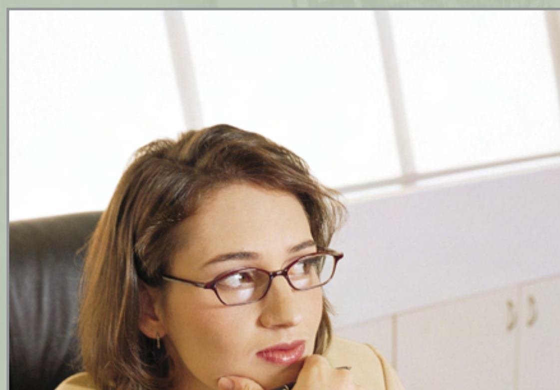

June 30, 2006

Financial Report

Workers' Compensation Fund
Washington Department of Labor and Industries

Department of LABOR AND INDUSTRIES

December 2006

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L&I's Mission Statement

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 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.

Message from Assistant Director Robert Malooly

Our goal is to run the best workers' compensation system in the country for our customers. That means we will:

- Manage claims efficiently and eliminate unnecessary delays.
- Price the insurance correctly.
- Provide help to employers and injured workers as they navigate the system for the first time.
- Maximize investment earnings within the bounds of sound investments.
- Minimize disability so that injured workers return to a productive job they can safely do.
- Give money back to our customers when we have excess funds.
- Collect premiums owed, so that employers compete on a level playing field.
- Listen and be open to new ways of doing business.

We don't always meet those goals, but we certainly try. In the fiscal year that ended last June 30, our accomplishments were as simple as answering the phones on the first or second ring, and as complex as expanding L&I's Online Claim & Account Center to better serve our customers.

Along the way, we again succeeded at managing our health care expenses. In 2006 we held inflation to just below 5 percent, compared with a 7.7 percent average for the rest of the industry. And with help from the Washington State Investment Board, we finished the year with over $1.7 billion in our contingency reserve. A significant chunk of that money will be returned to employers and workers in the form of lower rates in 2007 and a rate holiday in the Medical Aid Fund in the second half of next year.

For that success, considerable credit goes to the vast majority of Washington employers and workers who focused on safety and avoided injuries.

L&I's commitment to you is that we will continue to work with our customers to build on those successes.

Sincerely,

Robert Malooly, Assistant Director
Insurance Services Division

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INDEPENDENT AUDITORS' REPORT

Judy Schurke, Acting Director
The Washington Department of Labor and Industries
Workers' Compensation Fund
Tumwater, Washington

We have audited the accompanying financial statements (including the individual fund financial statements) of the Workers' Compensation Fund of the Washington Department of Labor and Industries as of and for the year ended June 30, 2006. The Washington Department of Labor and Industries is a part of the State of Washington's primary government. These financial statements are the responsibility of the Washington Department of Labor and Industries' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the Workers' Compensation Fund and do not purport to, and do not, present fairly the financial position of the Washington Department of Labor and Industries as of June 30, 2006, or the changes in its net assets or cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Workers' Compensation Fund of the Washington Department of Labor and Industries as of June 30, 2006, and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States. Also in our opinion, the financial statements present fairly, in all material respects, the financial position of each of the individual funds of the Workers' Compensation Fund of the Washington Department of Labor and Industries as of June 30, 2006, and the changes in net assets and cash flows of such funds for the year then ended in conformity with accounting principles generally accepted in the United States.

The accompanying management discussion and analysis and required supplementary information listed in the accompanying table of contents is not a required part of the basic financial statements, but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The introductory section of this report is not a required part of the financial statements, and we did not audit or apply limited procedures to such information and do not express any assurance on such information.

/S/ PETERSON SULLIVAN PLLC

November 17, 2006

Management Discussion and Analysis

This section of the Workers' Compensation Fund of the Washington Department of Labor and Industries ("The Workers' Compensation Fund") annual financial report presents management's discussion and analysis of the financial performance of the Workers' Compensation Fund during the year ended June 30, 2006. This discussion should be read in conjunction with the accompanying financial statements and footnotes. The financial statements, footnotes, and this discussion are the responsibility of Workers' Compensation Fund management.

Some history and things that make the Workers' Compensation Fund of the State of Washington unique:

1. Washington's "Workmen's Compensation Act" established the industrial insurance system in 1911. Initially it only covered workers in hazardous jobs. The first annual report, in 1912, listed every company covered, the number of people each company employed, how much it paid in premiums, and how many injuries were reported. The first slogan was "SAFETY FIRST."

2. In 1923, Washington became the only state where workers paid a significant portion of the insurance premiums. In 2006 their share averaged 24.1 percent.

3. Washington remained an exclusive State Fund until 1972, when the system underwent a major overhaul. It was expanded to include all workers, and large employers, who met certain financial and safety criteria, were allowed to self-insure.

4. In 1999 and 2000, the State Fund's contingency reserve had grown to the point that Labor and Industries paid $400 million in dividends to employers and dramatically lowered rates.

5. Between 2003 and 2005, average rates rose 42.5 percent.

6. Since its inception in 1981, L&I's Retrospective Rating Program has refunded over $1.5 billion to participating employers and their associations.

7. Washington's injured-worker benefits rank fifth highest in the nation, while 35 states have premium rates that average higher than ours.

8. In Fiscal Year 2006, L&I's health care costs rose 4.9 percent, compared with a 7.7 percent average for the nation's workers' compensation insurers.

Workplace Injuries

In Fiscal Year 2006, Washington's workers' compensation system covered about 2.4 million workers employed by 165,000 employers. Nearly 141,000 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 half of all injuries were to workers 30 to 50 years of age. A total of 7,480,000 days were lost from work. The most common injury was cuts and abrasions, followed by back sprains and strains, and then leg and foot strains and sprains. Sixty-six fatal pensions were awarded.

Workers' Compensation Fund

The contingency reserve is the difference between assets and the amount that L&I expects to pay out in future benefits on claims already filed. The fiscal year began with a contingency reserve deficit of $6.6 billion mainly due to the Supplemental Pension cost of living adjustments that by statute are not to be fully funded. During the year, assets declined from $12.3 billion to $12.2 billion. Net revenues for 2006 were $1.79 billion.

Better than expected investment earnings throughout the year resulted in considerable growth in the State Fund's contingency reserve, giving L&I the ability to lower premium rates in 2007 by an average of 2 percent. That will represent a $31 million savings for employers. Because much of the contingency reserve is concentrated in the Medical Aid Fund, L&I has proposed reducing that fund's rate to zero for the second half of 2007. The savings would be about $315 million. Because employers and workers pay equally into that fund, both would benefit equally.

In 2006, the Workers' Compensation Finance Committee was created and is made up of representatives from business, labor, and L&I. The committee's role is to advise the Department on State Fund financial issues. In the past year, committee members discussed and offered advice on 2007 rates, the proposed six-month rate holiday, the appropriate level for the contingency reserve, proposed changes in the formula L&I uses to calculate an employer's rates, and use of State Fund monies to pay for non-industrial insurance programs run by Labor and Industries.

Accomplishments in 2006

- Through the use of evidence-based medicine, closely monitoring of prescription drug use and an emphasis on prescribing drugs from the state's preferred drug list, L&I was again able to hold medical inflation well below the national average for workers' comp insurers.
- L&I expanded its Eastern Washington Center of Occupational Health & Education to include doctors in 16 counties east of the Cascades, ensuring that injured workers in remote areas of the state have access to quality health care.
- L&I's Online Claims & Account Center greatly expanded the amount of available information and business that can be conducted electronically, better serving injured workers, employers, and health care providers.
- L&I's Fraud Prevention and Compliance Program collected $10.20 for every dollar spent on detecting and preventing fraud and abuse of the workers' compensation system.

