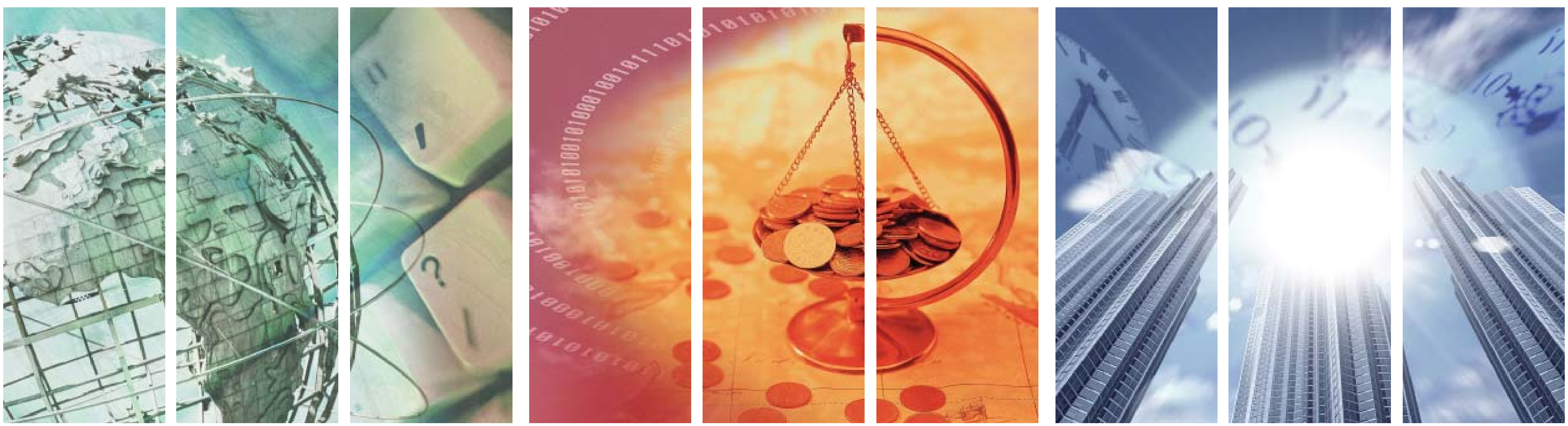
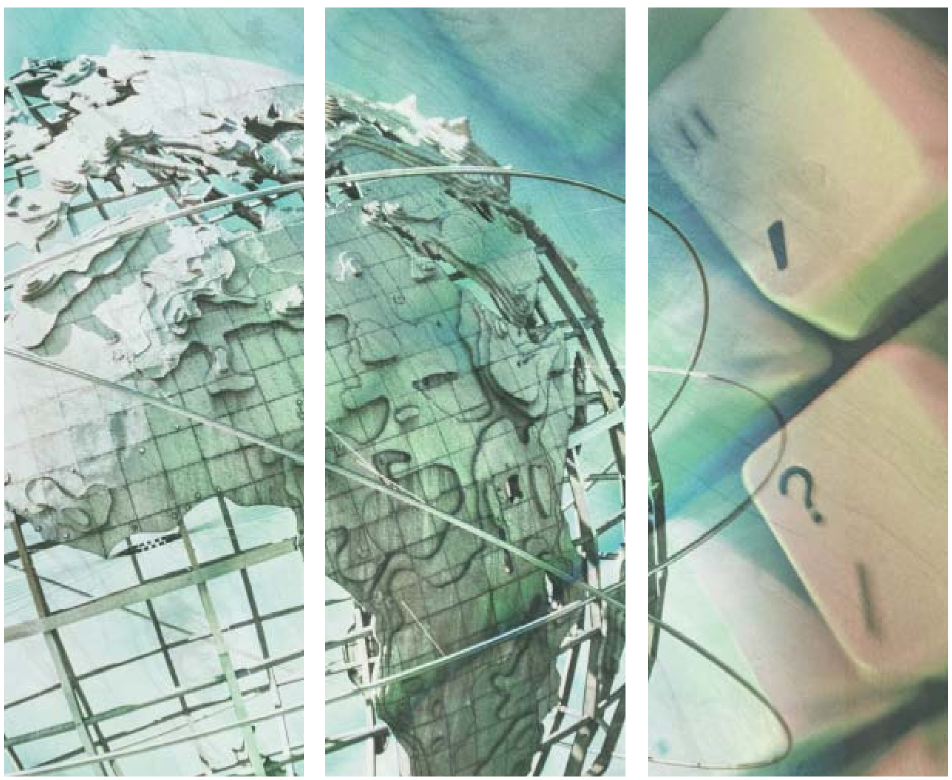
2006

WASHINGTON STATE INVESTMENT BOARD

TWENTY-FIFTH ANNUAL REPORT



Introduction



MESSAGE FROM THE CHAIR

June 30, 2006

The Washington State Investment Board (WSIB) plays a major role in providing retirement security for teachers, firefighters, law enforcement, school employees, and thousands of state and local government public employees, all of whom contribute a great deal to our quality of life. We also manage investments for several other public funds that help support Washington's injured workers and their employers, benefit our colleges and universities, and provide for people with developmental disabilities. Through our efforts to prudently manage and maximize investment returns for the benefit of the pension and other public trust funds that we manage, the WSIB makes a significant contribution to Washington's economy and quality of life.

With more than $70 billion in total assets under management, the WSIB works to consistently deliver high returns over the long term through responsible and cost-effective investments. As chair of the WSIB's 15-member Board of governing fiduciaries, it is my privilege to present the 2006 Annual Report highlighting how we continue to improve effective governance, transparency, and other responsible practices to ensure the investment assets we manage are appropriately accounted for and safeguarded.

This was a very successful year for the WSIB. As the fiscal year ended on June 30, 2006, the retirement and other funds we manage grew to $70.3 billion in total market value. The Commingled Trust Fund (CTF) for defined benefit pension funds earned an impressive 16.7% rate of return, ending the year with a total of $53.8 billion or $6.3 billion more compared to last year.

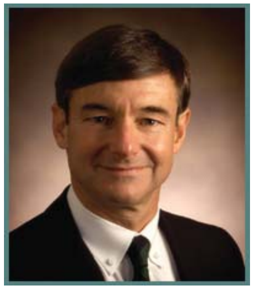
Other notable accomplishments for 2006 include increasing our commitment to international private equity and real estate investments to expand our geographic and economic exposure; intensifying our focus on governance issues with the addition of a full-time corporate governance officer; expanding our risk management and compliance capabilities for stronger internal controls and accountability; and examining and clarifying our investment beliefs to shore up the discipline and perspective we need to make prudent investment decisions and maintain solid performance over the long-term.

We said goodbye this year to Board member Debbie Brookman, who left to pursue a new position. On behalf of everyone at the WSIB, we thank Debbie for her exemplary service in representing active members of the Public Employees Retirement System (PERS) and as chair of the Private Markets Committee. In her stead, we welcome Mason Petit and look forward to his new perspective and scrutiny. Finally, I want to thank the entire Board and WSIB staff for their contributions throughout the year and our constituents for their continued support and trust.

Patrick McElligott, Chair

LETTER OF TRANSMITTAL

June 30, 2006



To the best of our knowledge, the data provided in this report is a fair and accurate representation of the WSIB's performance and financial operations. The Introductory Section includes a message from the Chair; this letter of transmittal, and information about the Board, outside help, and staff. The Investment Section contains performance information on total assets under management, asset class program and portfolio descriptions, and information regarding in-state investments. The Financial Section includes the Management Discussion and Analysis (MD & A), and basic financial statements and schedules.

The Legislature created the WSIB in 1981 as an independent board of trustees whose fiduciary responsibility is to manage investments for retirement and public trust funds with the highest standard of professional conduct for the exclusive benefit of fund participants and beneficiaries. The Board's primary investment objective is to establish policies and procedures designed exclusively to maximize return at a prudent level of risk.

Message from the Executive Director

Fiscal 2006 was a very good year for the beneficiaries of the public pension and other trust funds managed by the WSIB. Good investment choices and exceptional earnings made the WSIB the second best performing public pension plan in the country.

It would be easy to look at the many positive investments results of 2006 – detailed in this report – and be satisfied that we are doing our best. But we must constantly challenge ourselves to do better, because it is through those efforts that we honor the dignity of the work of all the people we serve, including more than 400,000 active and retired public employees, teachers, school employees, firefighters, and law enforcement officers throughout the state.

One of the best ways to thank them for all they do to make Washington an excellent place to live is to fulfill the promise of adequate and reliable pension benefits when they retire from public service. All of us at the WSIB—Board members and staff-- have the honor to help make sure that promise is kept by prudently managing how their pension fund assets are invested.

The increasing complexity of today's global financial markets compels the WSIB to be more strategically positioned to successfully maximize the opportunities for future growth and sustain investment long-term performance.

Looking back: Strategic Themes for 2006

"Greatness is not a function of circumstance. Greatness, it turns out, is largely a matter of conscious choice, and discipline." Jim Collins, author of Good to Great.

Over the past few years, the WSIB has made significant progress in re-structuring the entire organization to make sure we have the people, technology, research capacity, and governance processes in place to transition from what we consider good to great. While the bulk of this report deals with our investment decisions and results, I want all beneficiaries to be aware of our efforts to create the framework we need to promote and achieve organizational excellence.

As I said earlier, this has been an ongoing transformation with each year building on the accomplishments and successes of the previous year. In keeping with that strategy, the WSIB adopted three major themes for change in 2006 and our accomplishments within the context of those themes were as follows:

Rigorous focus on investment performance and decision making

- Adopted a best practices framework for Private Equity
- Established a centralized research function
- Examined and defined the WSIB staff's investment beliefs

- Implemented an innovation portfolio fund to expand investment opportunities
- Developed an investment product review process to plan operationally for new investment vehicles

Achieve Exemplary Governance

- Reviewed and updated selected board charters and policies
- Conducted an internal board governance review and created a plan for ongoing improvement
- Received a "clean" audit from the State Auditor's office with no findings or citations for 14th consecutive year

Develop, Inspire and Support People who are Passionate about Investment Management

- Recruited the best employees for new positions through targeted recruitments: Corporate Governance Officer, Research Director, IT Director, IT Project Manager, Compliance Officer, and Fixed Income Assistant Investment Officer

Looking ahead: Our Strategic Challenge for 2007

The challenge for 2007 and foreseeable future is to ensure that the progression from good to great transcends any one person or group of individuals who serve on the Board and work for the organization. Reaching that goal will require the collective talent, imagination and discipline of each of us at the WSIB. For the next phase of our transition, we have identified the following critical steps:

- Develop a statement of investment beliefs that clearly articulate the Board's risk appetite and tolerance.
- Create a framework for investment risk analysis and ensure that risk assessment is built into every aspect of the decision-making process, from asset allocation and portfolio construction to deal sourcing, partner selection, and buy/sell securities decisions
- Expand IT infrastructure to strengthen business processes and enhance data integration and analytics for investment decision making and operational excellence
- Continue our efforts to build a Performance Management System that attracts and retains the best employees and leads to exemplary performance agency-wide

Washington has one of the best funded and most secure public pension systems in the country. The lion's share (approximately 80%) of the money used to fund the system is generated by earnings on the investments of retirement assets managed by the WSIB. The WSIB receives no general state tax revenue. Appropriated expenses cover normal agency operations, including staff, facilities, equipment, utilities, and supplies and are subject to a biennial appropriation from the Legislature.

