Washington State Department of
Labor & Industries

Comprehensive Annual Financial Report
Workers' Compensation Program

For the Fiscal Year Ended June 30, 2007

December 2007

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Washington State Investment Board

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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

INDEPENDENT AUDITORS' REPORT

Judy Schurke, Director
The Workers' Compensation Program
of the State of Washington
Tumwater, Washington

We have audited the accompanying financial statements (including the individual fund financial statements) of the Workers' Compensation Program of the State of Washington as of and for the year ended June 30, 2007. The Workers' Compensation Program of the State of Washington is a part of the State of Washington's primary government. These financial statements are the responsibility of the management of the Workers' Compensation Program of the State of Washington. 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 Program of the State of Washington and do not purport to, and do not, present fairly the financial position of the Washington State Department of Labor and Industries as of June 30, 2007, or the changes in its fund equity 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 Program of the State of Washington as of June 30, 2007, and the changes in fund equity 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 Program of the State of Washington as of June 30, 2007, and the changes in fund equity 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

December 11, 2007

Management's Discussion and Analysis

This section of the Workers' Compensation Program of the state of Washington ("Workers' Compensation Program") annual financial report presents management's discussion and analysis of the financial performance of the Workers' Compensation Program for the fiscal year that ended June 30, 2007. This discussion should be read in conjunction with the accompanying financial statements and notes to the financial statements. The financial statements, notes to the financial statements, and this discussion are the responsibility of the Workers' Compensation Program management.

Financial Highlights

- The Workers' Compensation Program total assets at June 30, 2007, were $13.46 billion, an increase of $1.27 billion or 10.4% compared to June 30, 2006.
- The Workers' Compensation Program total liabilities at June 30, 2007, were $21.64 billion, an increase of $2.39 billion or 12.4% compared to June 30, 2006.
- The Workers' Compensation Program operating revenues for Fiscal Year 2007 were $1.74 billion, a decrease of $47.8 million or 2.7% compared with the prior year.
- The Workers' Compensation Program operating expenses for Fiscal Year 2007 were $3.84 billion, an increase of $1.57 billion or 69.5% compared with the prior year.
- The Workers' Compensation Program fund deficit at June 30, 2007, was $8.19 billion, an increase of $1.12 billion or 15.9% compared to June 30, 2006.

Overview of the Financial Statements

The Workers' Compensation Program is accounted for as an enterprise fund of the state of Washington, reporting business activities under the accrual basis of accounting much like a private business enterprise.

These financial statements report the financial condition and results of operations of five accounts including the Accident, Medical Aid, Pension Reserve, Supplemental Pension, and Second Injury Funds, known collectively as the Workers' Compensation Program. The Accident, Medical Aid and Pension Reserve Funds represent the Workers' Compensation Program Basic Plan.

This discussion and analysis serves as an introduction to the Workers' Compensation Program financial statements, which consist of the following components:

- The Combining Balance Sheet provides information about the Program's assets and liabilities, and reflects the Program's financial position as of June 30, 2007.

- The Combining Statement of Revenues, Expenses, and Changes in Fund Equity reflect both operating and nonoperating revenues and expenses for the fiscal year.

- The Combining Statement of Cash Flows reflects cash collections and payments to arrive at the net increase or decrease in cash and pooled investments during the fiscal year.

- The Notes to the Financial Statements are an integral part of the financial statements and are essential to a full understanding of the Workers' Compensation Program financial position and results of operations presented in the financial statements.

- The Supplementary Information section includes required supplemental information that presents ten years of claims development information. This section also includes the Actuarial Opinion from an independent actuarial firm who attested to the loss and loss adjustment estimates.

General Information on the Workers' Compensation Program of the State of Washington

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 Workers' Compensation Program or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Financial Analysis of the Workers' Compensation Program

Assets, Liabilities, and Fund Equity (in millions)

	2007	2006
Assets:		
Current assets	$ 2,399.6	$ 1,947.0
Investments, noncurrent	10,983.4	10,170.5
Capital assets	73.0	69.8
Total assets	$13,456.0	$12,187.3
Liabilities:		
Current liabilities	$ 3,629.5	$ 3,133.4
Noncurrent liabilities	18,012.0	16,114.7
Total liabilities	21,641.5	19,248.1
Fund Equity:		
Invested in capital assets, net of related debt	40.0	33.0
Unrestricted	(8,225.5)	(7,093.8)
Total fund deficit	(8,185.5)	(7,060.8)
Total liabilities and fund equity	$ 13,456.0	$12,187.3

Current assets increased from Fiscal Year 2006 to Fiscal Year 2007 by $452.6 million. The change resulted from an increase of $356.4 million in collateral held under security lending agreements due to an increase in securities lending activity. The $38.2 million increase in premiums receivable assessed for the last quarter of the fiscal year, which is a function of the increase in hours worked, is partially offset by the impact of rate decreases.

Current liabilities other than claims and judgments payable from Fiscal Year 2006 to Fiscal Year 2007 increased by $404.2 million. This change is a result of a $356.4 million increase in security lending activities and a $47.8 million increase in other current liabilities due to the timing of cash transactions during Fiscal Year 2007.

Total claims and judgments payable is $19.75 billion at the end of Fiscal Year 2007 compared to $17.76 billion for the previous year. Liabilities for the Supplemental Pension Account for future cost-of-living adjustments increased by $1.52 billion since June 30, 2006. This was caused by the recent growth in the state's average annual wage as calculated by the Washington State Employment Security Department. By law, cost-of-living adjustments for timeloss and pension benefits are tied to the annual changes in this calculated average wage. For calendar year 2007 and beyond, actuaries are estimating that the state's average annual wage will increase higher than estimates prepared during Fiscal Year 2006.

The Workers' Compensation Program total fund deficit increased $1.12 billion during Fiscal Year 2007. This overall deterioration in financial position is a result of many factors as highlighted below:

- Premiums and assessments revenues during Fiscal Year 2007 were $1.69 billion compared to $1.76 billion for Fiscal Year 2006. This decrease of $68.9 million resulted from an increase in retrospective rating adjustments of $32.7 million and a premium rate decrease during Fiscal Year 2007.

- Compared to Fiscal Year 2006, Fiscal Year 2007 premiums and claims expenses increased by $1.59 billion is largely due to an increase in claims payable which is actuarially estimated.