Using the Annual Financial Report

The Combining Statement of Fund Net Assets, Combining Statement of Revenue, Expenses and Changes in Fund Net Assets, and the Combining Statement of Cash Flows are prepared under the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the Workers' Compensation Funds.

Financial Highlights

The Workers' Compensation Fund net assets decreased by $502,688,696 or 7.7% mainly due to the inflation factor consideration for COLA, and pension liabilities.

Workers' Compensation Fund operating revenues increased $69,353,000 or 4%, while operating expenses decreased $139,610,700 or 5.8%.

The Workers' Compensation Fund Operating Revenue was $1,790,419,093, an increase of $69,353,000 or 4% over fiscal year 2005.

Discussion of Financial Activity

The Combining Statement of Fund Net Assets presents the assets, liabilities, and net assets of the Workers' Compensation Fund as of the end of the fiscal year 2006. Its purpose is to present a fiscal snapshot of the Workers' Compensation Fund. Changes in net assets (the difference between assets and liabilities) are an indicator of the improvement or erosion of the Workers' Compensation Fund financial health when considered with non-financial facts such as economic conditions and growth, and increased safety in workplaces.

Comments Regarding Operating Revenues and Expenditures

Net operating revenues increased $69,353,000 or 4% over fiscal year 2005. Premiums and assessments increased $68,425,326 or 4% over fiscal year 2005 due to increased hours reported by state employers.

Premiums and claims expense decreased $167,335,849 or 7.7% over fiscal year 2005 due to agency's success at controlling health-care costs. Also employers and workers have contributed to a declining frequency of workplace injuries and illnesses.

The Statement of Cash Flows presents information related to cash inflow and outflow, and helps measure the ability to meet financial obligations as they mature. The statement is divided into five sections. The first section shows operating cash flows and net cash used by the operating activity of the Workers' Compensation Fund. The second shows cash flows from non-capital financing activities showing cash received and spent for non-operating, non-investing, and non-capital financing purposes. The third section deals with the cash used for the acquisition of capital assets and related items. The fourth section shows investing activities including the purchases, proceeds, and investment income received and expense incurred from investing activities. Finally, section five reconciles the net cash used to the operating income or loss reflected on the Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets.

Contacting the Workers' Compensation Fund Financial Management

This financial report is designed to provide to all those with an interest in the Workers' Compensation Program with a general overview of the Workers' Compensation Fund and to show the Workers' Compensation Fund's accountability for the revenues it receives. If you have questions about this report or need additional financial information, contact Chief Accounting Officer, Department of Labor and Industries, PO Box 44830, Olympia, WA 98504-4830.

Financial Statement

Workers' Compensation Fund of the Washington Department of Labor and Industries
Combining Statement of Fund Net Assets
June 30, 2006

ASSETS	**Accident**	**Medical**	**Pension**	**Supplemental**	**Second**	
Current Assets:	**Fund**	**Aid Fund**	**Reserve Fund**	**Pension Fund**	**Injury Fund**	**Total**
Cash and pooled investments	$ 2,848,482	$ (242,787)	$ 737,518	$ 645,192	$ 20,773,819	$ 24,762,224
Trust cash	-	-	842,406	-	-	842,406
Trust investments	-	-	7,615,611	-	-	7,615,611
Investments	650,438,839	236,968,622	283,719,083	53,114,577	-	1,224,241,121
Receivables net of allowance	332,756,948	188,999,617	34,920,270	91,041,406	17,723,721	665,441,962
Due from Workers' Compensation Funds	21,623,416	91,499	18	474,010	529,837	22,718,780
Due from other state funds and agencies	86,228	153,176	6,299	8,093	-	253,796
Due from other governments	716,245	189,605	-	-	-	905,850
Inventories	84,601	84,600	-	-	-	169,201
Prepaid expenses	2,907	2,904	-	-	-	5,811
Total Current Assets:	1,008,557,666	426,247,236	327,841,205	145,283,278	39,027,377	1,946,956,762
Noncurrent Assets:						
Investments, noncurrent	3,826,786,647	3,787,960,819	2,433,468,383	122,257,706	-	10,170,473,555
Capital assets, net	35,113,533	34,730,255				69,843,788
Total Noncurrent Assets	3,861,900,180	3,822,691,074	2,433,468,383	122,257,706	-	10,240,317,343
Total Assets	$ 4,870,457,846	$ 4,248,938,310	$ 2,761,309,588	$ 267,540,984	$ 39,027,377	$ 12,187,274,105
LIABILITIES						
Current Liabilities:						
Accounts payable	$ 4,015,256	$ 2,179,326	$ 1,193,821	$ 234,284	$ -	$ 7,622,687
Deposits payable	801,089	2,954,437	-	-	-	3,755,526
Accrued liabilities	160,980,755	7,012,812	740,179	136,936	6,572	168,877,254
Obligations under security lending agreements	650,438,839	236,968,622	283,719,083	53,114,577	-	1,224,241,121
Bonds payable	1,617,500	1,617,500	-	-	-	3,235,000
Due to Workers' Compensation Funds	77,031	771,108	21,853,871	16,770	-	22,718,780
Due to other state funds and agencies	2,082,671	2,337,567	-	3,984	-	4,424,222
Unearned revenues	512,537	976,221	9,804,580	1,594,976	-	12,888,314
Claims and judgments payable	690,816,543	421,771,543	247,634,865	325,353,310	-	1,685,576,261
Total Current Liabilities	1,511,342,221	676,589,136	564,946,399	380,454,837	6,572	3,133,339,165
Non-Current Liabilities:						
Claims and judgments payable	2,705,335,070	2,513,142,940	2,177,626,239	8,673,420,000	-	16,069,524,249
Bonds payable	16,795,000	16,795,000	-	-	-	33,590,000
Other long-term liabilities	5,994,621	5,594,438	-	-	-	11,589,059
Total Non-Current Liabilities	2,728,124,691	2,535,532,378	2,177,626,239	8,673,420,000	-	16,114,703,308
Total Liabilities	4,239,466,912	3,212,121,514	2,742,572,638	9,053,874,837	6,572	19,248,042,473
Net Assets:						
Invested in capital assets, net of related debt	16,697,351	16,314,131	-	-	-	33,011,482
Unrestricted	614,293,583	1,020,502,665	18,736,950	(8,786,333,853)	39,020,805	(7,093,779,850)
Total Net Assets (Deficit)	$ 630,990,934	$ 1,036,816,796	$ 18,736,950	$ (8,786,333,853)	$ 39,020,805	$ (7,060,768,368)

The notes to the financial statements are an integral part of this statement.

