net of third party recoveries. Nonincremental claims adjustment expenses for the Workers' Compensation Program have been included as a part of claims payable.

Note 9 – Reinsurance

Management maintains an agreement with a reinsurance broker to purchase reinsurance at reasonable rates. Current rates exceed what are considered reasonable rates. Therefore, the Industrial Insurance Fund does not carry any catastrophic reinsurance coverage for its workers' compensation program. However, management remains in contact with the broker and will purchase reinsurance coverage when it becomes available at reasonable rates.

Note 10 – State Fund Employee Compensated Absences and Retirement Plan

10.A. Employee Compensated Absences

State employees accrue vested annual leave at a variable rate based on years of service. In general, accrued annual leave cannot exceed 30 days at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested, i.e., the state does not pay employees for unused sick leave upon termination except upon employee death or retirement. At death or retirement, the Industrial Insurance Fund is liable for 25 percent of the employee's accumulated sick leave. In addition, the state has a "sick leave buyout option" in which each January, employees who accumulate sick leave in excess of 60 days may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the state's policy to liquidate unpaid compensated absences leave outstanding at June 30 with future resources rather than advance funding it with currently available expendable financial resources.

The Industrial Insurance Fund recognizes the expense and accrues a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits as applicable as the leave is earned.

10.B. Employee Retirement Plan

Industrial Insurance Fund employees participate in the Washington State Public Employees' Retirement System (PERS) administered by the Department of Retirement Systems. PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans, and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by February 28, 2002, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3.

Under PERS, the employee and employer contribute a percentage of the employee's compensation. The Industrial Insurance Fund contributed $5,589,871 to this plan during the fiscal year ended June 30, 2007.

An actuarial valuation of the PERS plan for the Industrial Insurance Fund as a stand-alone entity is not available. Pension note disclosures for PERS are included in the Comprehensive Annual Financial Report for the state of Washington. A copy of this report may be obtained by contacting the Accounting Division of the Office of Financial Management at PO Box 43113, Olympia, Washington 98507-3113, or online at www.ofm.wa.gov/cafr.

Note 11 – Related Party Transactions

The Industrial Insurance Fund has transfers of expenditures and cash within the Accident, Medical Aid, and Pension Reserve Funds, and the Supplemental Pension Fund and the Second Injury Fund from the Workers' Compensation Program.

Note 12 – Commitments and Contingencies

Effective July 1, 1992, the Washington State Legislature required the Industrial Insurance Fund under RCW 48.22.070 to participate in an assigned risk pool providing workers' compensation coverage under the United States Longshoreman and Harbor Workers' Act. The Industrial Insurance Fund is obligated to participate 50 percent in the underwriting losses or surpluses of the assigned risk pool. This participation is scheduled to continue indefinitely due to amending legislation passed in 1997. However, the Industrial Insurance Fund has not made any payments to this risk pool since enactment of this indefinite commitment.

Note 13 – Summary of Significant Litigation

The Industrial Insurance Fund is party to numerous routine legal proceedings that normally occur in operations. At any given point, there may be numerous lawsuits that could impact expenses. There is a recurring volume of tort and other claims for compensation and damages against the Industrial Insurance Fund. The collective impact of these claims, however, is not likely to have a material impact on Industrial Insurance Fund revenues or expenses.

Supplementary Information

Industrial Insurance Fund - Basic Plan
Claims Development Information (Schedule P)

Fiscal Years 1998 through 2007 (expressed in millions)

The table below illustrates how the Industrial Insurance Fund Basic Plan earned revenues (net of reinsurance) and investment income compare to the related costs of losses (net of loss assumed by re-insurers) and other expenses assumed by the Fund as of the end of each of the last ten fiscal years. The Industrial Insurance Fund has not purchased reinsurance since September 30, 2002, and has never had a qualifying event that generated a recovery.

The rows of the table are defined as follows:

1. This line shows each fiscal year's earned contribution revenues and investment revenues.
2. This line shows the Basic Plan's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).
3. This section shows the cumulative amounts paid as of the end of successive years for each policy year.
4. This section shows how each policy year's incurred claims increased or decreased as of the end of successive years. Annual re-estimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known.
5. This line compares the latest re-estimated incurred claims amount to the amount originally established (line 2) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and re-estimates is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years.

The columns of the table show data for successful years.

		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1.	Net earned required contribution and investment revenues	$ 2,013	$ 927	$ 1,057	$ 1,449	$ 1,197	$ 2,111	$ 1,337	$ 2,452	$ 1,392	$ 2,406
2.	Estimated incurred claims and expenses, end of policy year	1,700	1,732	1,902	1,925	2,124	2,284	2,505	2,308	2,141	2,196
3.	Paid (cumulative) as of:										
	End of policy year	196	205	218	230	226	233	244	260	278	295
	One year later	420	438	473	494	500	501	528	556	589	
	Two years later	545	564	608	646	653	650	681	715		
	Three years later	627	643	706	747	756	751	784			
	Four years later	684	707	777	825	834	824				
	Five years later	731	758	837	890	896					
	Six years later	770	800	889	943						
	Seven years later	805	840	933							
	Eight years later	838	876								
	Nine years later	868									
4.	Reestimated incurred claims and expenses:										
	End of policy year	1,700	1,732	1,902	1,925	2,124	2,284	2,505	2,308	2,141	2,196
	One year later	1,627	1,690	1,838	1,963	2,158	2,277	2,203	1,989	2,053	
	Two years later	1,651	1,694	1,913	2,067	2,277	2,045	1,971	1,939		
	Three years later	1,643	1,770	1,977	2,226	2,079	1,853	1,864			
	Four years later	1,678	1,794	2,088	2,039	1,906	1,767				
	Five years later	1,690	1,839	1,881	1,864	1,859					
	Six years later	1,687	1,682	1,778	1,835						
	Seven years later	1,554	1,578	1,755							
	Eight years later	1,503	1,560								
	Nine years later	1,478									
5.	Increase (decrease) in estimated incurred claims and expenses from end of policy year	(222)	(172)	(147)	(90)	(265)	(517)	(641)	(369)	(88)	