- Fiscal Year 2007 operating expenses other than premiums and claim expenses were $253.7 million compared to $266.4 million in Fiscal Year 2006. This decrease primarily resulted from a reduction in depreciation expense from $25.6 million in Fiscal Year 2006 to $8.2 million in Fiscal Year 2007. During Fiscal Year 2006 we recognized more depreciation expense resulting from changes to estimated useful lives of capital assets.

- In Fiscal Year 2007, the Workers' Compensation Program earned net investment earnings of $966.5 million, compared to a net investment loss $33.8 million in Fiscal Year 2006. This includes unrealized gains for equities and Treasury Inflation Protected Securities (TIPS), and realized gains for equities, TIPS, and fixed income securities. 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. Total gains in the equities were high due to the increasing stock market trend up to June 30, 2007.

Summary of Changes in Fund Equity (in millions)

	2007	2006
Operating revenues:		
Premiums and assessments	$1,689.1	$1,757.9
Miscellaneous revenue	53.6	32.5
Nonoperating revenues:		
Earnings (loss) on investments	966.5	(33.8)
Other revenues	7.0	7.6
Total revenues	2,716.2	1,764.2
Operating expenses:		
Salaries and wages	120.2	116.9
Employee benefits	37.9	33.4
Personal services	3.8	2.9
Goods and services	70.8	64.2
Travel	3.5	3.5
Premiums and claims	3,585.7	1,998.4
Depreciation	8.2	25.6
Miscellaneous expenses	9.3	19.9
Nonoperating expenses:		
Interest expense	1.6	2.1
Total expenses	3,841.0	2,266.9
Loss before contributions and transfers	(1,124.7)	(502.7)
Change in fund equity	(1,124.7)	(502.7)
Fund deficit – beginning of year	(7,060.8)	(6,558.1)
Fund deficit – end of year	$(8,185.5)	$(7,060.8)

Capital Asset and Debt Administration

- **Capital assets.** The Workers' Compensation Program investment in capital assets for its fiduciary activities as of June 30, 2007, was $73.0 million, net of accumulated depreciation. This reflects a net increase of $3.2 million over the previous year as a result of capitalizing internally developed software during the 2006/2007 Biennium. Additional information on the Workers' Compensation Program capital assets can be found in Note 1.D.4 on pages 26-27 of this report, and Note 5 on page 36 of this report.

- **Long-term debt.** The bond proceeds provided funding for the acquisition and construction of the building and grounds for the Department of Labor and Industries headquarters in Tumwater. At the end of Fiscal Year 2007, the Workers' Compensation Program had $33.1 million in outstanding bonds payable, which represent a 10.2% decrease from the prior fiscal year end. The decrease is the result of two semi-annual payments and the reissue/refunding of three bond series previously issued. Additional information on the Workers' Compensation Program bond debt obligations can be found in Note 6.A on pages 37-39 of this report.

Other Matters Impacting Next Fiscal Year

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.

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.

Financial Statements

State of Washington Workers' Compensation Program

Combining Balance Sheet

June 30, 2007

	BASIC PLAN						
	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total Basic Plan	Supplemental Pension Fund	Second Injury Fund	Total
ASSETS							
Current Assets:							
Cash and pooled investments	$ 6,594,492	$ 1,971,353	$ 1,097,258	$ 9,663,103	$ 499,879	$ 36,649,751	$ 46,812,733
Trust cash	-	-	1,515,523	1,515,523	-	-	1,515,523
Trust investments	-	-	6,539,367	6,539,367	-	-	6,539,367
agreements	731,042,682	491,723,110	334,285,998	1,557,051,790	23,606,815	-	1,580,658,605
Receivables, net of allowance	342,080,952	210,972,058	39,947,054	593,000,064	95,529,582	15,067,250	703,596,896
Due from Workers' Compensation Funds	47,614,338	220,821	-	47,835,159	7,140	11,116,554	58,958,853
Due from other state funds and agencies	151,786	226,794	-	378,580	5,143	-	383,723
Due from other governments	755,101	195,283	-	950,384	-	-	950,384
Inventories	83,932	83,932	-	167,864	-	-	167,864
Prepaid expenses	15,107	15,107	-	30,214	-	-	30,214
Total Current Assets:	1,128,338,390	705,408,458	383,385,200	2,217,132,048	119,648,559	62,833,555	2,399,614,162
Noncurrent Assets:							
Investments, noncurrent	4,059,611,314	4,160,519,971	2,661,095,245	10,881,226,530	102,186,129	-	10,983,412,659
Capital assets, net	37,252,830	35,740,021	-	72,992,851	-	-	72,992,851
Total Noncurrent Assets	4,096,864,144	4,196,259,992	2,661,095,245	10,954,219,381	102,186,129	-	11,056,405,510
Total Assets	$ 5,225,202,534	$ 4,901,668,450	$ 3,044,480,445	$ 13,171,351,429	$ 221,834,688	$ 62,833,555	$ 13,456,019,672
LIABILITIES AND FUND EQUITY							
LIABILITIES							
Current Liabilities:							
Accounts payable	$ 5,910,749	$ 6,392,748	$ 1,491,770	$ 13,795,267	$ 115,593	$ -	$ 13,910,860
Deposits payable	648,280	2,075,625	-	2,723,905	-	-	2,723,905
Accrued liabilities	164,525,388	6,820,683	1,284,485	172,630,556	176,196	7,316	172,814,068
Obligations under securities lending agreements	731,042,682	491,723,110	334,285,998	1,557,051,790	23,606,815	-	1,580,658,605
Bonds payable	1,762,500	1,762,500	-	3,525,000	-	-	3,525,000
Due to Workers' Compensation Funds	200,639	30,179	58,580,177	58,810,995	147,857	-	58,958,852
Due to other state funds and agencies	2,730,661	2,963,608	-	5,694,269	-	-	5,694,269
Unearned revenues	1,091,204	945,113	9,479,213	11,515,530	2,181,232	-	13,696,762
Claims payable	700,661,707	448,299,515	271,098,781	1,420,060,003	357,466,684	-	1,777,526,687
Total Current Liabilities	1,608,573,810	961,013,081	676,220,424	3,245,807,315	383,694,377	7,316	3,629,509,008
Non-Current Liabilities:							
Claims payable	2,737,182,292	2,714,595,484	2,360,928,219	7,812,705,995	10,156,259,316	-	17,968,965,311
Bonds payable	14,777,500	14,777,500	-	29,555,000	-	-	29,555,000
Other long-term liabilities	6,970,646	6,562,911	-	13,533,557	-	-	13,533,557
Total Non-Current Liabilities	2,758,930,438	2,735,935,895	2,360,928,219	7,855,794,552	10,156,259,316	-	18,012,053,868
Total Liabilities	4,367,504,248	3,696,948,976	3,037,148,643	11,101,601,867	10,539,953,693	7,316	21,641,562,876
Fund Equity:							
Invested in capital assets, net of related debt	20,712,113	19,199,325	-	39,911,438	-	-	39,911,438
Unrestricted	836,986,173	1,185,520,149	7,331,802	2,029,838,124	(10,318,119,005)	62,826,239	(8,225,454,642)
Total Fund Equity (Deficit)	857,698,286	1,204,719,474	7,331,802	2,069,749,562	(10,318,119,005)	62,826,239	(8,185,543,204)
Total Liabilities and Fund Equity	$ 5,225,202,534	$ 4,901,668,450	$ 3,044,480,445	$ 13,171,351,429	$ 221,834,688	$ 62,833,555	$ 13,456,019,672