Workers Compensation Fund of the Washington Department of Labor and Industries
Combining Statement of Revenue, Expenses, and Changes in Fund Net Assets
For the Year Ended June 30, 2006

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Total
OPERATING REVENUES:						
Premiums and assessments	$ 745,222,278	$ 624,534,340	$ 17,017,490	$ 301,400,324	$ 69,740,894	$ 1,757,915,326
Miscellaneous revenue	21,492,173	1,831,080	9,368	9,171,146	-	32,503,767
Total Operating Revenues	766,714,451	626,365,420	17,026,858	310,571,470	69,740,894	1,790,419,093
OPERATING EXPENSES:						
Salaries and wages	60,403,879	56,546,963	-	-	-	116,950,842
Employee benefits	17,342,382	16,068,514	-	-	-	33,410,896
Personal services	888,299	2,057,097	-	-	-	2,945,396
Goods and services	33,444,512	30,782,633	-	-	-	64,227,145
Travel	2,206,595	1,270,609	-	-	-	3,477,204
Premiums and claims	477,895,384	578,218,819	374,747,456	565,058,635	2,472,857	1,998,393,151
Depreciation	13,351,422	12,199,232	-	-	-	25,550,654
Miscellaneous expenses	10,522,177	5,263,800	682,504	3,403,086	10,445	19,882,012
Total Operating Expenses	616,054,650	702,407,667	375,429,960	568,461,721	2,483,302	2,264,837,300
Operating Income (Loss)	150,659,801	(76,042,247)	(358,403,102)	(257,890,251)	67,257,592	(474,418,207)
NONOPERATING REVENUES (EXPENSES):						
Earnings (loss) on investments	(86,289,508)	108,293,160	(59,594,512)	3,781,673	-	(33,809,187)
Interest expense	(1,030,793)	(1,030,790)	-	-	-	(2,061,583)
Other revenue	6,297,428	1,302,273	-	580	-	7,600,281
Total Nonoperating Revenues (Expenses)	(81,022,873)	108,564,643	(59,594,512)	3,782,253	-	(28,270,489)
Income (Loss) Before Contributions and Transfers	69,636,928	32,522,396	(417,997,614)	(254,107,998)	67,257,592	(502,688,696)
Capital contributions (Return of capital contributions)	31,201	-	(31,201)	-	-	-
Transfers in	-	-	217,502,397	-	28,868,208	246,370,605
Transfers out	(154,408,358)	(2,473,031)	(970,962)	-	(88,518,254)	(246,370,605)
Net Contributions and Transfers	(154,377,157)	(2,473,031)	216,500,234	-	(59,650,046)	-
Change in Net Assets	(84,740,229)	30,049,365	(201,497,380)	(254,107,998)	7,607,546	(502,688,696)
Net Assets (Deficit) - Beginning of year	715,731,163	1,006,767,431	220,234,330	(8,532,225,855)	31,413,259	(6,558,079,672)
Net Assets (Deficit) - End of year	$ 630,990,934	$ 1,036,816,796	$ 18,736,950	$ (8,786,333,853)	$ 39,020,805	$ (7,060,768,368)

The notes to the financial statements are an integral part of this statement.

Workers' Compensation Fund of the Washington Department of Labor and Industries
Combining Statement of Cash Flows
For the Year Ended June 30, 2006

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:						
Receipts of premiums and assessments	$ 719,582,589	$ 632,511,265	$ 17,605,435	$ 312,917,322	$ 72,283,401	$ 1,754,900,012
Payments to suppliers	(34,550,128)	(35,438,290)	-	-	-	(69,988,418)
Payments to/for beneficiaries	(506,900,967)	(512,741,580)	(238,590,540)	(290,898,673)	(2,474,241)	(1,551,606,001)
Payments to employees	(78,234,203)	(72,511,648)	-	-	-	(150,745,851)
Other	15,124,341	(192,586)	-	1,633,841	-	16,565,596
Net Cash Flows from Operating Activities	115,021,632	11,627,161	(220,985,105)	23,652,490	69,809,160	(874,662)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Transfers in	-	-	217,502,397	-	28,402,850	245,905,247
Transfers out	(154,408,358)	(2,473,031)	(505,605)	-	(88,518,253)	(245,905,247)
Operating grants received	5,659,627	1,167,145	-	-	-	6,826,772
License fees collected	3,996	652	-	595	-	5,243
Net Cash Flows from Noncapital Financing Activities	(148,744,735)	(1,305,234)	216,996,792	595	(60,115,403)	6,832,015
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Interest paid	(1,030,793)	(1,030,790)	-	-	-	(2,061,583)
Principal payments on bonds payable	(1,526,894)	(1,526,855)	-	-	-	(3,053,749)
Acquisitions of capital assets	(1,211,284)	(1,240,466)	-	-	-	(2,451,750)
Net Cash Flows from Capital and Related Financing Activities	(3,768,971)	(3,798,111)	-	-	-	(7,567,082)
CASH FLOWS FROM INVESTING ACTIVITIES:						
Receipt of interest	237,064,718	152,201,740	135,172,164	6,667,949	-	531,106,571
Receipt of dividends	6,498,294	18,833,852	4,011,449	-	-	29,343,595
Investing expenses	(31,847,078)	(9,176,918)	(11,570,036)	(1,732,795)	-	(54,326,827)
Proceeds from sale of investment securities	386,714,774	391,342,907	99,502,761	334,160,166	-	1,211,720,608
Purchases of investment securities	(560,372,650)	(558,052,519)	(231,849,074)	(362,787,907)	-	(1,713,062,150)
Net Cash Flows from Investing Activities	38,058,058	(4,850,938)	(4,732,736)	(23,692,587)	-	4,781,797
Net increase (decrease) in cash and pooled investments	565,984	1,672,878	(8,721,049)	(39,502)	9,693,757	3,172,068
Cash & pooled investments, Beginning of year	2,282,498	(1,915,665)	9,458,567	684,694	11,080,062	21,590,156
Cash & pooled investments, End of year	$ 2,848,482	$ (242,787)	$ 737,518	$ 645,192	$ 20,773,819	$ 24,762,224

The notes to the financial statements are an integral part of this statement.

Workers' Compensation Fund of the Washington Department of Labor and Industries

Combining Statement of Cash Flows

For the Year Ended June 30, 2006 (continued)

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Total
Cash Flows from Operating Activities:						
Operating Income (Loss)	$ 150,659,801	$ (76,042,247)	$ (358,403,102)	$ (257,890,251)	$ 67,257,592	$ (474,418,207)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Flows from Operations:						
Depreciation	13,351,423	12,199,232	-	-	-	25,550,655
Change in Assets: Decrease (Increase)						-
Receivables	(58,827,350)	2,251,886	2,918,446	2,322,910	2,552,817	(48,781,291)
Inventories	6,033	6,033	-		-	12,066
Prepaid expenses	11,484	11,484	-		-	22,968
Change in Liabilities: Increase (Decrease)						
Claims and judgements payable	9,820,241	73,200,773	134,499,551	279,310,530	-	496,831,095
Accrued liabilities	-	-	-	(90,699)	(1,249)	(91,948)
Net Cash Flows from Operating Activities	$ 115,021,632	$ 11,627,161	$ (220,985,105)	$ 23,652,490	$ 69,809,160	$ (874,662)

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Total
Non Cash Investing, Capital and Financing Activities:						
Decrease in fair value of investments	$ 336,577,161	$ 66,108,559	$ 209,288,056	$ 1,670,644	$ -	$ 613,644,420

Notes to Combining Financial Statements

Note 1 - Summary of Significant Accounting Policies

The accompanying combining financial statements of the Washington Department of Labor and Industries Workers' Compensation Fund (the Workers' Compensation Fund) have been prepared in conformity with generally accepted accounting principles (GAAP). The Office of Financial Management (OFM) of the State of Washington is the primary authority for the Workers' Compensation Fund accounting and reporting requirements. OFM has adopted the pronouncements of the Governmental Accounting Standards Board (GASB), which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. For enterprise fund reporting, the state follows only those private-sector standards issued on or before November 30, 1989, unless those pronouncements conflict with or contradict the pronouncements of the GASB. Following is a summary of the significant accounting policies:

A. Reporting Entity

Title 51 RCW establishes the State of Washington's Workers' Compensation Program. The statute requires all applicable employers to insure payment of benefits for job related injuries and diseases through the Workers' Compensation Fund or through self-insurance. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations through private insurers.

The Workers' Compensation Fund, an enterprise fund, is used to account for the Workers' Compensation Program which provides time-loss, medical, disability, and pension payments to qualifying individuals sustaining work-related injuries. The financial statements present only the activity of the Workers' Compensation Fund and do not present the financial position and results of operations and cash flows of the Washington Department of Labor and Industries or the State of Washington. The main benefit plans of the Workers' Compensation Program are funded based on rates that will keep these plans solvent in accordance with recognized actuarial principles. The supplemental pension cost-of-living adjustments (COLA) granted for time-loss and disability payments, however, are funded on a pay-as-you-go basis. By statute, the state is only allowed to collect enough revenue to fund the current COLA payments.