This report was prepared to conform with accounting and reporting principles established by the Governmental Accounting Standards Board (GASB). Specific accounting treatments are detailed in the Notes to the Financial Statements found in the report's Financial Section.

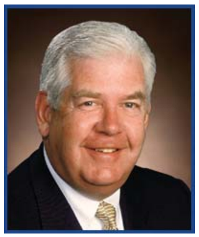
For the pension and public trust fund beneficiaries that we serve, all of us at the WSIB look forward to meeting the challenges of the coming years and are proud to be entrusted with the investment and governance responsibilities that significantly contribute to your long-term, financial security and strength.

Joseph A. Dear

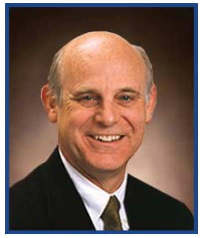
Joseph A. Dear, Executive Director

BOARD MEMBERS

Voting members


Michael J. Murphy, State Treasurer


Sandra J. Matheson

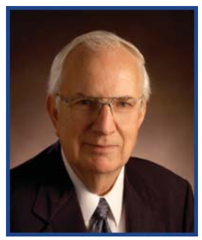

Gary K. Weeks


David Scott


Glenn Gorton, Vice-Chair


Patrick McElligott, Chair


Deborah Brookman


George Masten


Helen Sommers


Lisa Brown

Non-voting members


Robert S. Nakahara, CPA


Charles A. Kaminski, CFA


John W. Magnuson, CPM, CRE


Jeffrey Seely


David Nierenberg

COMMITTEES

Board Established Committees

Individual Board members are appointed by the Chair to serve on any of the Board's 4 different committees in order to more efficiently analyze investment and governance issues. Committee recommendations are brought to the Board for consideration and a vote.

The Administrative Committee oversees organizational, personnel, budget, legal, and legislative issues, as well as strategic asset allocation.

The Audit Committee oversees audit activities and operations, and nominates candidates for the non-voting positions on the Board. The Committee also develops and monitors the Conflict of Interest Policy for the Board, reviews performance-reporting requirements, and deals with corporate governance policies and issues.

The Private Markets Committee develops policy and structure for private market and real estate opportunities, and reviews those investments for recommendations to the Board.

The Public Markets Committee develops policy and structure for public market investments (fixed income, domestic equity, international equity) and reviews individual equity managers to recommend to the Board.

STAFF

Joseph A. Dear - Executive Director

- Appointed November, 2002
- Former Government relations officer, Frank Russell Company
- Former Chief of staff for Governor Gary Locke
- Former Assistant secretary of labor, Occupational Safety and Health Administration
- Former Director, Washington State Department of Labor and Industries
- Former Member and chair, Washington State Investment Board

Gary Bruebaker, CFA, CPA - Chief Investment Officer

- 28 years executive management and public finance experience
- Former deputy state treasurer of Oregon
- Former president, Government Finance Officers Association of the U.S. & Canada

Theresa J. Whitmarsh - Chief Operating Officer

- 21 years insurance, finance, and technology management experience
- Former assistant and deputy director, Washington State Department of Labor and Industries
- Former vice president of leading data management company serving large, self-funded employers
- Former communications director for an insurance trade association

Senior Investment Officers

- Asset Allocation - Diana Will, CFA
- Fixed Income - William P. Kennett, CFA
- Private Equity - Thomas Ruggels
- Public Equity - Nancy Calkins, CIMA
- Real Estate - Steven M. Draper

Operations Managers & Administrators

- Business and Office Services - Celina Verme
- Information Systems - Jim Lee
- Investment Accounting - Steven C. Verschoor
- Portfolio Administration - Alicia Markoff

OUTSIDE HELP & ADVICE

Outside Help and Advice

Investment Accounting Data System

Financial Control Systems

Master Custodian Bank

State Street Bank

Insurance Portfolio Consultant

Conning Asset Mgmt.

General Investment Consultants

Callan Associates

Pension Consulting Alliance

R.V. Kuhns & Associates Inc.

Specialty Investment Consultants

Aon

Cortex Applied Research

Independent Fiduciary Services

Legal Services

Cox, Castle, & Nicholson	Proskauer Rose
Foster, Pepper & Shefelman	Preston, Gates & Ellis
Goodwin Procter	Song Mondress
Orrick	Washington Attorney General
Paul Hastings	

Private Equity Consultant

Capital Dynamics, Inc.

Real Estate Consultant

Courtland Partners

PARTNERSHIPS

Private Equity Partnerships

- APAX Partners
- Astorg Partners
- Austin Ventures
- Avenue Capital
- Banc Funds
- BC Partners
- BlackRock Asset Investors
- Boston Ventures
- Bridgepoint Europe
- Butler Capital Partners
- Capital Resource Partners
- CCMP Asia (fka JP Morgan)
- Charterhouse
- Cinven
- Clayton Dubilier & Rice
- Code, Hennessy & Simmons
- Contrarian Capital Management
- Cornerstone Equity
- Cypress Group
- Doughty Hanson
- Elevation Partners
- Endeavour Capital
- Essex Woodlands
- Evercore
- First Reserve
- Fisher Lynch Capital
- Fortress Investment Group
- Francisco Partners
- Frazier & Company
- Gilbert Global Equity Partners
- Green Mountain Partners
- Gryphon Partners
- GTCR
- HarbourVest Partners
- Hellman & Friedman
- Heritage Partners
- Indigo Capital Partners
- InterWest Partners
- INVESCO Private Capital
- Joseph Littlejohn & Levy
- Kolberg Kravis Roberts & Co.
- KSL Capital Partners
- Leonard Green & Partners
- Madison Dearborn Partners
- Matlin-Patterson Global Opportunities
- Menlo Ventures
- Mobius Venture Capital
- Morgan Stanley Ventures
- New Enterprise Associates
- Nordic Capital
- Oak Investment Partners
- Oaktree Capital Management
- Olympus Partners
- OVP Venture Partners
- Palamon Partners
- Pathway Capital Management
- Rice, Sangalis, Toole & Wilson
- Silver Lake Partners
- Spectrum
- Sprout Capital
- TA Associates
- Telecom Partners
- Texas Pacific Group
- The Blackstone Group
- Thomas Weisel Capital Partners
- TSG Capital Group
- U.S. Venture Partners
- Varde Partners
- Vestar Capital Partners
- Warburg Pincus
- Welsh Carson Anderson & Stowe

Real Estate Fund Managers

- Campbell Group
- Cherokee
- Colonnade
- Corporate Properties of the Americas
- Evergreen Investment Advisors
- Hancock Timber
- Hearthstone
- Hometown
- Hudson Advisors
- Indochina Capital
- ING Realty Partners
- JER Partners
- Lowe Enterprises
- Morgan Stanley
- Pacific Realty
- Principal Enterprise Capital
- Prosperitas
- Rockspring
- TA Associates
- Warburg, Pincus & Co.
- WA Holdings

Public Equity Fund Managers

- Arrowstreet Capital, L.P
- Barclays Global Investors
- Capital Guardian Trust Co.
- Capital International, Inc.
- F&C Emerging Markets Ltd.
- Fidelity Mgmt. Trust Co.
- Goldman Sachs Asset Mgmt.
- Grantham, Mayo, Van Otterloo
- Julius Baer Investment Mgmt.
- LSV Asset Mgmt.
- Mondrian Investment Partners Ltd.
- State Street Global Advisors
- William Blair & Co.

ENTERPRISE RISK MANAGEMENT

Key Risks

One strategic element of our organizational transition this year was establishing an Enterprise Risk Management (ERM) program. A cornerstone of a successful investment strategy is effective risk management. The WSIB's enterprise-wide approach to risk management includes the Board, executive management, audit, operational, and investment staff.

The WSIB faces two primary risks. The first arises simply from the deployment of the assets under our management in a fiercely competitive environment. We are required to adhere to investment policies and follow the standards and procedures that a prudent investor would follow in managing the assets of others.

The second primary risk is organizational, and stems from managing this investment effort within a governmental framework while implementing investment management strategies that are more closely aligned with private investment entities.

Risks are seen as opportunities for success as well as failure. The first step in assessing the WSIB's ability to manage risk was to identify our six enterprise risk categories:

- ✪ Fiduciary Risk. To manage this risk, the WSIB has an independent Board, retains the services of legal fiduciary counsel, and complies with state ethics laws. Our code of conduct and conflict of interest procedures, established for both the Board and staff, ensures that our values and expectations are understood and integrated throughout the Board and agency at all times.
- ✪ Market Risk. The potential for changes in the market value of our investment position is referred to as market risk. The primary market risks are interest rate risk, security pricing risk, and currency risk. We seek to control the overall level of market risk by broadly diversifying across asset classes, investment managers, and geographies.
- ✪ Strategic Risk. To manage this risk, we strive to have effective Board governance, the appropriate organizational structure for our mission, capable leadership, and an established strategic planning process. Our organizational structure includes an internal audit department, enterprise-wide risk management team and a business coordination group.
- ✪ Governmental and Environment Risk. This is the risk of not continuously understanding, anticipating, and responding to changes in our environment. The WSIB is a state agency operating under a government framework within a political environment that is not always aligned with the practices and priorities of investment entities. To help manage this, the executive director and our legislative liaison work to monitor actual or proposed legislative changes that may affect our ability to accomplish our mission.
- ✪ Operational Risk. Operational risk refers to losses that could arise from short-comings or failures in internal processes, people or systems, or from failures of external processes, people or systems that the WSIB depends on. We manage this risk through continuous improvements of our control structure; training, supervision and development of our staff; and the commitment of executive management to mitigate key operational risks identified by the ERM team.
- ✪ Reputation Risk. Failure in any of these prior five risk categories can affect the WSIB's credibility. The Board has adopted rigorous codes of conduct and conflict of interest policies to ensure that its actions meet the most stringent standards and review. We provide quality education, information and support to our Board members so they can make informed decisions. The WSIB is a sought after partner in the market place, is viewed as a trusted fiduciary by stakeholders and the legislature, and is a valued resource for the citizens of Washington state.

We are fiduciaries acting on behalf of more than 400,000 active and retired public employees, teachers, school employees, firefighters, and law enforcement officers throughout Washington state. We continuously review, assess, and manage our risk-management categories and other practices to ensure that risk is managed effectively.

CORPORATE GOVERNANCE

"Corporate governance has evolved over the past century to more effectively promote the allocation of the nation's savings to its most productive uses. And, generally speaking, the resulting structure of business incentives, reporting, and accountability has served us well. We could not have achieved our current level of national productivity if corporate governance had been deeply flawed. "

- Alan Greenspan, former chairman of the Federal Reserve Board, speaking to the Stern School of Business at New York University, March 26, 2002

The WSIB's commitment to prudently manage and invest the retirement and public trust funds of its beneficiaries does not stop at the corporate boardroom door.

The WSIB believes its goal to maximize investment returns includes vigilant oversight of the way companies in which public pension funds are invested are managed; the manner in which the company's board of directors carry out their corporate duties and responsibilities. Are they examples of "good governance?"