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

State of Washington Workers' Compensation Program
Combining Statement of Revenue, Expenses, and Changes in Fund Equity
For the Year Ended June 30, 2007

	BASIC PLAN						
	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total Basic Plan	Supplemental Pension Fund	Second Injury Fund	Total
OPERATING REVENUES:							
Premiums and assessments	$ 741,181,114	$ 605,707,595	$ 4,660,777	$ 1,351,549,486	$ 275,652,672	$ 61,869,482	$ 1,689,071,640
Miscellaneous revenue	48,318,660	2,501,356	320,099	51,140,115	2,448,685	87	53,588,887
Total Operating Revenues	789,499,774	608,208,951	4,980,876	1,402,689,601	278,101,357	61,869,569	1,742,660,527
OPERATING EXPENSES:							
Salaries and wages	60,911,002	59,333,311	-	120,244,313	-	-	120,244,313
Employee benefits	19,517,567	18,285,297	-	37,802,864	-	-	37,802,864
Personal services	1,243,577	2,556,777	-	3,800,354	-	-	3,800,354
Goods and services	36,521,127	34,292,767	-	70,813,894	-	-	70,813,894
Travel	2,204,331	1,277,291	-	3,481,622	-	-	3,481,622
Claims	555,989,588	759,769,804	452,558,061	1,768,317,453	1,815,520,032	1,887,313	3,585,724,798
Depreciation	4,062,981	4,156,869	-	8,219,850	-	-	8,219,850
Miscellaneous, net	11,695,550	(4,423,358)	436,084	7,708,276	1,612,086	1	9,320,363
Total Operating Expenses	692,145,723	875,248,758	452,994,145	2,020,388,626	1,817,132,118	1,887,314	3,839,408,058
Operating Income (Loss)	97,354,051	(267,039,807)	(448,013,269)	(617,699,025)	(1,539,030,761)	59,982,255	(2,096,747,531)
NONOPERATING REVENUES (EXPENSES):							
Earnings on investments	319,969,814	436,467,970	202,878,852	959,316,636	7,231,505	-	966,548,141
Other revenue	5,864,407	1,098,894	-	6,963,301	14,104	-	6,977,405
Interest expense	(776,426)	(776,425)	-	(1,552,851)	-	-	(1,552,851)
Total Nonoperating Revenues (Expenses)	325,057,795	436,790,439	202,878,852	964,727,086	7,245,609	-	971,972,695
Income (Loss) Before Contributions and Transfers	422,411,846	169,750,632	(245,134,417)	347,028,061	(1,531,785,152)	59,982,255	(1,124,774,836)
Transfers in	-	-	294,333,861	294,333,861	-	45,663,216	339,997,077
Transfers out	(195,704,494)	(1,847,954)	(60,604,592)	(258,157,040)	-	(81,840,037)	(339,997,077)
Net Contributions and Transfers	(195,704,494)	(1,847,954)	233,729,269	36,176,821	-	(36,176,821)	-
Changes in Fund Equity	226,707,352	167,902,678	(11,405,148)	383,204,882	(1,531,785,152)	23,805,434	(1,124,774,836)
Fund Equity (Deficit) - Beginning of Year	630,990,934	1,036,816,796	18,736,950	1,686,544,680	(8,786,333,853)	39,020,805	(7,060,768,368)
Fund Equity (Deficit) - End of Year	$ 857,698,286	$ 1,204,719,474	$ 7,331,802	$ 2,069,749,562	$ (10,318,119,005)	$ 62,826,239	$ (8,185,543,204)

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

State of Washington Workers' Compensation Program
Combining Statement of Cash Flows
For the Year Ended June 30, 2007