Premiums are based on individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Workers' Compensation Fund offers a retrospective premium rating plan under which premiums are adjusted annually for up to four years following the plan year based on individual employers' loss experience. Initial adjustments to the standard premiums are paid to or collected from the employers approximately ten months after the end of each plan year.

The Workers' Compensation Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future claims adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported (IBNR). The length of time for which such costs must be estimated varies depending on the benefit involved. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liabilities, claims adjudication, and judgments, the process used in computing claim liabilities does not necessarily result in an exact amount. Claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques. These techniques are used to produce current estimates that reflect recent settlements, claim frequency, and other economic, legal, and social factors. A provision for inflation in the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

B. Workers' Compensation Fund Financial Statements

Statement of Fund Net Assets – The Statement of Fund Net Assets presents assets and liabilities in order of liquidity. Net assets are classified into two categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, and reduced by outstanding balances of bonds, that is attributed to the acquisition, construction, or improvement of those assets.
- Unrestricted net assets consist of net assets that do not meet the definition of the preceding category.

Statement of Revenues, Expenses, and Changes in Fund Net Assets - The Statement reports the changes in net assets for the Workers' Compensation Fund.

The Workers' Compensation Fund consists of the following funds:

- <u>The Accident Fund</u> pays compensation directly to injured workers for lost wages during temporary disability, permanent partial disability awards, and awards pensions to survivors of fatally injured workers and to workers adjudged to be permanently and totally disabled. Such claim liabilities are discounted for fiscal year 2006 to the present value assuming a 2.5 percent annual interest rate.

  Revenues for this fund are provided by employer paid premiums, 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 Fund experience and premiums together; however, no retrospective premium adjustments are made through the Medical Aid Fund.

- <u>The Medical Aid Fund</u> pays for the cost of medical and vocational rehabilitation services to injured workers. Employers are allowed to withhold half of the medical aid premium from their employees' wages. Medical reserves are discounted to the present value assuming a 2.5 percent annual interest rate. Revenues for this fund are usually provided by equal contributions from employers and employees.
- <u>The Pension Reserve Fund</u> pays benefits to all permanently disabled pensioners including disabled employees of self-insured employers. These reserves are discounted to the present value assuming a 6.5 percent annual interest rate. Revenues to fund the pension payments are provided with transfers from the Accident Fund and reimbursement

payments from self-insurers invested in securities selected to cover payments for the expected life of the injured worker.

- The Supplemental Pension Fund provides for supplemental cost-of-living adjustments (COLA) to injured employees receiving disability payments. However, the enabling legislation requires this fund to operate on a current payment basis and is subject to legislative cancellation. No assets are allowed to accumulate for the future servicing of current claims.

  Cost-of-living pension payment increases are based on the increase in the state average wage during the preceding calendar year and are granted in July of the ensuing year. Revenues for COLA payments arise from assessments to self-insured and State Fund employers; half of the assessment may be deducted from employees' wages.

- The Second Injury Fund is used to pay pension costs on claims where permanent total disability is at least partially caused by a prior injury. It is funded by amounts received from the Accident and Medical Funds for state fund claims and by self-insured assessment for self-insured claims. An allowance for future second injury benefit payments is contained within the Accident and Medical Aid Fund claim reserves for State Fund claims. Therefore, this fund does not carry any reserves.

Operating and Non-operating Revenues and Expenses - Operating revenues for the funds consists mainly of premiums collected. Operating expenses consist of claims paid to covered individuals, claims adjustment expenses, and administrative expenses. All revenues and expenses not meeting this definition are reported as non-operating, including interest expense and investment gains and losses.

C. Measurement Focus and Basis of Accounting

The Workers' Compensation Fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operations of the funds are included on the statement of fund net assets. The Statement of Revenues, Expenses, and Changes in Net Assets presents increases (i.e., revenues) and decreases (i.e., expenses) in total net assets. Net assets are presented as 1) invested in capital assets, net of related debt, and 2) unrestricted.

The Workers' Compensation Fund is reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

D. Assets, Liabilities, and Net Assets

1. Cash and Pooled Investments

Investments of surplus or pooled cash balances are reported on the accompanying Statement of Fund Net Assets, and Statement of Cash Flows as "Cash and Pooled Investment." The Office of the State Treasurer invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. As a result, the cash balances of funds with surplus pooled balances are not reduced for these investments. For reporting purposes, pooled cash is stated at fair value or amortized cost, which approximates fair value. For the purposes of the Statement of Cash Flows, the Workers' Compensation Fund considers cash and short-term, highly-liquid investments, that are both readily convertible to cash and are so near their maturity dates that they present insignificant risk of changes in value because of changes in interest rates, to be cash equivalents.

Long-term investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges and security pricing services. Additional disclosure describing investments is provided in Note 2.

The U.S. Department of Energy has contracted with Labor and Industries to pay benefits to the Hanford workers injured on the job. Funds provided by the U. S. Department of Energy in advance to cover the pension liability determined by Labor and Industries are recorded as "Trust Cash" and "Trust Investments." As of June 30, 2006 Trust Cash amounted to $842,406 and is available to reimburse Labor and Industries for monthly pension payments. As of June 30, 2006, Trust Investments amounted to $7,615,611, was invested in U.S. Treasury Notes, and is also available to reimburse Labor and Industries for future expenses. For the year ended June 30, 2005, cash and investment from U.S. Department of Energy was reported as cash.

2. Receivables

Receivables in the Workers' Compensation Fund have arisen in the ordinary course of business. Receivables consist of amounts due for Workers' Compensation premiums, amounts due for overpayment of benefits to injured workers and providers, investment interest receivable, and other miscellaneous receivables. Receivable due for Workers' Compensation premiums for the quarter ended June 30, 2006 are estimated. Receivables are recorded when either the asset or revenue recognition criteria (refer to Note 1.C) have been met. All receivables are reported net of an allowance for accounts estimated to be uncollectible.

3. Inventories

Consumable inventories, consisting of expendable materials and supplies held for consumption, are valued and reported in the financial statement. The Workers' Compensation Fund expenses inventories when used or sold.

4. Capital Assets

Except as noted below, it is the Workers' Compensation Fund's policy to capitalize:

- all land
- all capital assets with a unit cost of $5,000 or more, and
- Capital assets acquired by capital leases with a net present value or fair market value, whichever is less. Less than $10,000 is not capitalized.

Purchased capital assets are valued at cost where historical records are available and at estimated historical cost where no historical records exist. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use. Normal maintenance and repair costs that do not materially add to the value or extend the life of capital assets are not capitalized.

The value of assets constructed for use in the Workers' Compensation Fund includes all direct construction costs and indirect costs that are related to the construction.

Art collections and library reserve collections that are considered inexhaustible in that their value does not diminish over time, are not capitalized by the Workers' Compensation Fund if all of the following conditions are met:

- The collection is held for public exhibition, education or research in furtherance of public service, rather than financial gain.
- The collection is protected, kept unencumbered, cared for, and preserved.
- The collection is subject to policy requirements that the proceeds from sales of collection items be used to acquire other items for the collection.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Generally, estimated useful lives are as follows:

- Buildings & building components - 5-50 years; furnishings, equipment & collections - 3-50 years; other improvements - 3-50 years.

During the fiscal year 2006 the Workers' Compensation Fund changed the estimated life for some capital assets from seven years to four years. This change resulted in an increase to depreciation expense of $7,277,445 in the Accident Fund and $6,320,128 in the Medical Aid Fund during the year ended June 30, 2006.