Source: Washington State Department of Labor and Industries

IDENTIFICATION

I, David F. Mohrman, am associated with the Tillinghast business of Towers Perrin. I am a member of the American Academy of Actuaries and meet its qualification standards for signing statements of actuarial opinion regarding property and casualty insurance company statutory Annual Statements. I am a Fellow of the Casualty Actuarial Society. My firm has been retained to render an opinion on the reserves for unpaid loss and loss adjustment expense liabilities at June 30, 2007 recorded in the consolidated balance sheet of the State of Washington Industrial Insurance Fund (the "Fund") and I have been assigned responsibility for that project.

SCOPE

I have examined the reserves listed in Exhibit A, as shown in the Financial Statement of the Fund as prepared, as of June 30, 2007.

My examination of the loss and loss adjustment expense reserves was based upon data and related information prepared by the Fund. In this regard, I relied on Judy Schurke, Director, and William Vasek, Chief Actuary of the Washington State Department of Labor and Industries, as to the accuracy and completeness of the data. I evaluated the data used directly in my analysis for reasonableness and consistency. My evaluation did not reveal any data points materially affecting my analysis that fell outside of the range of reasonable possibilities. In performing this evaluation, I have assumed that the Fund (a) used its best efforts to supply accurate and complete data and (b) did not knowingly provide any inaccurate data. In other respects, my examination included the use of such actuarial assumptions and methods and such tests of calculations as I considered necessary.

My review was limited to the items in Exhibit A, and did not include an analysis of any income statement items or other balance sheet items.

RELEVANT COMMENTS

The Fund has no ceded or assumed reinsurance.

The Fund has represented to me that it has no unearned premium for long duration contracts, defined as single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase.

I have reviewed the Fund’s exposure to asbestos and environmental claims. In my opinion, the chance of material liability related to asbestos and environmental claims is remote, since the Fund covers workers compensation for all insured employers in the State of Washington, and the Fund did not write lines of business which are typically exposed to such losses.

I believe that there are significant risks and uncertainties that could result in material adverse deviation in the loss and loss adjustment expense reserves. In consideration of the use of this opinion for purposes of monitoring the Contingency Reserve of the Fund, I consider $400,000,000 to be material for this Fund, calculated as 20% of the Contingency Reserve. I have identified the major risks and uncertainties as reserve leverage, reserve discounting, and medical inflation. The absence of other risks and uncertainties from this listing does not imply that additional factors will not be identified in the future as having been a significant influence on the Fund's reserves.

Changes to the interest rates for discounting could result in material changes to reserves and, therefore, the Contingency Reserve.

Future medical payments for workers compensation claims are subject to inflation. Small differences in the rate of medical inflation from expectations could result in the reserves being inadequate or redundant for covering future medical payments.

Loss (and loss adjustment expense) reserves have been discounted to present value based on an actuarially derived projected payment pattern and a 2.5% interest rate for the Accident and Medical Aid Funds, and 6.5% for the Pension Reserve Fund. I am not expressing an opinion on this rate. The amount of discount is $6,479,496,000.

Reserves are established net of anticipated salvage and subrogation.

OPINION

In my opinion, the amounts recorded in the Financial Statement for the sum of items 1 and 2 on Exhibit A:

a) are in accordance with NAIC requirements;

b) are consistent with amounts computed in accordance with the Casualty Actuarial Society Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves and relevant standards of practice promulgated by the Actuarial Standards Board; and

c) make a reasonable provision for all unpaid loss and loss expense obligations of the Fund under the terms of its contracts and agreements.

VARIABILITY

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss expenses, it is necessary to project future loss and loss adjustment expense payments. Actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections.

Further, my projections make no provision for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Fund's historical data base or which are not yet quantifiable.

An actuarial report, including underlying workpapers supporting the findings expressed in this statement of actuarial opinion, has been provided to the Fund to be retained for a period of seven years at its administrative offices and available for regulatory examination.

This statement of opinion is solely for the use of, and only to be relied upon by the Fund and the Agency.

Date: December 14, 2007

David F. Mohrman, FCAS, MAAA
Principal
Towers Perrin
Forestal Centre
175 Powder Forest Drive
Weatogue, CT 06089
(860) 843-7041

Exhibit A: SCOPE

	Accident Fund Column 1 Amount	Medical Aid Fund Column 2 Amount	Pension Reserve Fund Column 3 Amount	Total Column 4 Amount
1. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Line 1)	$3,254,334,000	$2,911,256,000	$2,628,785,000	$8,794,375,000
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Line 3)	$164,617,000	$249,715,000	$0	$414,332,000

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December 2007