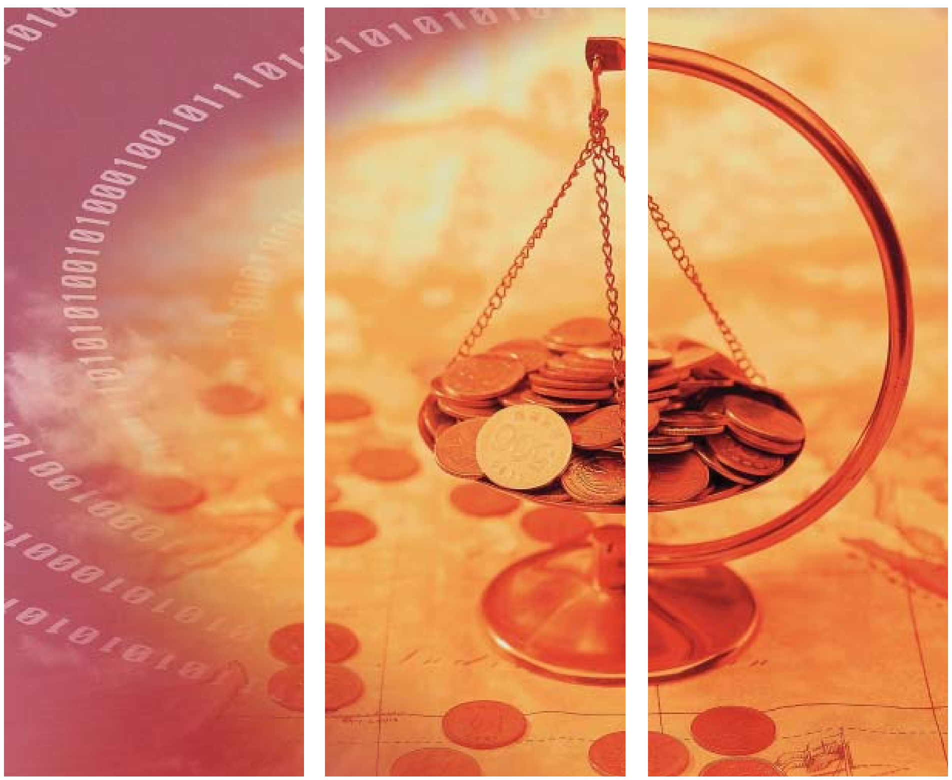
Increasingly studies are reporting that companies with good governance tend to produce higher returns on equity than poorly governed firms. The Corporate Library, which monitors corporate governance at more than 2,100 companies, found that stocks of well governed companies returned an average of 15% for the 18 months that ended Dec. 31, 2005, compared with 12.5% for the overall market.

This year the WSIB voted almost 4,200 proxy ballots. Proxy votes were cast on almost 30,000 individual proxy proposals, dealing primarily with election of directors, ratification of auditor, compensation plans, and shareholder proposals.

The WSIB withheld its vote from more than 4,000 incumbent directors, primarily because of lack of board independence or unacceptable compensation practices. In order to register our displeasure, the WSIB voted against more than 300 compensation plans and against almost 500 compensation committee members for paying excessive compensation.

As one of the country's largest institutional investors, the WSIB believes the proxy voting ballot is one of the most effective ways to influence greater board transparency, integrity and accountability.

Investments



PLANS UNDER MANAGEMENT - RETIREMENT COMMINGLED TRUST FUND

Retirement Plans

The WSIB manages investments for 15 separate pension plans. The Department of Retirement Systems (DRS), whose director also serves as an ex-officio voting member on the Investment Board, administers the plans for public employees (PERS), teachers (TRS), classified school employees (SERS), law enforcement officers and firefighters (LEOFF), and other employees of participating local subdivisions including judges (JRA) and the state patrol (WSP). DRS is not the administrative arm for the volunteer firefighters pension fund (VFF), but the investment assets for those funds are managed by the WSIB. The active members by system increased from 289,422 one year ago to 290,142. The total of retired members by system is 153,557.

Retirement Fund Performance

The defined benefit retirement funds are invested through the Commingled Trust Fund (CTF). The CTF pools retirement fund assets to more efficiently manage and reduce administrative costs and investment fees. Over the past 10 years, the fund has grown from $32.5 billion to $53.8 billion including employer and employee contributions, plus net investment returns, less benefit payments and fund transfers (this does not include Plan 3 self-directed defined contribution funds).

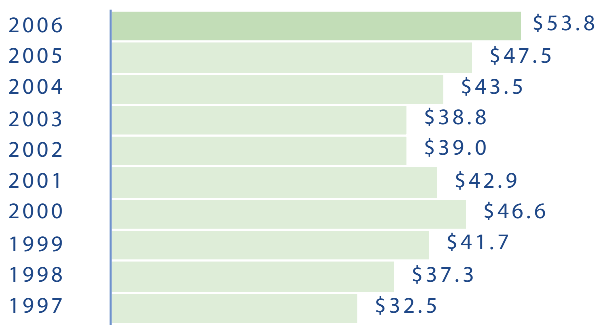
The WSIB measures fund performance by comparing expected investment returns for performance of the individual asset classes to appropriate benchmarks. Although returns vary quarterly and annually, long-term expectations and realizations should exceed the actuarially assumed rate of return over time.

When comparing fund performance from one year to the next, it is important to remember that asset classes differ in their behavior and volatility. Most public market investments can be priced instantaneously and fair market value can be determined with certainty. However, real estate and private equity investments are very illiquid and not easily priced. It may take years before expected returns are realized.

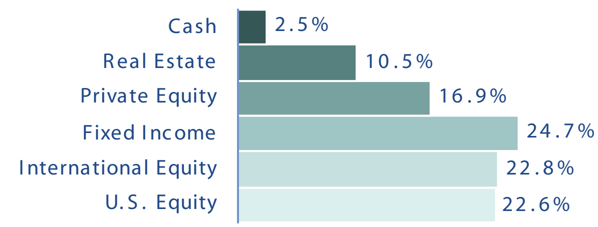
CTF Historical Market Values (billions)

	1 Year	3 Year	5 Year	10 Year
CTF Total Fund	16.7%	15.5%	8.5%	9.6%

Fiscal years ended June 1997 to 2006



Strategic Asset Allocation



Asset allocation is often considered to be the most important driver of investment performance. In basic terms, it is the process of selecting a mix of asset classes, such as stocks and bonds, and strategically determining their proportions within an investment portfolio.

Individual asset classes have distinct characteristics and historic market patterns show that when some fall in value, others rise. Asset allocation decisions account for nearly 92% of the variation between returns on different investment portfolios. Investment portfolio assets are strategically diversified to help offset declines in any one class, smooth out marketplace ups and downs, and reduce overall investment risk.

To meet the financial objectives of each fund, the WSIB constantly monitors and adjusts asset allocations for the various investment portfolios we manage. For example, the CTF is invested in 5 basic asset classes including public equity, fixed income, private equity, real estate, and cash. The Board establishes long-term policy targets

for each asset class and acceptable ranges the asset class can vary from the target. Strategic allocations are formally reviewed at least every 4 years and, if necessary, revised. The last asset allocation study for the CTF was completed in September of 2005.

During FY 2006 the WSIB's strategic allocation for the CTF was revised to eliminate the home country bias from the public equity component, resulting in a transfer of almost $2.9 billion to international public equity.

U.S. Equity Program

	1 Year	3 Year	5 Year	10 Year
U.S. Equity	9.9%	13.1%	4.0%	8.6%

The most significant impact on the WSIB's equity program during FY 2006 was the change in the asset allocation which reduced the U.S. equity target from 31% to 23% and increased the international equity target from 15% to 23%.

Since the U.S. equity markets are generally efficient, the WSIB invests the U.S. equity program primarily in a low-cost, broad-based index fund. During FY 2006, about one-quarter of the U.S. equity program was transitioned into risk-controlled enhanced index strategies to add potential value to the portfolio.

Year in Review

The U.S. equity market generated a higher return of 9.9% than the 8.3% earned in FY 2005; however, still in the single digit level. Higher interest rates and fuel costs continued to dampen investor enthusiasm. The value segment outperformed growth and small outperformed the large within capitalization.

Highlights

- 8% of the CTF assets were reallocated from U.S. equity to international equity.
- The portfolio value was $13.1 billion at the end of the fiscal year.
- The WSIB's U.S. equity program performed as expected, matching the Dow Jones Wilshire 5000 index with a return of 9.9%. Other U.S. equity market index returns were lower--Russell 3000 returning 9.6% and the S&P 500 providing an 8.6% return.

International Equity Program

	1 Year	3 Year	5 Year	10 Year
Intl. Equity	27.2%	24.9%	11.5%	6.8%

The most significant impact on the WSIB's equity program during FY 2006 was the change in the asset allocation which increased the international equity target from 15% to 23% and reduced the U.S. equity target from 31% to 23%. This strategic move added value to the overall CTF as the WSIB's international portfolio returned 27.2% compared to the 9.9% return for the U.S. portfolio.

Inefficiencies in international equity markets, as compared to U.S. equity markets, provide greater opportunities to add value with active management. Accordingly, the developed markets international equity program uses a combination of passive and active mandates and the emerging markets equity program is 100% actively managed.

Our active international developed markets equity managers are allowed to identify and invest in promising emerging markets' opportunities with the goal of generating higher returns for the international equity portfolio. To provide the necessary flexibility to meet this goal, the Board approved a range of 5.0% to 10.0% of the total international equity allocation for dedicated emerging markets equity, with a fixed goal set each year. For FY 2006 the emerging markets target was 8.5% of the total international equity portfolio.

Year in Review

International equity markets continued to perform well, completing a third straight year of above-average returns. Increased economic momentum overseas--particularly in Japan--outweighed any concerns over higher interest rates, inflation, and geopolitical issues. France, Germany, Japan, and the United Kingdom were the primary

contributors to returns, while New Zealand was the worst performing country. The financial sector continued to be one of the main contributors to return, along with the industrial, materials, and consumer discretionary sectors. The telecommunications sector was the worst performing sector.

Highlights

- International equity was one of the CTF's best performing asset classes for FY 2006. The portfolio value increased from $7.8 billion to $12.6 billion.
- The total international equity portfolio returned 27.2% compared to the MSCI ACWI ex U.S. return of 28.4% for FY 2006. The WSIB's developed markets portfolio matched the MSCI EAFE + Canada benchmark return of 26.9%, and the emerging markets portfolio returned 35.8%, outperforming the return of the MSCI Emerging Markets benchmark of 35.5%.

Fixed Income Program

	1 Year	3 Year	5 Year	10 Year
Fixed Income	0.3%	2.9%	5.7%	6.7%

The domestic fixed income program is actively managed by WSIB staff against a performance benchmark of the Lehman Universal Index. The main sectors in the portfolio are U.S. treasuries, U.S. treasury inflation protection securities (TIPS), credit bonds, mortgage backed securities (MBS), and commercial mortgage backed securities (CMBS).

Year in Review

In anticipation of interest rates moving higher during FY 2006, the portfolio's duration (a measure of the sensitivity of market value to changes in the level of interest rates) was kept below the duration of the Universal Index. This helps the portfolio in times of rising interest rates and negative returns but not in times of stable or falling rates and positive returns. During the past year, the yield on the 10-year treasury increased from 3.9% to 5.1%.