The cost and related accumulated depreciation of capital assets retired from service, or disposed of, are removed from the accounting records.

5. Compensated Absences

Workers' Compensation Fund 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 Workers' Compensation Fund does not pay employees for unused sick leave upon termination except upon employee death or retirement. At death or retirement, the Workers' Compensation Fund is liable for 25 percent of the employee's accumulated sick leave. In addition, the Workers' Compensation Fund 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 Workers' Compensation Fund'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 Workers' Compensation 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.

6. Retirement Plan

Workers' Compensation Fund employees are participating in the State of Washington Public Employees' Retirement System ("PERS"). PERS is a defined benefit pension plan. Under the plan the employee and employer contribute a percentage of the employee's compensation. The Workers' Compensation Fund contributed $3,020,815 to this plan during the fiscal year ended June 30, 2006. An actuarial valuation of the PERS plan for the Workers' Compensation Fund as a stand-alone entity is not available.

7. Non-Current Liabilities

Long-term obligations of the Workers' Compensation Fund are reported as non-current liabilities on the Statement of Fund Net Assets. Bonds payable are reported net of applicable original issuance premium or discount.

Note 2 — Deposits and Investments

A. Deposits

Custodial credit risk is the risk associated with the failure of a depository financial institution. In the event of a depository financial institution's failure, it is the risk that the Workers' Compensation Fund would not be able to recover its deposits or collateralized securities that are in the possession of the outside parties.

The Workers' Compensation Fund minimizes custodial credit risk by restrictions set forth in state law. Statutes restrict the State Treasurer to deposit funds in financial institutions that are physically located in Washington unless otherwise expressly permitted by statute and authorized by the Washington Public Deposit Protection Commission (PDPC). The PDPC (established under Chapter 39.58 of the Revised Code of Washington) constitutes a multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool.

The Federal Deposit Insurance Corporation (FDIC) covers the Workers' Compensation Fund insured deposits and the PDPC provides collateral protection.

B. Investments

1. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship over the investment of the Workers' Compensation Fund 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. Additionally, the WSIB must 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, Workers' Compensation Fund investments are to be managed to limit fluctuations in the 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:

- Maintain the 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 Workers' Compensation Funds are subject to the following constraints:

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

- 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.
- Allocation of equity investments between U.S. and international equities must fall within prescribed limits. 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 100 percent passively managed 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.
- 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 5 percent of total fixed income holdings.

2. Securities Lending

State law and WSIB policy permit participation in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Bank and Trust (SSB) to act as agent for the WSIB in securities lending transactions. As SSB is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

The securities lending collateral balances included are from securities required to be listed under GASB Statement 3 Category 3 – Uninsured and unregistered with securities held by the counterparty, or by its trust department or agent but not in the Workers' Compensation Fund's name. (This includes the amount of any repurchase agreement that exceeds the market value of the underlying securities).

In accordance with GASB Statement 28, the Workers' Compensation Fund reports securities lent (the underlying securities) as assets in the Statement of Fund Net Assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Workers' Compensation Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are reported in the Statement of Fund Net Assets. Securities lending transactions collateralized by securities that the Workers' Compensation Fund does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities.

Securities were loaned and collateralized by the WSIB's agent with cash and U.S. government securities (exclusive of mortgage backed securities and letters of credit), and irrevocable letters of credit. When the loaned securities were denominated in United States dollars, were securities whose primary trading market was located in the United States, or were sovereign debt issued by foreign governments, the collateral requirement was 102 percent of the market value of the securities loaned. When the loaned securities were not denominated in United States dollars or were securities whose primary trading market was not located in the United States, the collateral requirement was 105 percent of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006, was $1.224 billion and $1.207 billion, respectively.

During Fiscal Year 2006, securities lending transactions could be terminated on demand by either the Workers' Compensation Fund or the borrower. The average term of overall loans was 32 days.

Cash collateral was invested by the WSIB's agents in securities issued or guaranteed by the U.S. government, the WSIB's short-term investment pool (average weighted maturity of 312 days), or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. SSB indemnified the WSIB by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. SSB's responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During Fiscal Year 2006, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Workers' Compensation Fund incurred no losses during Fiscal Year 2006 resulting from a default by either the borrowers or the securities lending.

3. 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 Workers' Compensation Fund's fixed income investments are actively managed to exceed the return of the Lehman Aggregate Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2006, the durations of the various fixed income classes were within the duration targets of the Lehman Aggregate Index.

The Workers' Compensation Fund investments include both U.S. agencies and corporate debt variable-rate securities, most of which reset periodically to the market interest rate. Because these securities frequently re-price to prevailing market rates, interest rate risk is substantially reduced at each periodic reset date.

The following schedule, expressed in thousands, presents the Workers' Compensation Fund investments by type and provides information about the interest rate risks associated with the investments as of June 30, 2006. 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.

Investment Type	Fair Value	1 year	1-5 years	6-10 years	10 years	Rating
Asset Backed Securities	$ 5,162	$ -	$ 5,162	$ -	$ -	Aaa
Mortgages:						
Collateralized Mortgage Obligations	1,612,418	7,578	230,737	294,589	1,079,514	Multiple
Pass Throughs	2,744	244	2,492	8	-	Aaa
Non-Standard Mortgages	28,355	12,901	13,574	-	1,880	Multiple
Commercial Mortgage Backed Securities	633,660	5,513	369,677	258,470	-	Multiple
Corporate Bonds - Domestic	4,455,071	256,743	1,021,374	1,023,649	2,153,305	Multiple
Government Securities-Domestic:						
US Government Treasuries	1,077,209	19,682	73,769	85,823	897,935	Aaa
US Government Agencies	210,062	-	-	-	210,062	Aaa
Variable Rate Notes	62,785	62,785	-	-	-	Multiple
	8,087,466	$ 365,446	$ 1,716,785	$ 1,662,539	$ 4,342,696	
Commingled Index Funds-Domestic	1,584,407					
Commingled Index Funds-Foreign	321,622					
Money Market Funds	176,979					
Securities Lending Collateral Balances	1,224,241					
	11,394,715					
Less current portion	1,224,241					
	$ 10,170,474					

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	Variable Rate Notes	Collateralized Mortgage Obligations	Non-Standard Mortgages	Commercial Mortgage Backed Securities	**Total**
Aaa	$ 420,927	$ -	$ 1,542,972	$ 26,733	$ 586,052	$ 2,576,684
Aa1	131,418	-	-	-	-	131,418
Aa2	111,824	-	-	-	-	111,824
Aa3	509,083	20,053	-	-	-	529,136
A1	589,182	34,998	-	-	-	624,180
A2	465,974	-	-	-	-	465,974
A3	523,906	-	-	-	-	523,906
Baa1	559,517	-	-	-	-	559,517
Baa2	806,528	7,734	-	-	-	814,262
Baa3	234,391	-	-	-	-	234,391
NR	102,321	-	69,446	1,622	47,608	220,997
Total	$ 4,455,071	$ 62,785	$ 1,612,418	$ 28,355	$ 633,660	$ 6,792,289

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4. Credit Risk

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Workers' Compensation Fund investment policy mitigates credit risk by limiting holdings of below investment grade fixed income securities. The rated debt investments of the Workers' Compensation Funds as of June 30, 2006, 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 Workers' Compensation Fund policy states that the cost of no corporate fixed income issue shall not exceed 3 percent of the investment'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. There was no concentration of credit risk as of June 30, 2006.

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

5. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair market value of an investment or a deposit. The WSIB does not have a formal policy to limit foreign currency risk. The Workers' Compensation Funds had $321.6 million invested in an international commingled equity index fund. As such, no currency denomination is presented.