	BASIC PLAN						
	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total Basic Plan	Supplemental Pension Fund	Second Injury Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:							
Receipts from customers	$ 736,691,724	$ 592,864,960	$ 3,746,431	$ 1,333,303,115	$ 271,499,045	$ 64,525,952	$ 1,669,328,112
Payments to/for beneficiaries	(510,920,112)	(532,697,244)	(245,534,223)	(1,289,151,579)	(299,834,936)	(1,886,569)	(1,590,873,084)
Payments to employees	(78,443,126)	(75,585,810)	-	(154,028,936)	-	-	(154,028,936)
Payments to suppliers	(39,612,941)	(37,200,914)	-	(76,813,855)	-	-	(76,813,855)
Other	36,611,576	6,913,180	(115,985)	43,408,771	836,599	87	44,245,457
Net Cash Flows from Operating Activities	144,327,121	(45,705,828)	(241,903,777)	(143,282,484)	(27,499,292)	62,639,470	(108,142,306)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:							
Transfers in	-	-	294,333,861	294,333,861	-	35,076,499	329,410,360
Transfers out	(243,168,117)	(1,847,954)	(2,554,252)	(247,570,323)	-	(81,840,037)	(329,410,360)
Operating grants received	5,972,973	1,240,352	-	7,213,325	-	-	7,213,325
License fees collected	3,240	1,421	-	4,661	491	-	5,152
Net Cash Flows from Noncapital Financing Activities	(237,191,904)	(606,181)	291,779,609	53,981,524	491	(46,763,538)	7,218,477
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:							
Interest paid	(679,251)	(679,249)	-	(1,358,500)	-	-	(1,358,500)
Principal payments on bonds payable	(1,687,967)	(1,687,926)	-	(3,375,893)	-	-	(3,375,893)
Acquisitions of capital assets	(5,984,529)	(4,946,370)	-	(10,930,899)	-	-	(10,930,899)
Net Cash Flows from Capital and Related Financing Activities	(8,351,747)	(7,313,545)	-	(15,665,292)	-	-	(15,665,292)
CASH FLOWS FROM INVESTING ACTIVITIES:							
Receipt of interest	250,579,403	160,325,319	146,436,972	557,341,694	8,946,371	-	566,288,065
Receipt of dividends	6,502,670	21,070,952	4,108,714	31,682,336	-	-	31,682,336
Investment expenses	(40,062,279)	(14,294,335)	(17,625,368)	(71,981,982)	(2,990,107)	-	(74,972,089)
Proceeds from sale of investment securities	497,824,466	396,306,423	150,633,222	1,044,764,111	381,983,117	-	1,426,747,228
Purchases of investment securities	(609,881,720)	(507,568,665)	(333,069,632)	(1,450,520,017)	(360,585,893)	-	(1,811,105,910)
Net Cash Flows from Investing Activities	104,962,540	55,839,694	(49,516,092)	111,286,142	27,353,488	-	138,639,630
Net increase (decrease) in cash and pooled investments	3,746,010	2,214,140	359,740	6,319,890	(145,313)	15,875,932	22,050,509
Cash and pooled investments, Beginning of year	2,848,482	(242,787)	737,518	3,343,213	645,192	20,773,819	24,762,224
Cash and pooled investments, End of year	$ 6,594,492	$ 1,971,353	$ 1,097,258	9,663,103	$ 499,879	$ 36,649,751	$ 46,812,733
Cash Flows from Operating Activities:							
Operating Income (Loss)	$ 97,354,051	$ (267,039,807)	$ (448,013,269)	(617,699,025)	$ (1,539,030,761)	$ 59,982,256	(2,096,747,530)
from Operating Activities:							
Depreciation	4,062,981	4,156,869	-	8,219,850	-	-	8,219,850
Change in Assets Decrease (Increase):							
Receivables	(5,013,298)	(12,467,069)	(914,346)	(18,394,713)	(4,153,627)	2,656,470	(19,891,870)
Inventories	668	668	-	1,336	-	-	1,336
Prepaid expenses	(12,202)	(12,202)	-	(24,404)	-	-	(24,404)
Change in Liabilities Increase (Decrease):							
Claims and judgements payable	41,692,387	227,980,517	206,765,896	476,438,800	1,514,952,690	-	1,991,391,490
Current liabilities	6,242,534	1,675,196	257,942	8,175,672	732,406	744	8,908,822
Net Cash Flows from Operating Activities	$ 144,327,121	$ (45,705,828)	$ (241,903,777)	$ (143,282,484)	$ (27,499,292)	$ 62,639,470	$ (108,142,306)
Noncash Investing, Capital, and Financing Activities:							
Increase in fair value of investments	$ 8,160,102	$ 166,617,235	$ 35,473,081	210,250,418	$ 1,463,661	$ -	$ 211,714,079
Refunding bonds issued	7,267,500	7,267,500	-	14,535,000	-	-	14,535,000
Refunded bonds redeemed	(7,455,000)	(7,455,000)	-	(14,910,000)	-	-	(14,910,000)

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

Notes to the Combining 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

The accompanying financial statements of the Workers' Compensation Program of the state of Washington have been prepared in conformity with generally accepted accounting principles. The Office of Financial Management (OFM) of the state of Washington is the primary authority for the Workers' Compensation Program 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:

1.A. Reporting Entity

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 Workers' Compensation Program consists of five enterprise funds to account for activity related to providing time-loss, medical, disability, and pension payments to qualifying individuals sustaining work-related injuries or occupational diseases. The accompanying financial statements present only the activity of the Workers' Compensation Program and do not present the financial position, results of operations, or cash flows of the Washington State Department of Labor and Industries or the state of Washington. The Workers' Compensation Program Basic Plan is funded based on rates that will keep the plan solvent in accordance with recognized actuarial principles. The Supplemental Pension Fund provides for cost-of-living adjustments (COLA) granted for time-loss and disability payments. These costs, however, are funded on a pay-as-you-go basis. By statute, the Workers' Compensation Program 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 are based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Workers' Compensation Program offers a retrospective premium rating plan under which premiums are adjusted annually for up to three 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 Program establishes claim liabilities based on estimates of the ultimate cost of claims (including future claims adjustment expenses) that have been reported but not resolved, and claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the benefit involved. Because actual claim costs depend on such complex factors as inflation, changes in doctrines of legal liabilities, claim 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 claim liabilities are charged or credited to claims expense in the periods in which they are made.

1.B. Financial Statements

Balance Sheet – The Balance Sheet presents assets and liabilities in order of liquidity. Fund equity is 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 are attributed to the acquisition, construction, or improvement of those assets.
- Unrestricted fund equity consists of the portion of fund equity that does not meet the definition of the preceding category.

Statement of Revenues, Expenses, and Changes in Fund Equity - This statement reports the changes in fund equity for the Workers' Compensation Program.

The Workers' Compensation Program consists of the following funds:

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 provides for supplemental COLA to injured employees receiving disability payments. However, the enabling legislation requires this fund to operate on a current payment basis. No assets are allowed to accumulate for the future servicing of current claims. Supplemental Pension Fund liabilities are discounted to the present value assuming a 2.5 percent annual interest rate.

COLA and timeloss 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-insured employers; half of the assessment shall be deducted from employees' wages.

The Second Injury Fund is used to pay pension costs on claims where a permanent total disability is at least partially caused by a prior injury. It is also used to fund job modifications for some temporarily disabled workers. It is funded by amounts received from the Accident and Medical Aid Funds for state-insured claims and by self-insured assessments for self-insured claims. An allowance for future second injury benefit payments is contained within the Accident and Medical Aid Funds' claim liabilities for state-insured claims; therefore, this fund does not carry any claim liabilities.