Highlights

- The portfolio value increased from $12.3 billion to $12.9 billion.
- The portfolio outperformed the Lehman Universal Index by 0.6%.
- The portfolio's quality remained the same at Aa1, relatively high, as high yield holdings continued to be underweighted relative to the index.
- Transactions included $1.3 billion in sales and $3.9 billion in purchases.
- Net purchases were made to TIPS, treasuries, and credits to increase those allocations. Purchases were also made to commercial mortgage obligations (CMOs) and pass-through mortgages to increase allocations and put pay downs of principal back to work.
- With rising interest rates, the best performing major sector for the portfolio was its cash position at 4.2%, followed by TIPS at 1.9%.
- The best returning sector for the index was mortgages at 0.4%.
- The more risky index sectors, emerging markets and high yield, returned 8.1% and 4.8%, respectively

Private Equity Program

	1 Year	3 Year	5 Year	10 Year
Private Equity	39.5%	30.0%	13.2%	16.0%

Private equity investments range from leveraged buyouts of mature companies to the investment of initial capital in start-up enterprises. These are illiquid, very long-term investments of up to 12 years or more and are attractive to institutional investors because, over long time horizons, they offer higher expected returns than traditional public equity investments.

Year in Review

During the fiscal year, the portfolio increased in value by $2.1 billion, due to strong investment returns and a continued brisk pace of investment. The portfolio is now nearing its asset allocation target, which is 17%.

There were several noteworthy events in the program during FY 2006. Capital Dynamics was hired as the private equity consultant, replacing Pacific Corporate Group who had served in that capacity for the previous 5 years. Also during FY 2006, the WSIB, jointly with the state of Oregon, established a private equity co-investment vehicle managed by Fisher Lynch Capital. Through this vehicle, Fisher Lynch will seek opportunities to invest capital directly into companies, primarily along-side funds in which Washington or Oregon are investors as a limited partner. This vehicle will allow the WSIB to invest in a diversified portfolio of high-quality companies at a lower cost.

Finally, McKinsey & Company, a leading global consulting firm, conducted a "best practices" review of the private equity program during FY 2006. This review concluded with a series of recommendations, which staff believes will make the program even stronger when fully implemented.

For the industry as a whole, it was a very active year. Fundraising activity continued at record levels. The investment pace was very strong, as was the pace of exits and the distribution of proceeds back to investors. These industry trends were reflected in the WSIB private equity portfolio during the year, as commitments to new funds, capital drawn for investment, and distributions received back all increased substantially from the previous fiscal year.

Highlights

- The portfolio value increased from $6.9 billion to $9.0 billion.
- $3.79 billion in commitments to funds were closed in FY 2006 compared to $1.84 billion in the prior year.
- $2.63 billion of committed capital was drawn for investment during the current fiscal year, compared to $1.92 billion in the prior year.
- $3.21 billion in distributions were returned to the WSIB during FY 2006, compared to $2.55 billion in the prior year.
- $6.6 billion of committed capital remained unfunded at fiscal year end, compared to $5.0 billion at the prior year-end.

Private equity uses March 31, 2006, market values, adjusted for cash flows in the second quarter of 2006.

Real Estate Program

	1 Year	3 Year	5 Year	10 Year
Real Estate	24.3%	19.8%	17.2%	14.9%

Our real estate partnership investments deliver risk-adjusted returns consistent with the WSIB's long-term return expectations for the asset class. The majority of these externally managed partnerships invest in high-quality properties leased to third parties. The steady income from lease payments, combined with the potential upside from appreciation, generate returns that are expected to fall between performance expectations for fixed income and equities. Many of our real estate partnerships do not involve co-investment with other financial investors, thereby providing the WSIB with superior governance provisions related to acquisition, liquidation, and an annual business plan process.

The majority of our partners own real estate assets as private market investments, so they are not subject to the potential volatility of the public markets. Capital is diversified among a variety of partners, each with their own investment style, and partnership assets are geographically diversified, including outside the U.S. Investments are made in a variety of property types to provide further diversification. Finally, our partners invest at different points in the real estate capital structure, as well as at different times in the property life cycle.

Year in Review

Real estate markets, particularly in the U.S., were subject yet again to record-setting capital inflows during the year. Larger allocations to real estate from numerous institutional investors globally resulted in a sharp increase in investment activity. The consequence of this market environment was continued upward pressure on commercial property valuations. The WSIB's real estate partners have benefited from this situation, both through their long-term ownership of high-quality investments and through the selective selling of some properties.

The WSIB's real estate investment strategy and direction remained unchanged during the year. The continuing focus is on creating a high-quality, long-term, stable income stream for the CTF from its real estate investments.

Highlights

- The portfolio value increased from $4.5 billion to $5.5 billion.
- For the one-year period ended March 31, 2006, the portfolio outperformed the NCREIF Index, 29.9% to 20.2%.
- The two strongest drivers of these high returns were the WSIB's investments in real estate operating companies (REOCs) and its investments outside the U.S.
- A continuing trend was that more relatively attractive investment opportunities were found outside the U.S. than domestically by our partners during the year.
- Domestically, the WSIB continues to overweight growth markets in its real estate portfolio, such as in the South and West.

Real estate uses March 31, 2006, market values, adjusted for cash flows in the second quarter of 2006.

OTHER PLANS UNDER MANAGEMENT

Defined Contribution Retirement Plans

PERS 3 - $1,094,301,260

SERS 3 - $851,387,696

TRS 3 - $3,156,843,276

As trustee of the Plan 3 retirement systems for Public Employees Retirement System (PERS 3), School Employees Retirement System (SERS 3), and Teachers Retirement System (TRS 3), the WSIB is responsible for the investment of plan assets and the provision of self-directed investment options to plan members. The administrative, accounting, and record-keeping work for these plans is provided by the DRS.

Deferred Compensation Program and Judicial Retirement Account

Deferred Compensation Program (DCP) - $2,184,813,106

The WSIB is responsible for investing DCP funds and providing investment options for program participants. DRS is responsible for DCP administration, accounting, and record-keeping.

Judicial Retirement Account (JRA) - $17,119,878

The JRA is a defined contribution supplemental retirement fund for state judges. Investments are self-directed by participants in the Judges' Supplemental Retirement Program utilizing the DCP investment options offered by the WSIB. The Office of the Administrator for the Courts administers the fund, while accounting and record-keeping is done by DRS.

Daily-Valued Funds for Self-Directed Investment Programs

Horizon Funds - $320,391,347

These internally managed, daily-valued balanced funds give participants in the self-directed defined contribution retirement plans (TRS/SERS/PERS Plan 3's, DCP, and JRA) the ability to choose between different diversified asset allocation models that fit their personal risk and return objectives. Each Horizon Fund is regularly rebalanced by the WSIB to preserve the proper asset mix.

Bond Market Fund - $375,710,712

The goal of this daily-valued fund is to provide participants of the self-directed defined contribution retirement plans (TRS/SERS/PERS Plan 3's, DCP, and JRA) attractive returns while controlling risk by investing in high-quality corporate bonds. The fund is internally managed by WSIB staff and is intended for participants who want an intermediate-term investment designed to match or moderately exceed the returns of the Lehman Intermediate Credit Index.

Savings Pool - $701,392,030

This option is intended as a conservative short-term investment vehicle when the primary objectives are protecting current income and preserving principal while earning a rate of return in excess of the current yield of U.S. Treasury securities of similar maturities. The Savings Pool is a diversified portfolio of guaranteed investment contracts (GICs) and short-term cash funds.

Labor and Industries' Funds

Total Market Value - $10,266,849,709

The WSIB manages Industrial Insurance funds on behalf of the Department of Labor and Industries (L & I). The Industrial Insurance portfolio consists of 4 separate funds. The Accident Fund, which is used primarily to pay disability benefits. The Medical Aid Fund, which is used for services required by the injured worker and administrative costs. The Pension Reserve Fund is maintained by transfers of money from the Accident Fund at the time that a new pensioner is setup. The Supplemental Pension Fund is used to supplement time loss and to compensate for cost-of-living increases .

Accident Fund - $3,867,827,176

Medical Aid Fund - $3,815,259,006

Pension Reserve Fund - $2,460,314,829

Supplemental Pension Fund - $123,448,698

Permanent Funds

Total Market Value - $712,819,394

The Permanent Funds are non-expendable trusts. The principal for each fund remains intact and investment earnings, less expenses, are reinvested or distributed to a beneficiary fund. 5 of these funds were established through federal government land grants to help Washington's schools and colleges with bond repayment, capital development, and facilities maintenance. The state Department of Natural Resources transfers proceeds from the sale of land and timber to the WSIB for investment purposes. Fund proceeds are invested in fixed income and short-term holdings, with the exception of the Common School Fund, which is also invested in the U.S. Equity Market Index Fund.

Agricultural College Fund - $150,563,410
Scientific Fund - $166,740,242
Normal School Fund - $205,542,307
State University Fund - $25,236,818
Common School Fund - $164,731,466
Millersylvania Park Fund - $5,151

Other Funds

Total Market Value - $509,754,340

These funds were created by Washington State legislation over the years to fund various mandates and can be liquidated as needed to fund those mandates. These funds are invested by the WSIB until they are completely liquidated or legislation closes the funds.

Game and Special Wildlife Fund - $9,444,277
Employees' Insurance Reserve - $79,656,757
Radiation Perpetual Fund - $298,632
Reclamation Revolving Fund - $380,719
Emergency Reserve Fund - $68,076,559
Pension Stabilization Fund - $351,897,696

Guaranteed Education Tuition Fund -

Total Market Value - $707,999,750

The Guaranteed Education Tuition (GET) Program allows individuals or groups to purchase state college and university tuition units for future use at current prices. Program administration is under the authority of the Committee on Advanced Tuition Payment. The WSIB serves as trustee for the funds and invests them in a mix of short-term holdings, TIPS, U.S. Equity, and International Equity.

Developmental Disabilities Endowment (DDEF) Fund

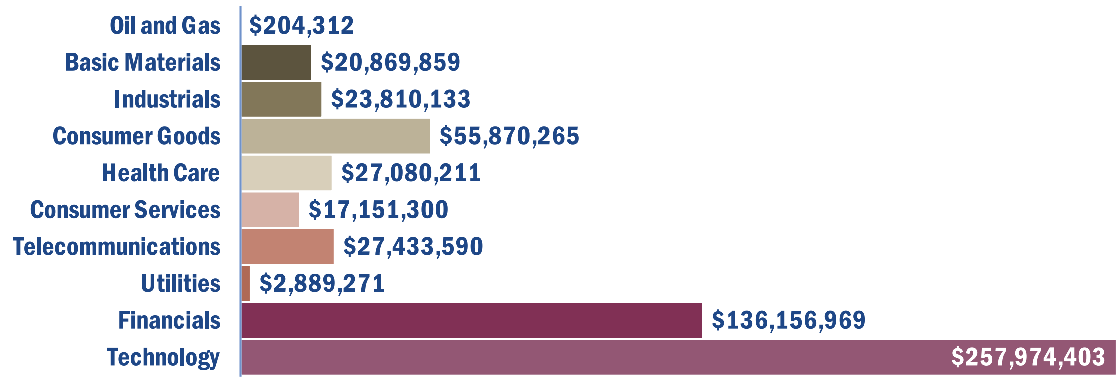
Total Market Value - $12,999,619

The Developmental Disabilities Endowment Trust Fund (DDEF) was established to support individuals with developmental disabilities through private contributions and public appropriations. The WSIB invests the fund in a mix of short-term holdings, TIPS, fixed income, and U.S. Equity.