6. Derivatives

The Workers' Compensation Fund is authorized to utilize various derivative financial instruments, including mortgage-backed securities, financial futures, forward contracts, interest rate and equity swaps, and options to manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns. Derivative transactions involve, to varying degrees, market and credit risk. The Workers' Compensation Fund mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the Workers' Compensation Fund authority to invest in derivatives, international active equity managers may make limited investments in financial futures, forward contracts or other derivative securities to manage exposure to currency rate risk and equalize excess cash holdings. No such derivative securities were held as of June 30, 2006. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2006, the only derivative securities held directly by Workers' Compensation Funds were collateralized mortgage obligations of $1.612 billion.

7. Reverse Purchase Agreements

State law permits Workers' Compensation Fund to enter into reverse repurchase agreements. That is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the state or provide securities or cash of equal value, Workers' compensation Fund would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. There were no reverse repurchase agreements during Fiscal Year 2006, and there were no liabilities outstanding as of June 30, 2006.

Note 3 – Receivables

Receivables at June 30, 2006, consisted of the following:

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Total Receivables
Actual premium receivable	$ 63,233,415	$ 28,636,012	$ -	$ 9,282,036	$ -	$ 101,151,463
Estimated premium receivable	248,980,000	150,451,000	-	52,348,000	-	451,779,000
Estimated Self Insurance premium receivable	2,838,424	1,726,439	1,793,222	18,758,021	17,648,740	42,764,846
Total premium receivables	315,051,839	180,813,451	1,793,222	80,388,057	17,648,740	595,695,309
Receivable from overpayments	32,314,726	3,471,793	4,521,812	14,224,480	-	54,532,811
Investment interest receivable	43,787,682	28,242,830	28,025,742	1,411,830		101,468,084
Safety fines & penalties receivable	-	-	-	9,225,862	-	9,225,862
Miscellaneous receivable	21,019	228,497	1,361,085	6,105	126,029	1,742,735
	391,175,266	212,756,571	35,701,861	105,256,334	17,774,769	762,664,801
Less: allowance for uncollectible receivable	58,418,318	23,756,954	781,591	14,214,928	51,048	97,222,839
Receivables, net of allowance	$ 332,756,948	$ 188,999,617	$ 34,920,270	$ 91,041,406	$ 17,723,721	$ 665,441,962

Note 4 - Interfund Balances and Transfers

The following balances at June 30, 2006, represent due from and due to balances for other State Funds and Agencies:

Due from other State Funds and Agencies

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Totals
General Fund	$ 112	$ 39,382	$ -	$ -	$ -	$ 39,494
Special Revenue Funds	8,766	36,372	-	7,871	-	53,009
Other State Agencies	76,269	76,483	-	-	-	152,752
Other Suspense Funds	1,081	939	6,299	222	-	8,541
Due From Other State Fund and Agencies	$ 86,228	$ 153,176	$ 6,299	$ 8,093	$ -	$ 253,796

Due to Other State Funds and Agencies

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Totals
General Fund	$ 572	$ 33,686	$ -	$ 621	$ -	$ 34,879
Special Revenue Funds	80,334	76,670	-	215	-	157,219
Other State Agencies	1,986,795	2,218,114	-	-	-	4,204,909
Other Suspense Funds	14,970	9,097	-	3,148	-	27,215
Due to Other State Funds and Agencies	$ 2,082,671	$ 2,337,567	$ -	$ 3,984	$ -	$ 4,424,222

All balances are expected to be paid within one year from the date of the financial statements. These balances resulted from the time lag between the dates that (1) goods and services were provided and when the payments occurred and (2) transfers were accrued and when the liquidations occurred.

Note 5 – Capital Assets

The following is a summary of capital asset activity for the year ended June 30, 2006:

Capital Assets:	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Capital Assets, not being depreciated:				
Land and Collections	$ 3,239,748	$ -	$ -	$ 3,239,748
Software in Development	-	4,954,734	-	4,954,734
Total capital assets not being depreciated	3,239,748			8,194,482
Capital assets, being depreciated:				
Buildings	62,441,040	-	-	62,441,040
Accumulated depreciation	(17,370,850)	(1,248,822)	-	(18,619,672)
Net buildings	45,070,190			43,821,368
Furnishings, Equipment, and Collections	50,927,017	3,163,648	(2,509,785)	51,580,880
Accumulated Depreciation	(12,586,383)	(24,281,423)	2,369,513	(34,498,294)
Net furnishings, equipment, and collections	38,340,634			17,082,587
Other Improvements	1,020,401	-	-	1,020,401
Accumulated Depreciation	(254,642)	(20,408)	-	(275,050)
Net other improvements	765,759			745,351
Total capital assets being depreciated	84,176,582			61,649,306
Capital assets, net	$ 87,416,331			$ 69,843,788

Software in Development

Software in development consists of the following projects at June 30, 2006:

Project		Software in Development June 30, 2006	Remaining Project Budget
Online Reporting and Customer Access (ORCA) Phase II			
	Accident Fund	$ 2,016,239	$ 4,284,498
	Medical Aid Fund	2,016,252	4,284,013
		4,032,491	8,568,511
Self Insured Electronic Data Report System (SIEDRS) (SHB 1310)			
	Accident Fund	$ 150,791	$ 440,000
	Medical Aid Fund	150,791	440,000
		301,582	880,000
WISHA Information Network (WIN)			
	Accident Fund	$ 520,019	$ 935,577
	Medical Aid Fund	100,642	155,695
		620,661	1,091,272
Total Software in Development		$ 4,954,734	$ 10,539,783

Note 6 – Non-Current Liabilities

A. Bonds Payable

The Workers' Compensation Fund is responsible for semi-annual payments on a certain portion of four series of general obligation bonds issued by the State of Washington between 1993 and 1998. The bond proceeds provided funding for the acquisition and construction of the building and grounds known as the Department of Labor and Industries headquarters in Tumwater, Washington and refunding of general obligation bonds previously outstanding.

The terms of the bond payment obligations are as follows:

- **The General Obligation Bonds of Series R-93B**
  The Workers' Compensation Fund is required to make varying annual principal and interest payments, with the final payment due in 2015. The principal amount of these bonds outstanding was $18,785,000 at June 30, 2006. Bonds outstanding at June 30, 2006, have interest rates between 5.375% and 5.70%.

- **The General Obligation Bonds of Series R-96B**
  The Workers' Compensation Fund is required to make varying annual principal and interest payments, with the final payment due in 2011. The principal amount of these bonds outstanding was $6,065,000 at June 30, 2006. Bonds outstanding at June 30, 2006, have interest rates between 5.00% and 5.50%.

- **The General Obligation Bonds of Series R-96C**
  The Workers' Compensation Fund is required to make varying annual principal and interest payments, with the final payment due in 2011. The principal amount of these bonds outstanding was $5,050,000 at June 30, 2006. Bonds outstanding at June 30, 2006, have interest rates between 4.90% and 6.0%.

- **The General Obligation Bonds of Series R-98A**
  The Workers' Compensation Fund is required to make varying annual principal and interest payments, with the final payment due in 2015. The principal amount of these bonds outstanding was $6,925,000 at June 30, 2006. Bonds outstanding at June 30, 2006, have interest rates between 4.50% and 5.0%.