Operating and Nonoperating Revenues and Expenses - Operating revenues for the Workers' Compensation Program consist 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 nonoperating, including interest expense and earnings on investments.

1.C. Measurement Focus and Basis of Accounting

The Workers' Compensation Program's funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operations of the program are included on the Balance Sheet. The Statement of Revenues, Expenses, and Changes in Fund Equity presents increases (i.e., revenues) and decreases (i.e., expenses) in total fund equity.

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

1.D. Assets, Liabilities, and Fund Equity

1.D.1. Cash and Pooled Investments

Investments of surplus or pooled cash balances are reported on the accompanying financial statements as "Cash and Pooled Investments." 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 Program 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 and pooled investments.

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 the Department of Labor and Industries to pay benefits to Hanford workers injured on the job. Funds provided by the U.S. Department of Energy in advance to cover the pension liability determined by the Department of Labor and Industries are recorded as "Trust Cash" and "Trust Investments." As of June 30, 2007, Trust Cash amounted to $1,515,523 and is available to reimburse the Department of Labor and Industries for monthly pension payments. As of June 30, 2007, Trust Investments totaling $6,539,367 were invested in U.S. Treasury Notes, and is also available to reimburse the Department of Labor and Industries for future expenses.

1.D.2. Receivables

Receivables of the Workers' Compensation Program 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. Receivables due for workers' compensation premiums for the quarter ended June 30, 2007 are estimated. Receivables are recorded when either the asset or the 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. Accounts receivable are generally expected to be collected within one year following the end of the fiscal year.

The Workers' Compensation Program uses the allowance method for establishing an allowance for uncollectible receivables. Management regularly reviews receivables and adjusts the allowance accordingly based on specific percentages calculated using the aged general ledger accounts receivable. These percentages are determined by historical analysis of past accounts receivable and related amounts found to be uncollectible. Interest accrues on overdue accounts receivable at the rate of one percent per month. When an account is deemed uncollectible, it is written off against the allowance; however such accounts are not forgiven until legally allowed to be excused. The Workers' Compensation Program does not require collateral for its accounts receivable except for self-insurance pension receivables.

1.D.3. Inventories

Consumable inventories consist of expendable materials and supplies held for consumption and are reported in the Balance Sheet at average cost. The Workers' Compensation Program expenses consumable inventories when used.

1.D.4. Capital Assets

Except as noted below, it is the state's policy to capitalize:

- all land;
- all capital assets with a unit cost of $5,000 or more;
- capital assets acquired by capital leases with a net present value or fair market value, whichever is less, of $10,000 or more.

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 Program includes all direct construction costs and indirect costs that are related to the construction.

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

• Buildings and building components	5-50 years
• Furnishings, equipment, and collections	3-50 years
• Other improvements	3-50 years

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

1.D.5. Compensated Absences

Workers' Compensation Program 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 Program does not pay employees for unused sick leave upon termination except upon employee death or retirement. At death or retirement, the Workers' Compensation Program 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 Workers' Compensation Program 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.

1.D.6. Retirement Plan

Workers' Compensation Program 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 Workers' Compensation Program contributed $5,589,871 to this plan during the fiscal year ended June 30, 2007.

An actuarial valuation of the PERS plan for the Workers' Compensation Program 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.

1.D.7. Noncurrent Liabilities

Long-term obligations of the Workers' Compensation Program are reported as noncurrent liabilities on the Balance Sheet. Bonds payable are reported net of applicable original issuance premium or discount.

Note 2 – Deposits and Investments

2.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 Program would not be able to recover its deposits or collateralized securities that are in the possession of the outside parties.

The Workers' Compensation Program 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 Program insured deposits and the PDPC provides collateral protection.

2.B. Investments

2.B.1. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship over the Workers' Compensation Program 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, Workers' Compensation Program 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 Workers' Compensation Program 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.2. Securities Lending

The Workers' Compensation Program participates in securities lending programs to augment investment income. State Street Bank and Trust (SSB) acts as agent for securities lending transactions. As SSB is the custodian bank, it is counterparty to securities lending transactions.

The Securities Lending Collateral Balances are from securities required to be listed under GASB 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 Program 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 Program reports securities lent (the underlying securities) as assets in balance sheet. 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 Program has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are reported in the balance sheet. Securities lending transactions collateralized by securities that the Workers' Compensation Program 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 Workers' Compensation Program'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, 2007 was $1.58 billion and $1.55 billion respectively.

During Fiscal Year 2007, securities lending transactions could be terminated on demand by either the Workers' Compensation Program or the borrower. The average term of overall loans was 28 days.

Cash collateral was invested by the Workers' Compensation Program's agents in securities issued or guaranteed by the U.S. government, the Workers' Compensation Program's short-term investment pool (average weighted maturity of 220 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 Workers' Compensation Program 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 2007, 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 Program incurred no losses during Fiscal Year 2007 resulting from a default by either the borrowers or the securities lending.

2.B.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 Program 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 Workers' Compensation Program 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 Workers' Compensation Program 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					
Securities Lending Collateral Balances	1,580,659					
Total	12,564,071					
less current portion	1,580,659					
	$ 10,983,412					

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

	Investment Type (expressed in thousands)			
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

2.B.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 Program investment policy mitigates credit risk by limiting holdings of below investment grade fixed income securities. The rated debt investments of the Workers' Compensation Program 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 Workers' Compensation Program 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 Workers' Compensation Program would not be able to recover its investment securities or collateral securities that are in the possession of the custodian. The Workers' Compensation Program has no formal policy regarding custodial credit risk. However, as all of the Workers' Compensation Program assets are registered and held in the state of Washington's name, they are not subject to custodial credit risk.

2.B.5. 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 Workers' Compensation Program does not have a formal policy to limit foreign currency risk. The Workers' Compensation Program had $316.9 million invested in an international commingled equity index fund. As such, no currency denomination is presented.

2.B.6. Derivatives

The Workers' Compensation Program 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 Program 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.

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 equitize excess cash holdings. No such derivative securities were held as of June 30, 2007. 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, 2007, the only derivative securities held directly by the Workers' Compensation Program were collateralized mortgage obligations of $1.7 billion.

2.B.7. Reverse Purchase Agreements

State law permits the Workers' Compensation Proram 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 Workers' Compensation Program or provide securities or cash of equal value, the Workers' Compensation Program 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 2007 and there were no liabilities outstanding as of June 30, 2007 arising from reverse purchase agreements.