INVESTING IN WASHINGTON

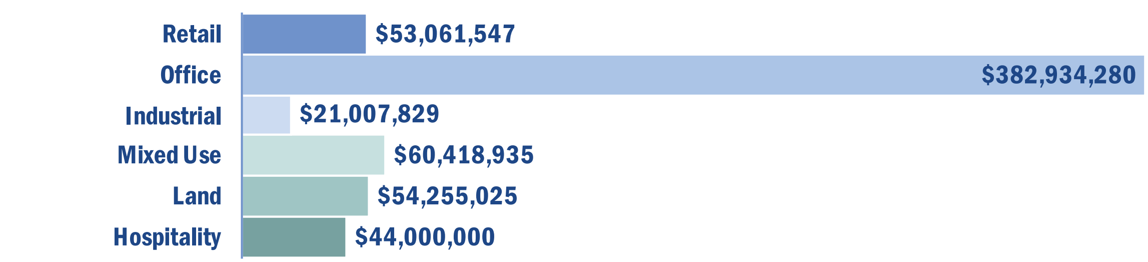
The WSIB seeks the best investment opportunities no matter where they might be located. The state of Washington is home to many successful companies and in-state investments can be found in all of the WSIB's portfolios. For fiscal year 2006, public equity invested $474.2 million, fixed income $85.8 million, private equity $95.2 million, and real estate was at $615.7 million for a total of $1.3 billion.

Industry Breakdown - Public Equity, Fixed Income, and Private Equity



Property Type Breakdown - Real Estate

The real estate amount represents the total capital that the WSIB has invested in Washington properties.



Financials

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis serves as an introduction to the Washington State Investment Board (WSIB) basic financial statements, which consist of the basic financial statements and notes to the financial statements. The statements included are for the retirement systems Commingled Trust Fund (CTF), Labor and Industries Funds, Permanent Trust Funds, Other Funds, Guaranteed Education Trust Funds, and Developmental Disabilities Endowment Trust Funds. The financial statements are reported separately due to the unique goals and objectives for each set of funds.

Basic Financial Statements

The basic financial statements presented include the Statement of Net Assets, which reports the assets by general asset category, the Statement of Changes in Net Assets, which reports the contributions to, withdrawals from and investment earnings for the fiscal year ending June 30, 2006.

Notes to the Financial Statements

The notes to the financial statements presented are an integral part of the financial statements and include additional information not readily evident in the statements themselves.

Contacting WSIB's Financial Management

This financial report is designed to provide a general overview of WSIB's investment activities.

If you have any questions about this report or need additional information, contact:

The Washington State Investment Board

2100 Evergreen Park Drive SW

P.O. Box 40916, Olympia, WA 98504-0916

Phone: 360-956-4600

Website: www.sib.wa.gov.

RETIREMENT FUNDS

Commingled Trust Fund and Plan-Specific Investments

As Managed by the Washington State Investment Board

June 30, 2006

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Retirement Funds (Commingled Trust Fund and Plan-Specific Investments) of the state of Washington as managed by the Washington State Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Retirement Funds as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Washington State Department of Retirement Systems. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Retirement Funds as of June 30, 2006, and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

As explained in Note 1, the financial statements include investments valued at $14,685,445,567 (27% of net assets), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Retirement Funds of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/s/ Peterson Sullivan PLLC

October 12, 2006

Retirement Funds - Commingled Trust Fund and Plan-Specific Investments

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Retirement Funds of the state of Washington managed by the WSIB. The WSIB manages funds for other state of Washington departments. This section of this report represents only the Retirement Funds portion. The Retirement Funds are the largest investor in funds managed by the WSIB.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the Retirement Funds. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the Retirement Funds for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the Retirement Funds for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the Retirement Funds.

As shown in Table 1, the assets under the WSIB's management within the Retirement Funds increased by $6.4 billion during the fiscal year ended June 30, 2006. The market value of Retirement Funds assets is directly impacted by the activity of the various capital markets within which the WSIB invests. However, one of the benefits of the diversification gained by investing across various investment types as well as broadly within an asset class is the reduction in aggregate volatility of the total investment portfolio. The WSIB, upon receiving recommendations from staff and other investment experts, makes the asset allocation decisions for the Retirement Funds. Staff conducts rebalancing between asset classes as markets move pursuant to WSIB policy.

As reflected in Table 1, liquidity assets increased from $1.312 billion to $1.364 billion, for an increase of $52 million or 4.0%. The primary reason for the increase is the addition of enhanced index managers in domestic public equity, who are allowed to hold more cash compared to previous managers, and the increase in the amount of monies invested with international public equity managers. Assets for both of these increases came from domestic public equity index funds

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Liquidity Investments	$1,364,253,761	$1,311,718,576	$52,535,185	4.0%
Total Fixed Income Investments	13,235,045,155	11,485,218,894	1,749,826,261	15.2%
Total Public Equity Investments	24,402,533,571	23,220,945,885	1,181,587,686	5.1%
Total Real Estate Investments	5,656,672,459	4,423,171,252	1,233,501,207	27.9%
Total Private Equity Investments	9,028,773,108	6,898,946,891	2,129,826,217	30.9%
Total Investments	53,687,278,054	47,340,001,498	6,347,276,556	13.4%
Total Accruals	193,778,760	131,600,261	62,178,499	47.3%
Total Net Assets at Market Value	$53,881,056,814	$47,471,601,759	$6,409,455,055	13.5%

that do not have liquidity assets. Fixed income investments increased from $11.485 billion to $13.235 billion, for an increase of $1.750 billion or 15.2%. The reasons for the increase are investment earnings, including market valuation increases, and cash infusion from other asset classes totaling $600 million. Public equity investments increased from $23.221 billion to $24.403 billion, for an increase of $1.182 billion or 5.1%. This was due to increases in market values of equity investments despite liquidating $1.602 billion of investments aimed at removing some of the profits from this asset class and rebalancing closer to its asset target of 46.0%. Real estate investments increased from $4.423 billion to $5.657 billion, for an increase of $1.234 billion or 27.9%. This was due to new investments of $1.513 billion and increases in market values of $1.105 billion, less distributions from our partners of $1.384 billion. Private equity investments increased from $6.899 billion to $9.029 billion, for an increase of $2.130 billion or 30.9%. This was due to draws from additional funding of existing investments, new investments of $2.636 billion, and increases in market values of $2.710 billion, less distributions from our partners of $3.216 billion.

As shown in Table 2, benefit withdrawals less retirement contributions, or net withdrawals by retirement plans, decreased from $1.537 billion to $1.395 billion, for a decrease of $143 million or 9.3%. This was primarily due to increases in contribution rates for both employees and employers in most of the retirement plans offset slightly by a net increase in benefit payments at the plan level as additional public employees retired during the year. Total net investment income and increases in market values increased from $5.638 billion to $7.804 billion, for an increase of $2.166 billion or 38.4%. This was due to the plan level investment return increasing from 13.3% in 2005 to 16.7% in 2006. See Table 1 for information on changes at the asset level.

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$47,471,601,759	$43,371,363,961	$4,100,237,798	9.5%
Net Withdrawal by Retirement Plans	(1,394,504,967)	(1,537,567,538)	143,062,571	(9.3%)
Investment Earnings	7,810,042,256	5,642,747,079	2,167,295,177	38.4%
WSIB Operating Costs	(6,082,234)	(4,941,743)	(1,140,491)	23.1%
Net Investment Earnings	7,803,960,022	5,637,805,336	2,166,154,686	38.4%
Ending Total Net Assets at Market Value	$53,881,056,814	$47,471,601,759	$6,409,455,055	13.5%

Statement of Net Assets - June 30, 2006

	Commingled Trust Fund	Plan-Specific Investments	Total	Percent of Plan Assets
ASSETS				
Investments:				
LIQUIDITY:				
Money Market Funds	$ 1,188,606,207	$ 66,235,252	$ 1,254,841,459	
Foreign Currency	109,412,302		109,412,302	
Total Liquidity	1,298,018,509	66,235,252	1,364,253,761	2.5%
FIXED INCOME INVESTMENTS:				
Asset Backed Securities	16,103,201		16,103,201	
Collateralized Mortgage Obligations	1,395,844,863		1,395,844,863	
Pass Throughs	2,437,151,468		2,437,151,468	
Non-Standard Mortgages	5,065,398		5,065,398	
Commercial Mortgage Backed Securities	495,134,217		495,134,217	
Corporate Bonds - Domestic	4,582,392,236		4,582,392,236	
U.S. Government Treasuries	1,126,654,304		1,126,654,304	
U.S. Treasury Inflation Protected Securites	2,426,498,894		2,426,498,894	
Government Securities - Foreign	89,704,198		89,704,198	
Variable Rate Notes	660,496,376		660,496,376	
Total Fixed Income Investments	13,235,045,155		13,235,045,155	24.7%
EQUITY INVESTMENTS - Domestic:				
Corporate Stock	1,185,907,658		1,185,907,658	
Equity Index Funds	9,983,109,494		9,983,109,494	
Commingled Enhanced Equity Index Fund	973,244,199		973,244,199	
Total Equity Investments - Domestic	12,142,261,351		12,142,261,351	22.6%
EQUITY INVESTMENTS - Foreign:				
Corporate Stock	8,024,643,656		8,024,643,656	
Commingled Index Funds	4,235,628,564		4,235,628,564	
Total Equity Investments - Foreign	12,260,272,220		12,260,272,220	22.8%
ALTERNATIVE INVESTMENTS:				
Private Equity	9,028,773,108		9,028,773,108	
Real Estate	5,656,672,459		5,656,672,459	
Total Alternative Investments	14,685,445,567		14,685,445,567	27.4%
Total Investments	53,621,042,802	66,235,252	53,687,278,054	100.0%
Investment Earnings Receivable	165,268,088	737,970	166,006,058	
Due From Other Agencies	8,703		8,703	
Receivables for Investments Sold	218,426,623		218,426,623	
Collateral Held Under Securities Lending Agreements	5,669,883,242		5,669,883,242	
Total Assets	59,674,629,458	66,973,222	59,741,602,680	
LIABILITIES				
Obligations Under Securities Lending Agreements	5,669,883,242		5,669,883,242	
Investment Management Fees Payable	34,781,840		34,781,840	
Payable for Investments Purchased	155,880,784		155,880,784	
Total Liabilities	5,860,545,866		5,860,545,866	
Net Assets	$ 53,814,083,592	$ 66,973,222	$ 53,881,056,814	

Statement of Changes in Net Assets - June 30, 2006

	Commingled Trust Fund	Plan-Specific Investments	Total
Additions			
Investment Income:			
Interest, Dividends, and Other Investment Income	$ 1,689,556,352	$ 8,053,837	$ 1,697,610,189
Realized Capital Gains	4,203,215,233		4,203,215,233
Realized Capital Losses	(357,796,095)		(357,796,095)
Unrealized Gains	2,507,936,680		2,507,936,680
Less:			
Investment Expenses	(32,288,291)	(162,544)	(32,450,835)
Securities Lending Broker Rebates Paid	(208,472,916)		(208,472,916)
WSIB Operating Costs		(6,082,234)	(6,082,234)
Total Investment Income	7,802,150,963	1,809,059	7,803,960,022
Net Withdrawal by Retirement Plans		(1,394,504,967)	(1,394,504,967)
Investments in Commingled Funds	471,805,468	(471,805,468)	
Withdrawals from Commingled Funds	(1,895,544,093)	1,895,544,093	
Increase in Net Assets	6,378,412,338	31,042,717	6,409,455,055
Net Assets, Beginning of Year	47,435,671,254	35,930,505	47,471,601,759
Net Assets, End of Year	$ 53,814,083,592	$ 66,973,222	$ 53,881,056,814

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Funds

The Retirement Funds consists of retirement contributions for participants in the Washington State Retirement System. The Retirement System is administered by the Department of Retirement Systems (DRS). The financial statements present only the activity of the Retirement Funds as managed by the WSIB or Board. The WSIB has exclusive control of the investment of all money invested in the Retirement Funds. The financial statements do not present the financial position and results of operations of WSIB or DRS.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of GASB, which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges, and security pricing services. Certain investments, including real estate and private equity investments, are valued based on appraisals or periodic reports from limited partnerships' management and, generally, the reports are audited by independent auditors. The Retirement Funds have no investments of any commercial or industrial organization whose market value exceeds 5% or each plan's net assets. The assets of the Retirement Funds are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Purchases and sales of investments are also recorded on a trade date basis.