The principal and interest maturities of bonds payable for years ending June 30 are as follows:

Accident Fund						
By Fiscal Year		Principal		Interest		Total
2007	$	1,617,500	$	940,834	$	2,558,334
2008		1,750,000		850,235		2,600,235
2009		1,845,000		757,455		2,602,455
2010		1,945,000		658,812		2,603,812
2011		2,055,000		554,124		2,609,124
2012-2016		9,200,000		1,308,804		10,508,804
		18,412,500		5,070,264		23,482,764
Less Current Portion	$	1,617,500	$	940,834	$	2,558,334
	$	16,795,000	$	4,129,430	$	20,924,430
Medical Aid Fund						
By Fiscal Year						
2007	$	1,617,500	$	940,834	$	2,558,334
2008		1,750,000		850,235		2,600,235
2009		1,845,000		757,455		2,602,455
2010		1,945,000		658,812		2,603,812
2011		2,055,000		554,124		2,609,124
2012-2016		9,200,000		1,308,804		10,508,804
		18,412,500		5,070,264		23,482,764
Less Current Portion		1,617,500		940,834		2,558,334
	$	16,795,000	$	4,129,430	$	20,924,430
Total Debt Service Requirements	$	36,825,000	$	10,140,528	$	46,965,528

Total interest incurred on bonds payable for the year ended June 30, 2006, was $1,030,529 for the Accident Fund and $1,030,529 for the Medical Fund. There are no covenants related to the Workers' Compensation Fund's obligation for these bonds payable.

Debt Refunding

When advantageous, and permitted by statute and bond covenants, the State Finance Committee authorizes the refunding of outstanding bonds. When the state refunds outstanding bonds, the net proceeds of each refund issued are used to purchase U.S. government securities. These securities are placed in irrevocable trusts with escrow agents to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered defeased, and the liability has been removed from the Statement of Fund Net Assetss.

Prior Year Defeasances

In prior years, the state defeased certain general obligations and other bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the prior bond. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the Workers' Compensation Fund's financial statements.

B. Claims and Judgments

The schedule below, expressed in thousands, presents the changes in claims liabilities for the past two fiscal years for the fund's two benefit plans: Workers' Compensation Basic Plan (representing the Accident Fund, Medical Aid Fund, and Pension Reserve Funds) and Workers' Compensation Supplemental Pension Plan.

	Basic Plan		Supplemental Pension Plan		Grand Total	
	FY 2006	FY 2005	FY 2006	FY 2005	FY 2006	FY 2005
Unpaid claims and claim adjustment expenses						
at beginning of year	$ 8,555,911	$ 8,361,558	$ 8,722,984	$ 8,229,540	$ 17,278,895	$ 16,591,098
Incurred claims and claim adjustment expenses:						
Provision for insured events of the current year	1,833,937	1,741,476	615,713	1,574,029	2,449,650	3,315,505
Increase (decrease) in provision for insured events of prior years	(268,051)	(239,709)	(50,192)	(785,873)	(318,243)	(1,025,582)
Total incurred claims and claim adjustment expenses	1,565,886	1,501,767	565,521	788,156	2,131,407	2,289,923
Payments:						
Claims and claim adjustment expenses attributable:						
To events of the current year	277,626	259,673	-	-	277,626	259,673
To insured events of prior years	1,087,843	1,047,741	289,733	294,712	1,377,576	1,342,453
Total payments	1,365,469	1,307,414	289,733	294,712	1,655,202	1,602,126
Total unpaid claims and claim adjustment expenses at fiscal year end	$ 8,756,328	$ 8,555,911	$ 8,998,772	$ 8,722,984	$ 17,755,100	$ 17,278,895
Less current portion	1,360,224		325,352		1,685,576	

A description of the risks to which the Workers' Compensation Fund is exposed and the ways the Workers' Compensation Fund handles the risks is presented in Note 1.A. At June 30, 2006, $30 billion of unpaid claims and claim adjustment expenses are presented at their net present and settlement value of $17.7 billion. These claims are discounted at assumed interest rates of 2.5 percent (Accident Fund and Medical Aid Fund) to 6.5 percent (Pension Reserve Fund and Supplemental Pension Fund) to arrive at a settlement value that is net of third party recoveries.

The claims and claim adjustment liabilities of $17.7 billion, as of June 30, 2006, include $9.0 billion for supplemental pension cost-of-living adjustments (COLAs) that by statute are not to be fully funded.

These COLA payments are funded on a pay-as-you-go basis, and the Workers' Compensation Actuaries have indicated that future premium payments will be sufficient to pay these claims as they come due. The remaining claim liabilities of $8.7 billion are fully funded by long-term investments, net of obligations under securities lending agreements.

C. Non-Current Liability Activity

Following are the changes in non-current liabilities for the year ended June 30, 2006:

Long-term Liabilities	Balance June 30, 2005	Additions	Retirements	Balance June 30, 2006	Current Portion
Long-term debt					
Series R-93B	$ 18,895,000	$ -	$ 110,000	$ 18,785,000	$ 115,000
Series R-96B	8,135,000	-	2,070,000	6,065,000	2,200,000
Series R-96C	5,905,000	-	855,000	5,050,000	910,000
Series R-98B	6,935,000	-	10,000	6,925,000	10,000
Total long-term debt	39,870,000	-	3,045,000	36,825,000	3,235,000
Other liabilities					
Claims and judgements payable	17,278,894,478	2,131,407,000	1,655,200,968	17,755,100,510	1,685,576,261
Other long-term liabilties	11,264,398	10,175,686	9,851,026	11,589,059	-
Total other liabilities	17,290,158,876	2,141,582,686	1,665,051,994	17,766,689,569	1,685,576,261
Total Long-term liabilities	$ 17,330,028,876	$ 2,141,582,686	$ 1,668,096,994	$ 17,803,514,569	$ 1,688,811,261

D. Operating Leases

The Workers' Compensation 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 receiving no funding from the Legislature is remote, leases are considered non-cancelable 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, 2006:

Operating Leases (by Fiscal Year)	Accident Fund	Medical Aid Fund
2007	$ 2,567,744	$ 2,466,972
2008	1,629,315	1,627,787
2009	994,609	994,352
2010	765,060	764,769
2011	558,218	557,305
2012-2016	489,995	488,854
Total Future Minimum Payments	$ 7,004,941	$ 6,900,039

The total operating lease rental expenses for Fiscal Year 2006 was $9,425,066.

Note 7 - Deficit Net Assets

At June 30, 2006, the Workers' Compensation Fund had deficit net assets of $7.1 billion. The Workers' Compensation Fund, individual Supplemental Pension Fund, provides cost-of-living adjustments with deficit net assets of $8.8 billion at June 30, 2006. The main benefit plans of the Workers' Compensation Program are funded based on rates that will keep these plans solvent in accordance with recognized actuarial principles. The supplemental cost of living adjustments (COLA) granted for time-loss and disability payments however, are funded on a pay-as-you-go basis. By statute, the Fund is only allowed to collect enough revenue to provide for current COLA payments.

The following schedule details the changes in total net assets for the Workers' Compensation Fund during the fiscal year ended June 30, 2006:

	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Supplemental Pension Fund	Second Injury Fund	Net Assets (Deficit)
Balance, July 1, 2005	$ 715,731,163	$ 1,006,767,431	$ 220,234,330	$ (8,532,225,855)	$ 31,413,259	$ (6,558,079,673)
Fiscal Year 2006 Activity	(84,740,229)	30,049,365	(201,497,380)	(254,107,998)	7,607,546	(502,688,696)
Balance, June 30, 2006	$ 630,990,934	$ 1,036,816,796	$ 18,736,950	$ (8,786,333,853)	$ 39,020,805	$ (7,060,768,368)

Note 8 – Commitments and Contingencies

A. Summary of Significant Litigation

The Workers' Compensation 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 Workers' Compensation Fund. The collective impact of these claims, however, is not likely to have a material impact on Workers' Compensation Fund revenues or expenses.