Note 3 – Receivables

Receivables at June 30, 2007, consisted of the following:

Premium receivables:							
Actual premium receivable	$ 66,448,398	$ 31,709,067	$ -	$ 98,157,465	$ 9,004,042	$ -	$ 107,161,507
Estimated premium receivable	234,524,000	148,513,000	-	383,037,000	53,721,000	-	436,758,000
Estimated Self-Insurance premium receivable	3,154,004	3,036,266	2,332,267	8,522,537	22,956,813	15,065,676	46,545,026
Total premium receivables	304,126,402	183,258,333	2,332,267	489,717,002	85,681,855	15,065,676	590,464,533
Other receivables:							
Receivable from overpayments	39,568,584	4,964,793	5,665,545	50,198,922	15,459,764	-	65,658,686
Investment interest receivable	48,169,980	33,917,379	31,622,693	113,710,052	1,276,559	-	114,986,611
Safety fines & penalties receivable	-	-	-	-	6,211,593	-	6,211,593
Miscellaneous receivable	10,544	4,099,087	1,870,275	5,979,906	4,957	3,500	5,988,363
Total Receivables, gross	391,875,510	226,239,592	41,490,780	659,605,882	108,634,728	15,069,176	783,309,786
Less: Allowance for uncollectible receivables	49,794,558	15,267,534	1,543,726	66,605,818	13,105,146	1,926	79,712,890
Total Receivables, net of allowance	$ 342,080,952	$ 210,972,058	$ 39,947,054	$ 593,000,064	$ 95,529,582	$ 15,067,250	$ 703,596,896

Note 4 – Interfund/Interagency Balances

The following balances at June 30, 2007, represent amounts due from and due to other state funds and agencies:

Due from Other State Funds and Agencies	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total Basic Plan	Supplemental Pension Fund	Second Injury Fund	Total
General Fund	$ 1,920	$ 41,970	$ -	$ 43,890	$ -	$ -	$ 43,890
Special Revenue Funds	1,525	36,483	-	38,008	5,143	-	43,151
Other State Agencies	148,341	148,341	-	296,682	-	-	296,682
Total Due from Other State Funds and Agencies	$ 151,786	$ 226,794	$ -	$ 378,580	$ 5,143	$ -	$ 383,723

Due to Other State Funds and Agencies	Accident Fund	Medical Aid Fund	Pension Reserve Fund		Supplemental Pension Fund	Second Injury Fund	Total
General Fund	$ 53,733	$ 9,455	$ -	$ 63,188	$ -	$ -	$ 63,188
Special Revenue Funds	19,888	11,243	-	31,131	-	-	31,131
Other State Agencies	2,657,040	2,942,910	-	5,599,950	-	-	5,599,950
Total Due to Other State Funds and Agencies	$ 2,730,661	$ 2,963,608	$ -	$ 5,694,269	$ -	$ -	$ 5,694,269

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

Capital asset activity for the fiscal year ended June 30, 2007, was as follows:

Capital Assets	Beginning Balance July 1, 2006	Increases	Decreases	Ending Balance June 30, 2007
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	8,194,482			3,239,748
Capital assets, being depreciated:				
Buildings and building components	62,441,040	264,334	-	62,705,374
Accumulated depreciation	(18,619,671)	(1,248,821)	-	(19,868,492)
Net buildings and building components	43,821,369			42,836,882
Furnishings, equipment, and collections	51,580,881	16,157,105	(3,843,270)	63,894,716
Accumulated depreciation	(34,498,295)	(6,945,536)	3,476,616	(37,967,215)
Net furnishings, equipment, and collections	17,082,586			25,927,501
Other improvements	1,020,401	268,862	-	1,289,263
Accumulated depreciation	(275,050)	(25,493)	-	(300,543)
Net other improvements	745,351			988,720
Total capital assets, being depreciated, net	61,649,306			69,753,103
Total Capital Assets, net of depreciation	$ 69,843,788			$ 72,992,851

Note 6 – Noncurrent Liabilities

6.A. Bonds Payable

The Workers' Compensation Program 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 2007. 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 Program 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 $18,670,000 at June 30, 2007. Bonds outstanding at June 30, 2007, have interest rates between 5.375% and 5.70%. The original amount of this bond issue was $19,960,000 in 1993.

- **The General Obligation Bonds of Series R-98A**
  The Workers' Compensation Program is required to make varying annual principal and interest payments, with the final payment due in 2007. The principal amount of these bonds outstanding was $10,000 at June 30, 2007. Bonds outstanding at June 30, 2007, have interest rates of 4.50%. The original amount of this bond issue was $7,215,000 in 1997. This bond issue was partially refunded in 2007 by General Obligation Bonds Series R-2007C.

- **The General Obligation Bonds of Series R-2007A**
  The Workers' Compensation Program 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 $7,765,000 at June 30, 2007. Bonds outstanding at June 30, 2007, have interest rates of 5.00%. The original amount of this bond issue was $7,900,000 in 2007. This bond issue refunded the outstanding General Obligation Bonds Series R-96A and R-96C in 2007.

- **The General Obligation Bonds of Series R-2007C**
  The Workers' Compensation Program 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 $6,635,000 at June 30, 2007. Bonds outstanding at June 30, 2007, have interest rates between 4.0% and 5.0%. The original amount of this bond issue was $6,635,000 in 2007. This bond issue partially refunded the outstanding General Obligation Bonds Series R-98A in 2007.

The annual debt service requirements to maturity for general obligation bonds for fiscal years ending June 30 are as follows:

General Obligation Bonds	Principal	Interest	Total
Accident Fund:			
By Fiscal Year			
2008	$ 1,762,500	$ 791,960	$ 2,554,460
2009	1,812,500	768,565	2,581,065
2010	1,910,000	672,838	2,582,838
2011	2,015,000	571,319	2,586,319
2012	1,602,500	448,688	2,051,188
2013-2017	7,437,500	839,491	8,276,991
Total Accident Fund	16,540,000	4,092,861	20,632,861
Current portion	1,762,500	791,960	2,554,460
Noncurrent portion	14,777,500	3,300,901	18,078,401
Medical Aid Fund:			
By Fiscal Year			
2008	1,762,500	791,960	2,554,460
2009	1,812,500	768,565	2,581,065
2010	1,910,000	672,838	2,582,838
2011	2,015,000	571,319	2,586,319
2012	1,602,500	448,688	2,051,188
2013-2017	7,437,500	839,491	8,276,991
Total Medical Aid Fund	16,540,000	4,092,861	20,632,861
Current portion	1,762,500	791,960	2,554,460
Noncurrent portion	14,777,500	3,300,901	18,078,401
Total Debt Service Requirements	$ 33,080,000	$ 8,185,722	$ 41,265,722

Total interest incurred on bonds payable for the year ended June 30, 2007, was $776,426 for the Accident Fund and $776,425 for the Medical Aid Fund. There are no covenants related to the Workers' Compensation Program's obligation for these bonds.