Securities Lending

The Retirement Funds record collateral received under securities lending agreements where the Retirement Funds have the ability to spend, pledge, or sell the collateral without borrower default. Liabilities resulting from these transactions are also reported. Additionally, costs associated with securities transactions and broker commissions paid, are reported in the accompanying financial statements. The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Note 2. The Commingled Trust Fund (CTF) and Plan Specific Investments

The CTF is a diversified pool of investments which is used as an investment vehicle for thirteen separate retirement plans, excluding the Judicial Retirement Account (JRA) which is not part of the CTF. These plans hold "units" in the CTF, which represent a percentage ownership in the pool of investments. Plans are allowed to purchase or sell units in the CTF, based on the market value of the underlying assets, on the first business day of each month.

In addition to unit ownership in the CTF, each retirement plan holds its own short-term investments. These short-term investments are referred to as "plan-specific investments" in the accompanying financial statements and are used to manage the cash needs of each retirement plan.

The CTF consists of the Public Employees' Retirement System (PERS) Plans 1 and 2/3; the Teachers' Retirement System (TRS) Plans 1 and 2/3; the School Employees' Retirement System (SERS) Plans 2/3; the Law Enforcement Officers' and Fire Fighters' (LEOFF) Plans 1 and 2; the Washington State Patrol (WSP) Retirement Systems Plan 1 and 2; and the Volunteer Fire Firefighters' Retirement Plan (VFF). The CTF includes only the defined benefit portion of PERS Plan 3, SERS Plan 3 and TRS Plan 3, which are hybrid defined benefit/defined contribution plans.

Note 3. Breakdown of Plan Assets

The statement of net assets presents all DRS funds managed by WSIB. The following schedule presents the net assets of DRS broken down by ownerships by the various DRS pension plans. "DC" means "defined contribution" and "DB" means "defined benefit," two different types of plans.

Schedule of Participation

RETIREMENT PLANS:	Commingled Trust Fund	Plan-Specific Investments	Total Plan Assets	Percent of Plan Assets
PERS 1	$ 10,247,351,388	$ 5,965,094	$ 10,253,316,482	19.0%
PERS 2/3 (DC and DB Plans)	14,816,598,820	14,961,638	14,831,560,458	27.5%
TEACHERS 1	8,674,746,691	5,828,863	8,680,575,554	16.1%
TEACHERS 2/3 (DC and DB Plans)	6,818,287,787	18,061,390	6,836,349,177	12.7%
VOLUNTEER FIREFIGHTERS	120,822,347	675	120,823,022	0.2%
WSP 1/2	816,488,345	1,065,908	817,554,253	1.5%
LEOFF 1	5,561,851,508	1,492,071	5,563,343,579	10.3%
LEOFF 2	4,106,848,938	12,565,796	4,119,414,734	7.7%
SCHOOL EMPLOYEES 2/3 (DC and DB Plans)	2,651,087,768	7,029,860	2,658,117,628	5.0%
JUDICIAL		1,927	1,927	0.0%
Total Net Assets at June 30, 2006	$ 53,814,083,592	$ 66,973,222	$ 53,881,056,814	100.0%

Note 4. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid are summarized below and are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the Retirement Funds. Fees include investment management fees and commission, investment consultant fees, legal fees and other investment management related expenses.

PUBLIC EQUITY SECURITIES:	Fees	Assets Under Management
U.S. Passive Equity Manager	$ 3,465,545	$ 12,142,261,352
International Active Equity Managers	15,164,607	8,024,643,656
International Passive Equity Managers	3,549,975	4,235,628,564
ALTERNATIVE INVESTMENTS:		
Private Equity	3,743,009	9,028,773,108
Real Estate	651,920	5,656,672,459
OTHER FEES:		
Consultants and Advisors	1,646,745	
Custodians	2,196,352	
Legal Fees	777,618	
Miscellaneous Fees	1,092,520	
Total Investment Expenses	$ 32,288,291	$ 39,087,979,139

The WSIB operating costs are charged against the CTF owner funds based upon actual costs incurred by the WSIB to manage the investments.

Note 5. Unfunded Commitments

The Retirement Funds have entered into a number of agreements that commit the Retirement Funds, upon request, to make additional investment purchases up to predetermined amounts. As of June 30, 2006, the Retirement Funds had the following unfunded investment commitments:

Private Equity	$ 6,259,969,674
Real Estate	$ 5,233,133,553

Note 6. Public Employees' Retirement System Plan 3, Teachers' Retirement System Plan 3, and the School Employees' Retirement System Plan 3

The financial statements only include the portion of the PERS Plan 3, TRS Plan 3 and SERS Plan 3, which are invested in the CTF. It does not include PERS Plan 3, TRS Plan 3, or SERS Plan 3 self-directed investments, which are accounted for and reported on by the DRS.

Note 7. Deposit and Investment Risk Disclosures

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure the Retirement Funds' deposits may not be returned to the Retirement Funds. The WSIB does not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risk – Investments

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

The WSIB has been authorized by statute as having the investment management responsibility for Retirement Funds. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored corporations eligible for collateral purposes at the Federal Reserve) securities; non-dollar bonds; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leveraged buy-outs, real estate, or other forms of private equity; asset backed securities; and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as a percentage of the investments' full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The WSIB's fixed income investments are to be actively managed to exceed the return of the Lehman Universal Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2006, the funds' durations of the various fixed income classes were within the duration targets of the Lehman Universal Index.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the Retirement Funds investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations, and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

The Retirement Funds hold both U.S. agencies and corporate debt variable-rate securities, most of which reset periodically to the market interest rate. Because these securities frequently reprice to prevailing market rates, interest rate risk is substantially reduced at each periodic reset date. In the schedule below, variable-rate securities are presented according to the length of time until the next reset date rather than the stated maturity.

Schedule 1

Investment Type	Total Fair Value	Maturity: Less than 1 year	Maturity: 1-5 years	Maturity: 6-10 years	Maturity: More than 10 years	Effective Duration	Credit Rating
Asset Backed Securities	$ 1,716,933	$ -	$ 1,716,933	$ -	$ -	1.42	Multiple
Mortgages:							
Collateralized Mortgage Obligations	1,309,267,270	23,959,949	338,969,716	774,823,876	171,513,729	4.85	Multiple
Pass Throughs	2,362,069,259	708,767	1,485,032,664	876,327,828		3.88	Multiple
Non-Standard Mortgages	5,065,398		1,376,682	2,540,650	1,148,066	4.14	Multiple
Commercial Mortgage Backed Securities	495,134,217		248,260,540	246,873,677		4.26	Multiple
Corporate Bonds - Domestic	4,436,338,726	291,911,398	1,396,559,471	1,932,468,772	815,399,085	5.71	Multiple
Government Securities - Domestic:							
U.S. Government Treasuries	1,126,654,304	11,004,290	176,923,497	422,218,495	516,508,022	9.32	AAA
Treasury Inflation Protected Securities	2,412,535,972	541,913,789	1,071,869,465	798,752,718		2.47	AAA
Variable Rate Notes	162,759,298	156,085,779	6,673,519			0.10	Multiple
Government Securities - Foreign	89,704,198		59,218,132	30,486,066		3.47	Multiple
Commingled U.S. Enhanced Index Fund:							
Asset Backed Securities	14,386,268				14,386,268	14.39	AAA
Collateralized Mortgage Obligations	86,577,593				86,577,593	14.72	Multiple
Pass Throughs	75,082,209				75,082,209	18.42	AAA
Corporate Bonds - Domestic	146,053,510	3,487,048	97,229,696	8,112,404	37,224,362	5.64	Multiple
Treasury Inflation Protected Securities	13,962,922			13,962,922		5.54	AAA
Variable Rate Notes	497,737,078	1,246,906	95,751,529	16,364,514	384,374,129	12.12	Multiple
Total Retirement Funds Investments Categorized	13,235,045,155	$ 1,030,317,926	$ 4,979,581,844	$ 5,122,931,922	$ 2,102,213,463		

Investments Not Required to be Catergorized Under GASB Statement No. 3	
Corporate Stock - Domestic	1,185,907,658
Corporate Stock - Foreign	8,024,643,656
Commingled Index Funds - Domestic	10,956,353,693
Commingled Index Funds - Foreign	4,235,628,564
Money Market Funds	1,254,841,459
Private Equity	9,028,773,108
Real Estate	5,656,672,459
Currencies	109,412,302
Total Retirement Funds Investments Not Catergorized	40,452,232,899
Total Retirement Funds Investments	$ 53,687,278,054

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Retirement Funds' rated debt investments as of June 30, 2006, were rated by Moody's and/or an equivalent national rating organization. Investment types with multiple ratings are presented in the following schedule (Schedule 2) using the Moody's rating scale.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The WSIB policy states no corporate fixed income issue shall exceed 3% of cost at the time of purchase or 6% of market value thereafter of the fund, and no high yield issues shall exceed 1% of cost or 2% of market value of the fund. There was no concentration of credit risk exceeding these policy guidelines as of June 30, 2006.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The WSIB does not have a formal policy to limit foreign currency risk. The WSIB manages their exposure to fair value loss by requiring their international securities investment managers to maintain diversified portfolios by sector and by issuer to limit foreign currency and security risk. Risk of loss arises from changes in currency exchange rates. The Retirement Funds exposure to foreign currency risk is presented in the following schedule (Schedule 3) which provides information on deposits and investments held in various foreign currencies, which are stated in U.S. dollars. The Retirement Funds also had $4,235,628,564 invested in an international commingled equity index fund. As such, these currency denominations are not presented in this schedule.