B. Federal Assistance

The Workers' Compensation Fund has received federal financial assistance for specific purposes that are generally subject to review or audit by the grantor agencies. Entitlement to this assistance is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance resulting from a review or audit may become a liability of the Fund. The Workers' Compensation Fund does estimate and recognize a claims and judgments liability for disallowances when determined by the grantor agency or for probable disallowances based on experience pertaining to these grants; however, these recognized liabilities and any unrecognized disallowances are considered immaterial to the Fund's overall financial condition.

Supplementary Information

Workers' Compensation Fund - Basic Plan
Claims Development Information

Fiscal Years 1997 through 2006 (expressed in millions)

The table below illustrates how the Fund's 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 Workers' Compensation 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.

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1.	Net earned required contribution and investment revenues	$ 1,257	$ 2,013	$ 927	$ 1,057	$ 1,449	$ 1,197	$ 2,111	$ 1,337	$ 2,452	$ 1,392
2.	Estimated incurred claims and expenses, end of policy year	1,681	1,700	1,732	1,902	1,925	2,124	2,284	2,505	2,308	2,141
3.	Paid (cumulative) as of:										
	End of policy year	191	196	205	218	230	226	233	244	260	278
	One year later	409	420	438	473	494	500	501	528	556	
	Two years later	522	545	564	608	646	653	650	681		
	Three years later	596	627	643	706	747	756	751			
	Four years later	651	684	707	777	825	834				
	Five years later	693	731	758	837	890					
	Six years later	731	770	800	889						
	Seven years later	763	805	840							
	Eight years later	794	838								
	Nine years later	825									
4.	Reestimated incurred claims and expenses:										
	End of policy year	1,681	1,700	1,732	1,902	1,925	2,124	2,284	2,505	2,308	2,141
	One year later	1,602	1,627	1,690	1,838	1,963	2,158	2,277	2,203	1,989	
	Two years later	1,553	1,651	1,694	1,913	2,067	2,277	2,045	1,971		
	Three years later	1,575	1,643	1,770	1,977	2,226	2,079	1,853			
	Four years later	1,576	1,678	1,794	2,088	2,039	1,906				
	Five years later	1,601	1,690	1,839	1,881	1,864					
	Six years later	1,593	1,687	1,682	1,778						
	Seven years later	1,575	1,554	1,578							
	Eight years later	1,478	1,503								
	Nine years later	1,425									
5.	Increase (decrease) in estimated incurred claims and expenses from end of policy year	(256)	(197)	(154)	(124)	(61)	(218)	(431)	(534)	(319)	

Source: Washington State Department of Labor and Industries

Workers' Compensation Fund - Supplemental Pension Plan
Claims Development Information

Fiscal Years 1997 through 2006 (expressed in millions)

The table below illustrates how the Fund's Supplemental Pension Plan cost-of-living adjustments earned revenues (net of reinsurance) and investment income compare to the related costs of losses (net of loss assumed by re-insurers) as of the end of the last ten fiscal years. The Workers' Compensation Fund has not purchased reinsurance since September 30, 2002, and has never had a qualifying event that generated a recovery. The unallocated and other expenses of this plan are paid by the Workers' Compensation Basic Plan. This claims development information is reported separate from the basic plan for the following reasons:
(1) This plan covers self-insured, while the basic does not.
(2) This plan is not experienced rated while the basic plan is.
(3) Statutes restrict the funding of this plan to expected payments of the current year.

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 Supplemental Pension 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 successive fiscal years.

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1.	Net earned required contribution										
	and investment revenues	$ 154	$ 170	$ 193	$ 225	$ 267	$ 281	$ 293	$ 288	$ 326	$ 305
2.	Estimated incurred claims and										
	expenses, end of policy year	795	790	548	635	628	807	1,029	1,228	724	804
3.	Paid (cumulative) as of:										
	End of policy year	-	-	-	-	-	-	-	-	-	-
	One year later	4	6	7	8	5	2	5	2	1	
	Two years later	11	14	12	12	8	11	4	3		
	Three years later	13	17	18	17	22	6	6			
	Four years later	20	24	24	30	15	9				
	Five years later	27	30	37	27	19					
	Six years later	34	41	37	33						
	Seven years later	40	44	43							
	Eight years later	49	51								
	Nine years later	57									
4.	Reestimated incurred										
	claims and expenses:										
	End of policy year	795	790	548	635	628	807	1,029	1,228	724	804
	One year later	812	527	666	730	786	945	1,045	722	721	
	Two years later	610	727	754	844	910	1,046	676	720		
	Three years later	753	798	860	959	1,064	701	667			
	Four years later	817	860	932	1,099	727	682				
	Five years later	864	924	1,034	746	671					
	Six years later	898	971	732	722						
	Seven years later	936	695	678							
	Eight years later	705	670								
	Nine years later	658									
5.	Increase (decrease) in estimated										
	incurred claims and expenses										
	from end of policy year	(137)	(120)	130	87	43	(125)	(362)	(508)	(3)	

Source: Washington State Department of Labor and Industries

GAAP STATEMENT OF ACTUARIAL OPINION
DEPARTMENT OF LABOR AND INDUSTRIES
AS OF JUNE 30, 2006

Identification

I, David F. Mohrman, am associated with Towers, Perrin, Forster & Crosby. I am a member of the American Academy of Actuaries and meet its qualification standards for statements of actuarial opinion. I am also a Fellow of the Casualty Actuarial Society. The loss and loss adjustment expense reserves are the responsibility of the Department's management; my responsibility is to express an opinion of those reserves based on my review.

Scope

I have performed separate actuarial reviews of the GAAP reserves for loss and loss adjustment expense as of June 30, 2006, in the Accident Fund ($3,396,151,613), Medical Aid Fund ($2,934,914,483), and Pension Reserve Fund ($2,425,261,104), and Supplemental Pension Fund ($8,998,773,310) for the Department. These reserves are contained in the Workers' Compensation Fund Balance Sheet as of June 30, 2006.

My examination of the loss and loss adjustment expense reserves was based upon the review of the data and related information, methodology, assumptions, and calculations utilized by the Department. In this regard, I relied on the Department as to the accuracy and completeness of the data. In performing this evaluation, 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 Department (a) used its best efforts to supply accurate and complete data and (b) did not knowingly provide 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 listed above and did not include an analysis of any income statement items or other balance sheet items.

I evaluated the loss and loss adjustment expense reserves on a discounted basis with regard to the time value of money. The yields for discounting were 2.5% for the Accident Fund, the Medical Aid Fund, and the Supplemental Pension Fund and 6.5% for the Pension Reserve Fund. The average implied discount rate was 3.0%, which I consider reasonable. I evaluated the loss and loss adjustment expense reserves, net in regards to salvage and subrogation, and gross of reinsurance.

Opinion

In my opinion, these reserves are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board (including the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves) and make a reasonable provision for all the unpaid loss and loss adjustment expense obligations of the Department under the terms of its policies and agreements.

Comments

The Department writes a coverage whose risk factors expose the Department's reserves to significant variability. I have identified the major risk factors that could have a material impact as rising medical costs and any future court decisions that could have a retrospective impact on liabilities. The absence of other risk factors from this listing does not imply that additional risk factors will not be identified in the future as having been a significant influence on the Department's reserves.

The risk factor of rising medical costs is evident by the escalation of recent trend levels and continuation at this level would have a material impact on the reserves. Future court decisions are also a risk factor that could have a material impact.

I believe the risk factors above, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried reserve. In making this determination, I have considered a material adverse deviation to be one in which the actual reserves exceed the amounts above by an amount greater than 10% of the reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

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. These estimates incorporate actuarial assumptions as to future long-term contingencies based upon the available data. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Department's historical database or which are not yet quantifiable.

This statement of opinion is solely for the use of, and to be relied upon by, the Department and the State of Washington.

Date: December 28, 2006

David F. Mohrman

David F. Mohrman, FCAS, MAAA
Principal
Towers Perrin