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 Balance Sheet.

Current Year Defeasances

On November 14, 2006, the Workers' Compensation Program issued $8,947,569 General Obligation Refunding Bonds (series R-2007A) with an average interest rate of 5.0 percent to refund $9,031,290 General Obligation Bonds series R-96A and R-96C with an average interest rate of 5.58 percent. The refunding resulted in an $83,721 gross debt service savings over the next 3 ½ years.

On May 30, 2007, the Workers' Compensation Program issued $8,671,598 of General Obligation Refunding bond (series R-2007C) with an average interest rate of 5.0 percent to refund $9,184,095 General Obligation Bond series R-98A. The refunding resulted in a $512,497 gross debt service savings over the next 9 years.

Prior Year Defeasances

In prior years, the Workers' Compensation Program defeased certain general obligation 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. At fiscal year end, June 30, 2007, Series R-2007C, in the amount of $6,905,000, still remains in the trust fund. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the Workers' Compensation Program's financial statements.

6.B. Claims Payable

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

	Basic Plan		Supplemental Pension Plan		Grand Total	
Claims Payable	FY 2007	FY 2006	FY 2007	FY 2006	FY 2007	FY 2006
Unpaid claims and claim adjustment expenses at beginning of fiscal year	$ 8,756,328	$ 8,555,911	$ 8,998,772	$ 8,722,984	$ 17,755,100	$ 17,278,895
Incurred claims and claim adjustment expenses:						
Provision for insured events of the current fiscal year	1,646,531	1,833,937	491,866	615,713	2,138,397	2,449,650
Increase (decrease) in provision for insured events of prior fiscal years	258,175	(268,051)	1,324,454	(50,192)	1,582,629	(318,243)
Total incurred claims and claim adjustment expenses	1,904,706	1,565,886	1,816,320	565,521	3,721,026	2,131,407
Payments:						
Claims and claim adjustment expenses attributable to:						
Events of the current fiscal year	294,879	277,626	-	-	294,879	277,626
Insured events of prior fiscal years	1,133,389	1,087,843	301,366	289,733	1,434,755	1,377,576
Total payments	1,428,268	1,365,469	301,366	289,733	1,729,634	1,655,202
Total unpaid claims and claim adjustment expenses at fiscal year end	$ 9,232,766	$ 8,756,328	$ 10,513,726	$ 8,998,772	$ 19,746,492	$ 17,755,100
Current portion	$ 1,420,060		$ 357,467		$ 1,777,527	
Noncurrent portion	7,812,706		10,156,259		17,968,965	

A description of the risks to which the Workers' Compensation Program is exposed and the ways the risks are handled is presented in Note 1.A. At June 30, 2007, $32.7 billion of unpaid claims and claims adjustment expenses are presented at their net present and settlement value of $19.7 billion. These claims are discounted at assumed interest rates of 2.5 percent (Accident Fund, Medical Aid Fund, and Supplemental Pension Fund) to 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.

The claims and claims adjustment liabilities of $19.7 billion, as of June 30, 2007, include $10.5 billion for supplemental pension COLAs that are funded on a current basis per RCW 51.32.073. Management believes the funding is in compliance with the statute. The Basic Plan claim liabilities of $9.2 billion are fully funded by a diverse portfolio of fixed income instruments, equity index funds, and cash, managed by the Washington State Investment Board.

6.C. Changes in Long-Term Liabilities

Long-term liability activity for the fiscal year ended June 30, 2007, was as follows:

Long-Term Liabilities	Beginning Balance July 1, 2006	Additions	Reductions	Ending Balance June 30, 2007	Due Within One Year
Claims payable, noncurrent & current	$ 17,755,100,510	$ 3,721,026,000	$ (1,729,634,511)	$ 19,746,491,998	$ 1,777,526,687
Bonds payable:					
General Obligation bonds:					
Series R-93B	18,785,000	-	(115,000)	18,670,000	1,645,000
Series R-96B	6,065,000	-	(6,065,000)	-	-
Series R-96C	5,050,000	-	(5,050,000)	-	-
Series R-98A	6,925,000	-	(6,915,000)	10,000	10,000
Series R-2007A	-	7,900,000	(135,000)	7,765,000	1,790,000
Series R-2007C	-	6,635,000	-	6,635,000	80,000
Total bonds payable	36,825,000	14,535,000	(18,280,000)	33,080,000	3,525,000
Other long-term liabilities:					
Compensated absences	11,587,646	15,248,111	(13,302,201)	13,533,557	-
Certificates of particpiation	7,306	-	(5,893)	1,413	1,413
Total other long-term liabilities	11,594,952	15,248,111	(13,308,094)	13,534,970	1,413
Total Long-Term Liabilities	$ 17,803,520,462	$ 3,750,809,111	$ (1,761,222,605)	$ 19,793,106,968	$ 1,781,053,100

6.D. Operating Leases

The Workers' Compensation Program 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 - Deficit Fund Equity

At June 30, 2007, the Workers' Compensation Program had deficit fund equity of $8.2 billion. The Supplemental Pension Fund provides COLA with deficit fund equity of $10.3 billion at June 30, 2007. The Workers' Compensation Program Basic Plan is funded based on rates that will keep the plan solvent in accordance with recognized actuarial principles. Supplemental COLA adjustments granted for time-loss and disability payments however, are funded on a pay-as-you-go basis. By statute, the Supplemental Pension Fund is only allowed to collect enough revenue to provide for current COLA payments.