Schedule 2

Investment Type	Total Fair Value	Moody's Equivalent Credit Rating										
		Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Not Rated
Asset Backed Securities	$ 1,716,933	$ 1,716,933	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collateralized Mortgage Obligations	1,309,267,270	1,274,753,929										34,513,341
Pass Throughs	2,362,069,259	2,342,295,668										19,773,591
Non-Standard Mortgages	5,065,398	2,675,572										2,389,826
Commercial Mortgage Backed Securities	495,134,217	470,926,850										24,207,367
Corporate Bonds - Domestic	4,436,338,726	496,652,010	171,514,310	174,991,643	605,009,570	630,404,465	266,552,303	303,531,814	507,656,938	602,651,265	232,453,256	444,921,152
U.S. Government Treasuries	1,126,654,304	1,126,654,304										
Treasury Inflation Protected Securities	2,412,535,972	2,412,535,972										
Government Securities - Foreign	89,704,198	33,470,136										56,234,062
Variable Rate Notes	162,759,298			30,038,292	72,084,839		50,074,695			10,561,472		
Commingled U.S. Enhanced Index Fund:												
Asset Backed Securities	14,386,268	14,386,268										
Collateralized Mortgage Obligations	86,577,593	78,504,013										8,073,580
Pass Throughs	75,082,209	75,082,209										
Corportate Bonds - Domestic	146,053,510	31,077,302				2,159,022	3,443,958	8,624,086	9,405,307	38,076,814	15,667,211	37,599,810
Treasury Inflation Protected Securities	13,962,922	13,962,922										
Variable Rate Notes	497,737,078	343,292,777		4,255,173	19,993,486	6,228,647	8,475,202	28,783,088	11,344,641	25,290,204	7,862,473	42,211,387
Total	$ 13,235,045,155	$ 8,717,986,865	$ 171,514,310	$ 209,285,108	$ 697,087,895	$ 638,792,134	$ 328,546,158	$ 340,938,988	$ 528,406,886	$ 676,579,755	$ 255,982,940	$ 669,924,116

Schedule 3

Foreign Currency Denomination	Liquidity	Fixed Income	Equity	Private Equity	Real Estate	Total	Percent of Total Retirement Funds Investments
	Investment Type In U.S. Dollar Equivalent						
Australia-Dollar	$ 6,783,765	$ -	$ 313,514,178	$ -	$ -	$ 320,297,943	0.6%
Austria-Euro			71,119,580			71,119,580	0.1%
Belgium-Euro			46,265,796			46,265,796	0.1%
Brazil-Real	208,030	89,704,198	44,203,027			134,115,255	0.3%
Britain-Pound	14,181,359		1,350,898,007	75,950,837	69,515,579	1,510,545,782	2.8%
Canada-Dollar	145,447		287,915,258		15,966,226	304,026,931	0.6%
Chinese-Yuan					13,566,425	13,566,425	0.0%
Denmark-Krone	946,347		29,210,483			30,156,830	0.1%
E.M.U.-Euro	28,527,243		92,098,696	767,540,427	326,011,967	1,214,178,333	2.3%
Finland-Euro			80,399,381			80,399,381	0.2%
France-Euro			765,508,315			765,508,315	1.4%
Germany-Euro			600,718,978			600,718,978	1.1%
Greece-Euro			46,486,527			46,486,527	0.1%
Hong Kong-Dollar	4,933,825		184,985,489		16,935,864	206,855,178	0.4%
Hungary-Forint			9,083,172			9,083,172	0.0%
Indonesia-Rupiah	74,909		2,078,046			2,152,955	0.0%
Ireland-Euro			14,427,647			14,427,647	0.0%
Italy-Euro			297,959,287			297,959,287	0.6%
Japan-Yen	32,821,290		1,647,251,089		182,880,016	1,862,952,395	3.5%
Lithuania-Litas	5,298		132,059			137,357	0.0%
Luxembourg-Euro			3,181,517			3,181,517	0.0%
Malaysia-Ringgit			6,443,739			6,443,739	0.0%
Mexico-Peso	144		23,804,793			23,804,937	0.0%
Netherland-Euro			423,075,171			423,075,171	0.8%
New Zealand-Dollar	30,138		13,630,616			13,660,754	0.0%
Norway-Krone	12,670,979		149,271,221			161,942,200	0.3%
Pakistan-Rupee	50		12,690,125			12,690,175	0.0%
Philippines-Peso	14,427		1,257,258			1,271,685	0.0%
Poland-Zloty	16,455		48,455,839			48,472,294	0.1%
Portugal-Euro			9,576,733			9,576,733	0.0%
Singapore-Dollar	468,012		75,926,189	8,649,838		85,044,039	0.2%
South Africa-Rand	174		33,732,334			33,732,508	0.1%
South Korea-Won	68,920		51,955,042		9,941,183	61,965,145	0.1%
Spain-Euro			344,396,326			344,396,326	0.6%
Sweden-Krona	5,772,816		188,884,599	57,257,468		251,914,883	0.5%
Switzerland-Franc	1,742,674		453,230,031			454,972,705	0.8%
Thailand-Baht			1,871,386		226,013	2,097,399	0.0%
Turkey-Lira			22,410,331			22,410,331	0.0%
	109,412,302	89,704,198	7,748,048,265	909,398,570	635,043,273	9,491,606,608	17.7%
Foreign Investments Denominated in U.S. Dollars			276,595,391			276,595,391	0.5%
	$ 109,412,302	$ 89,704,198	$ 8,024,643,656	$ 909,398,570	$ 635,043,273	$ 9,768,201,999	18.2%

Note 8. Securities Lending

Washington State law and WSIB policy permit the Retirement Funds to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation (SSC) to act as agent for the WSIB in securities lending transactions. As SSC is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

In accordance with GASB Statement 28, the Retirement Funds report securities lent (the underlying securities) as assets in the statement of net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Retirement Funds have the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the statement of net assets. Securities lending transactions collateralized by securities that the WSIB 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 Retirement Funds' 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% 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% of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006, was $5,669,883,242 and $5,562,203,079, respectively.

During fiscal year 2006, securities lending transactions could be terminated on demand by either the Retirement Funds or the borrower. The weighted average maturity of overall loans was 32 days.

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

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

During fiscal year 2006, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Retirement Funds incurred no losses during fiscal year 2006 resulting from a default by either the borrowers or the securities lending agents.

Note 9. Derivatives

Retirement Funds are 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. Retirement Funds mitigate market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

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

Funds were collateralized mortgage obligations of $1,395,844,863.

There were no repurchase agreements outstanding at June 30, 2006. Repurchase agreements are collateralized at 102%. The collateral is priced daily and held by WSIB's agent in WSIB's name.

State law permits Retirement Funds 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 Retirement Funds or provide securities or cash of equal value, the Retirement Funds 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 the year and there were no liabilities outstanding as of June 30, 2006.

Note 10. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship of the Retirement Funds is vested within the voting members of the WSIB. The legislature has established a standard of care for investment of these funds in RCS 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes its investment decisions and seeks to meet the following investment objectives.

In accordance with RCW 43.33.110, the portfolio is managed to achieve a maximum return at a prudent level of risk.

The Retirement Fund Asset Allocation

WSIB establishes asset allocation targets that must be considered at all times when making investment decisions. The asset mix may deviate from the target. Deviations greater than predetermined acceptable levels require rebalancing back to the target. When as asset class exceeds its range, the goal of rebalancing will be to meet the target allocation within consideration of the other remaining asset classes.

Retirement funds are invested in the CTF. The CTF's performance benchmark objective is to exceed the return of a policy benchmark consisting of public market indices weighted according to asset allocation targets. The asset allocation for the CTF is formally reviewed every three or four years. Periodically, the WSIB reviews the asset allocation in relation to established ranges.

Public Markets Equity

The Public Markets Equity program seeks to achieve the highest return possible, consistent with the desire to control asset volatility. Asset volatility is controlled by ensuring protection for long-term liabilities, as shorter term liabilities are more suitably protected by lower volatility instruments such as fixed income securities and to provide diversification to the WSIB's overall investment program.

The Public Markets Equity portion of the Retirement Funds includes strategies in the U.S., developed international and emerging markets. Since the U.S. equity markets are generally efficient, the domestic equity portfolio is entirely (77%) passively managed with the rest in an enhanced index strategy. Over time, the domestic equity portfolio should track the return of a broad U.S. market benchmark, the Dow Jones Wilshire 5000 Index. Non-U.S. markets are generally less efficient than the U.S. market; therefore, more active management will be included in the approach taken with international markets. The weightings of the elements of the developed markets and emerging markets of the non-U.S. equity program will be similar to the weightings of the MSCI All Country World (U.S. Index) which serves as the benchmark for the WSIB's entire non-U.S. program.

Fixed Income

The Retirement Funds' fixed income investments are to be actively managed to exceed the return of the Lehman Universal Index, with volatility similar to or less than the index. The portfolio constraints state that no corporate fixed income issue shall exceed 3% of cost at the time of purchase or 6% of market value thereafter of the fund, and no high yield issues shall exceed 1% of cost or 2% of market value of the fund.

Permissible fixed income market segments include: U.S. Treasuries and government agencies, Treasury Inflation Protection Securities, investment-grade credit bonds, high yield bonds, publicly traded mortgage-backed securities, commercial mortgage-backed securities, privately placed mortgages, private placements of corporate debt, asset-backed securities, convertible securities, non-dollar bonds, real estate mortgages, and Washington State Housing Finance Commission taxable municipal bonds up to a total of $25 million with a maximum of $10 million per year. Other fixed income segments and instruments may be added from time to time as they are developed or deemed appropriate.

Private Equity Investing

The Retirement Funds can invest in any appropriate private equity investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not prohibited by the WSIB's policies or by law. As previously indicated, these investment types are divided into venture capital investments, corporate finance (including leveraged, management and employee buyouts), distressed, international and mezzanine investments. Private equity investments are made through limited partnership vehicles.

To meet the return and plan objectives, the private equity portfolio has diversified investments in companies in a variety of growth stages. The portfolio also includes a broad cross-section of opportunities in different industries, and geographic regions.

Real Estate Program

The WSIB's real estate program is an externally managed pool of selected partnership investments, intended to provide alternative portfolio characteristics when compared to traditional stock and bond investments. The majority of the WSIB's partnerships invest in institutional-quality real estate assets that are leased to third parties. The combination of income generated from bond-like lease payments, coupled with the hard asset qualities of commercial real estate, combine to generate returns that are expected to fall between the return expectations for fixed income and equities. The real estate portfolio is managed to deliver risk-adjusted returns that are consistent with the WSIB's long term return expectations for the asset class. The Retirement Fund's real estate partnerships typically invest in private real estate assets that are held for long-term income and appreciation. Many of the Retirement Fund's investment partnerships do not involve co-investment with other financial entities, thereby providing the WSIB with control provisions related to liquidation, acquisition, and ongoing operational decisions for annual capital expenditures.

Volatility including the real estate portfolio is minimized through a combination of factors. First, the majority of the Retirement Fund's partners own commercial real estate assets in a private investment form which are not subject to public market volatility. Secondly, real estate capital is diversified among a host of partners with varying investment styles. Thirdly, partnership assets are invested in numerous economic regions, including international markets, and in various property types. Finally, Retirement Fund's partners invest at different points within the asset's capital structure and life cycle.

The WSIB's current return objective for real estate calls for a target benchmark of 1-3% above the NCREIF index.

LABOR & INDUSTRIES' FUNDS

As Managed by the Washington State Investment Board

June 30, 2006

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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Labor and Industries' Funds of the state of Washington as managed by the Washington State Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Labor and Industries' Funds as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Department of Labor and Industries of the state of Washington. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Labor and Industries' Funds as of June 30, 2006, and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Labor and Industries' Funds of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/S/ PETERSON SULLIVAN PLLC

October 12, 2006

Labor & Industries' Funds

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Labor & Industries' Funds of the state of Washington (L & I Funds) managed by the WSIB. The WSIB manages funds for other state of Washington departments. This section of this report represents only the L & I Funds portion. The L & I Funds are the second largest investor in funds managed by the WSIB.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the L & I Funds. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the L & I Funds for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the L & I Funds for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the L & I Funds.