Changes in total fund equity for the Workers' Compensation Program during the fiscal year ended June 30, 2007, were as follows:

Fund Equity	Accident Fund	Medical Aid Fund	Pension Reserve Fund	Total Basic Plan	Supplemental Pension Fund	Second Injury Fund	Fund Equity (Deficit)
Balance, July 1, 2006	$ 630,990,934	$ 1,036,816,796	$ 18,736,950	$ 1,686,544,680	$ (8,786,333,853)	$ 39,020,805	$ (7,060,768,368)
Fiscal Year 2007 Activity	226,707,352	167,902,678	(11,405,148)	383,204,882	(1,531,785,152)	23,805,434	(1,124,774,836)
Balance, June 30, 2007	$ 857,698,286	$ 1,204,719,474	$ 7,331,802	$ 2,069,749,562	$ (10,318,119,005)	$ 62,826,239	$ (8,185,543,204)

Note 8 – Commitments and Contingencies

8.A. Summary of Significant Litigation

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

8.B. Federal Assistance

The Workers' Compensation Program 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 Workers' Compensation Program. The Workers' Compensation Program does estimate and recognize a claims 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 Program's overall financial condition.

8. C. Commitments and Contingencies

Effective July 1, 1992, the Washington State Legislature required the Workers' Compensation Program 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 Workers' Compensation Program 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 Workers' Compensation Program has not made any payments to this risk pool since enactment of this indefinite commitment.

Supplementary Information

Workers' Compensation Program - Basic Plan
Schedule of Claims Development Information

Fiscal Years 1998 through 2007 (expressed in millions)

The table below illustrates how the Workers' Compensation Program 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 Program as of the end of each of the last ten fiscal years. The Workers' Compensation Program 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 successive fiscal 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.	Re-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
	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

Workers' Compensation Program - Supplemental Pension Plan
Schedule of Claims Development Information

Fiscal Years 1998 through 2007 (expressed in millions)

The table below illustrates how the Workers' Compensation Program 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 Program 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 Program 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 Plan 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.

		1998	1999	2000	2001	2002	2003	2004	2005	2006
1.	Net earned required contribution and investment revenues	$ 170	$ 193	$ 225	$ 267	$ 281	$ 293	$ 288	$ 326	$ 305
2.	Estimated incurred claims and expenses, end of policy year	790	548	635	628	807	1,029	1,228	724	804
3.	Paid (cumulative) as of:									
	End of policy year	-	-	-	-	-	-	-	-	-
	One year later	6	7	8	5	2	5	2	1	3
	Two years later	14	12	12	8	11	4	3	4	
	Three years later	17	18	17	22	6	6	6		
	Four years later	24	24	30	15	9	8			
	Five years later	30	37	27	19	12				
	Six years later	41	37	33	23					
	Seven years later	44	43	38						
	Eight years later	51	50							
	Nine years later	59								
4.	Re-estimated incurred claims and expenses:									
	End of policy year	790	548	635	628	807	1,029	1,228	724	804
	One year later	527	666	730	786	945	1,045	722	721	927
	Two years later	727	754	844	910	1,046	676	720	848	
	Three years later	798	860	959	1,064	701	667	811		
	Four years later	860	932	1,099	727	682	759			
	Five years later	924	1,034	746	671	811				
	Six years later	971	732	722	792					
	Seven years later	695	678	834						
	Eight years later	670	780							
	Nine years later	759								
5.	Increase (decrease) in estimated incurred claims and expenses from end of policy year	(31)	232	199	164	4	(270)	(417)	124	123

Source: Washington State Department of Labor and Industries

To the State of Washington Workers' Compensation Program:

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 Workers' Compensation Program (the "Program") and I have been assigned responsibility for that project.

I have examined the reserves for unpaid loss and loss adjustment expense liabilities at June 30, 2007 recorded in the consolidated balance sheet of the Program. The reserves are as follows:

	Reserve as of June 30, 2007
Accident Fund	$3,437,843,999
Medical Aid Fund	3,162,894,999
Pension Reserve Fund	2,632,027,000
Total Basic Fund	$9,232,765,998
Supplemental Pension Fund	$10,513,726,000
Total Program	$19,746,491,998

The Program does not cede or assume any reinsurance.

My examination included the performance of independent projections of the Program's loss and loss adjustment expenses and such other tests and procedures as I considered necessary in the circumstances. In making my examination, I relied upon Judy Schurke, Director, Washington Department of Labor and Industries and William Vasek, Chief Actuary, Washington Department of Labor and Industries, as to the accuracy and completeness of its loss and loss adjustment expense data and other related information provided to Tillinghast.

Due to the inherent uncertainty associated with actuarial projections of future contingent events, it is possible that the actual future payments associated with the disposition of current loss and loss adjustment expense liabilities could prove to be materially different from the estimated amounts underlying the entries in the financial statements. I have assumed that historical loss emergence patterns will be predictive of the Program's future loss emergence. My estimates make no provision for the extraordinary future emergence of new classes of losses or types of loss not represented in the company's historical data base or which are not yet quantifiable. Nor have I examined whether the loss and loss adjustment expense reserves are backed by appropriate assets that have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

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 and the Medical Aid Fund, 6.5% for the Pension Reserve Fund, and 2.5% for the Supplemental Pension 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.

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 Fund Equity of the Program, I consider $2,000,000,000 to be material for this Program, calculated as approximately 10% of the Program's reserves. I have identified the major risks and uncertainties as reserve leverage, reserve discounting, medical inflation, and cost of living increases. 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 Program's reserves.

The Accident Fund, Medical Aid Fund and Pension Reserve Fund each have positive Fund Equity. The Supplemental Pension Fund is funded on a paid basis, and is in a deficit position using GAAP principles. In total, the Fund Equity is negative.

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

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.

The Supplemental Pension Fund covers payments above the basic indemnity benefit for cost of living adjustments, small differences between the cost of living adjustments assumed in the reserves and actual future cost of living adjustments could result in a material change in future costs and, therefore, the adequacy of the reserve.

In my opinion, the amounts recorded in the consolidated balance sheet as reserves for estimated loss and loss adjustment expense liabilities:

- are computed in accordance with commonly accepted actuarial methods and are fairly stated on an ultimate discounted basis in accordance with sound actuarial principles;

- are based upon actuarial assumptions which are reasonable given the coverages provided; and

- make good and sufficient provision in the aggregate for all unpaid loss and loss adjustment expense obligations.

Date: December 14, 2007

David F. Mohrman, FCAS, MAAA
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December 2007