As shown in Table 1, the net assets of the L & I Funds decreased by $46.9 million during the fiscal year ended June 30, 2006. The market value of L & I assets is directly impacted by the activity of the various capital markets within which the WSIB invests. However, one of the benefits of the diversification gained by investing across various investment types as well as broadly within an asset class is the reduction in aggregate volatility of the total investment portfolio. The WSIB, upon receiving recommendations from Labor & Industries staff, WSIB staff, and other investment experts, makes the asset allocation decisions for the L & I assets. Staff rebalance between asset classes as markets move pursuant to WSIB policy.

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Money Market Funds	$176,990,000	$151,922,449	$25,067,551	16.5%
Total Fixed Income Investments	8,087,467,791	8,226,019,317	(138,551,526)	(1.7%)
Total Equity Investments	1,906,029,210	1,807,367,834	98,661,376	5.5%
Total Investments	10,170,487,001	10,185,309,600	(14,822,599)	(0.1%)
Total Accruals	96,362,708	128,443,626	(32,080,918)	(25.0%)
Total Net Assets at Market Value	$10,266,849,709	$10,313,753,226	$(46,903,517)	(0.5%)

As reflected in Table 1, money market funds increased from $151.9 million to $177.0 million, for an increase of $25.1 million or 16.5%. The primary reason for the increase was increases in cash needs projections by L & I staff. Fixed income investments decreased from $8.226 billion to $8.087 billion, for a decrease of $138.5 million or 1.7%. This was primarily due to negative investment performance offset slightly by asset transfers from public equity in rebalancing. Public equity investments increased from $1.807 billion to $1.906 billion, for an increase of $98.7 million or 5.5%. This was due to increases in market values of equity investments offset slightly by asset transfers to fixed income in rebalancing.

As shown in Table 2, premiums less benefit payouts, or net amount withdrawn, decreased from $(44.5) million to $(12.6) million, for a net decrease of $31.9 million or 71.7%. This was primarily due to premium rate increases. Total net investment income and changes in market values decreased from $1.064 billion to $(34.3) million, for a decrease of $1.098 billion or 103.2%. This was due to the total L & I Funds' investment return decreasing from 11.37% in 2005 to (0.36)% in 2006. See Table 1 for information on changes at the asset level.

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$10,313,753,226	$9,294,518,195	$1,019,235,031	11.0%
Net Amount Contributed (Withdrawn)	(12,622,712)	(44,527,193)	31,904,481	(71.7%)
Investment Earnings	(32,957,874)	1,064,884,234	(1,097,842,108)	(103.1%)
WSIB Operating Costs	(1,322,931)	(1,122,010)	(200,921)	17.9%
Net Investment Earnings	(34,280,805)	1,063,762,224	(1,098,043,029)	(103.2%)
Ending Total Net Assets at Market Value	$10,266,849,709	$10,313,753,226	$(46,903,517)	(0.5%)

Statement of Net Assets - June 30, 2006

	Accident Fund	Medical Aid Fund	Pension Reserves Fund	Supplemental Pension Fund	Total	Percent of Total
ASSETS						
Investments:						
LIQUIDITY:						
Money Market Funds	$ 51,188,401	$ 31,842,449	$ 62,104,844	$ 31,854,306	$ 176,990,000	1.7%
FIXED INCOME INVESTMENTS:						
Asset Backed Securities		5,162,468			5,162,468	
Collateralized Mortgage Obligations	765,822,151	460,457,484	385,820,675	317,710	1,612,418,020	
Pass Throughs	805,289	1,545,599	393,303		2,744,191	
Non-Standard Mortgages	12,924,984	13,528,376	1,901,763		28,355,123	
Commercial Mortgage Backed Securities	261,454,564	230,961,334	141,244,182		633,660,080	
Corporate Bonds - Domestic	1,605,380,298	1,574,153,704	1,239,236,727	36,300,634	4,455,071,363	
U.S. Government Treasuries	609,208,555	155,942,802	258,260,255	53,798,501	1,077,210,113	
U.S. Government Agencies	112,381,203		97,681,177		210,062,380	
Variable Rate Notes	32,731,066	20,053,606	9,999,381		62,784,053	
Total Fixed Income Investments	3,400,708,110	2,461,805,373	2,134,537,463	90,416,845	8,087,467,791	79.5%
EQUITY INVESTMENTS:						
Commingled Index Funds - Domestic	318,747,343	1,064,259,294	201,400,571		1,584,407,208	
Commingled Index Funds - Foreign	56,142,793	230,053,704	35,425,505		321,622,002	
Total Equity Investments	374,890,136	1,294,312,998	236,826,076		1,906,029,210	18.8%
Total Investments	3,826,786,647	3,787,960,820	2,433,468,383	122,271,151	10,170,487,001	100.0%
Interest Receivable	43,787,682	28,242,831	28,025,743	1,411,831	101,468,087	
Receivable for Investments Sold	16,571	10,417	14,524		41,512	
Collateral Held Under Securities Lending Agreements	650,438,839	236,706,724	283,719,083	53,034,959	1,223,899,605	
Total Assets	4,521,029,739	4,052,920,792	2,745,227,733	176,717,941	11,495,896,205	
LIABILITIES						
Obligations Under Securities Lending Agreements	650,438,839	236,706,724	283,719,083	53,034,959	1,223,899,605	
Accounts Payable	2,763,724	955,062	1,193,821	234,284	5,146,891	
Total Liabilities	653,202,563	237,661,786	284,912,904	53,269,243	1,229,046,496	
Net Assets	$ 3,867,827,176	$ 3,815,259,006	$ 2,460,314,829	$ 123,448,698	$ 10,266,849,709	

Statement of Changes in Net Assets - June 30, 2006

	Accident Fund	Medical Aid Fund	Pension Reserves Fund	Supplemental Pension Fund	Total
Additions					
Investment Income:					
Interest, Dividends and Other Investment Income	$ 243,581,558	$ 169,810,895	$ 140,191,375	$ 7,061,331	$ 560,645,159
Realized Capital Gains	64,232,879	20,358,177	24,697,771	261,908	109,550,735
Realized Capital Losses	(24,981,869)	(6,541,998)	(3,191,682)	(76,188)	(34,791,737)
Unrealized Losses	(336,577,161)	(66,108,559)	(209,288,056)	(1,670,644)	(613,644,420)
Less:					
Investment Expenses	(32,032,185)	(9,128,647)	(11,688,827)	(1,867,952)	(54,717,611)
WSIB Operating Costs	(512,729)	(479,881)	(315,093)	(15,228)	(1,322,931)
Total Investment Income (Loss)	(86,289,507)	107,909,987	(59,594,512)	3,693,227	(34,280,805)
Net Amount Contributed (Withdrawn)	(38,058,058)	5,203,399	(3,725,281)	23,957,228	(12,622,712)
Residual Equity Transfers	(21,292,708)		21,292,708		
Increase (Decrease) in Net Assets	(145,640,273)	113,113,386	(42,027,085)	27,650,455	(46,903,517)
Net Assets, Beginning of Year	4,013,467,449	3,702,145,620	2,502,341,914	95,798,243	10,313,753,226
Net Assets, End of Year	$ 3,867,827,176	$ 3,815,259,006	$ 2,460,314,829	$ 123,448,698	$ 10,266,849,709

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Funds

The Labor & Industries' Funds consist mainly of insurance premiums collected from employers in the state of Washington. The financial statements present only the activity of the L & I Funds as managed by the WSIB. The WSIB has exclusive control of the investment of all money invested in the L & I Funds. The financial statements do not present the financial position and results of operations of the WSIB or the Washington Department of Labor & Industries.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of GASB, which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges, and security pricing services. The L & I Funds have no investments of any commercial or industrial organization whose market value exceeds 5% of each plan's net assets. The assets of the L & I Funds are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Purchases and sales of investments are also recorded on a trade date basis.

Securities Lending

The L & I Funds record collateral received under securities lending agreements where the funds have the ability to spend, pledge or sell the collateral without borrower default. Liabilities resulting from these transactions are also recorded. Additionally, costs associated with securities lending transactions, including broker commissions paid, are reported as investment management expenses in the accompanying statements.

The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Note 2. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid by the L & I Funds are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the L & I Funds. These fees include investment management fees and commissions, investment consultant fees, legal fees and other investment management related expenses. The WSIB operating costs are charged against the funds based upon actual costs incurred by the WSIB to manage the investments.

Note 3. Deposit and Investment Risk Disclosures

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure the L & I Funds deposits may not be returned to the L & I Funds. The L & I Funds do not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risk – Investments

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

The WSIB has been authorized by statute as having the investment management responsibility for the L & I Funds. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored corporation eligible for collateral purposes at the Federal Reserve) securities; non-dollar bond; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leverage buy-outs, real estate, or other forms of private equity; asset backed securities and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The L & I Funds' fixed income investments are to be actively managed to exceed the return of the Lehman Aggregate Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2006, the Funds' durations of the various fixed income classes were within the duration targets of the Lehman Aggregate Index.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the L & I Funds' investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations, and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

The L & I Funds hold both U.S. agencies and corporate debt variable-rate securities, most of which reset periodically to the market interest rate. Because these securities frequently reprice to prevailing market rates, interest rate risk is substantially reduced at each periodic reset date. In the schedule above, variable-rate securities are presented according to the length of time until the next reset date rather than the stated maturity.

Schedule 1

Investment Type	Total Fair Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Asset Backed Securities	$ 5,162,468	$ -	$ 5,162,468	$ -	$ -	1.02	AAA
Mortgages:							
Collateralized Mortgage Obligations	1,612,418,020	7,578,010	230,737,284	294,589,068	1,079,513,658	6.90	Multiple
Pass Throughs	2,744,191	244,278	2,492,033	7,880		2.12	AAA
Non-Standard Mortgages	28,355,123	12,901,533	13,573,858		1,879,732	1.92	Multiple
Commercial Mortgage Backed Securities	633,660,080	5,513,138	369,676,995	258,469,947		4.17	Multiple
Corporate Bonds - Domestic	4,455,071,363	256,742,801	1,021,374,292	1,023,649,138	2,153,305,132	7.81	Multiple
Government Securities-Domestic:							
US Government Treasuries	1,077,210,113	19,681,998	73,769,305	85,823,399	897,935,411	10.41	AAA
US Government Agencies	210,062,380				210,062,380	10.11	AAA
Variable Rate Notes	62,784,053	62,784,053				0.06	Multiple
	8,087,467,791	$ 365,445,811	$ 1,716,786,235	$ 1,662,539,432	$ 4,342,696,313		
Investments Not Required to be Catergorized Under GASB Statement No. 3:							
Commingled Index Funds-Domestic	1,584,407,208						
Commingled Index Funds-Foreign	321,622,002						
Money Market Funds	176,990,000						
Total Investments Not Categorized	2,083,019,210						
Total L & I Funds Investments	$ 10,170,487,001						

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The L & I Funds' rated debt investments as of June 30, 2006, were rated by Moody's and/or an equivalent national rating organization. Investment types with multiple ratings are presented in the following schedule (Schedule 2) using the Moody's rating scale.

Schedule 2

Investment Type	Total Fair Value	Moody's Equivalent Credit Rating: Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Not Rated
Asset Backed Securities	$ 5,162,468	$ 5,162,468	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collateralized Mortgage Obligations	1,612,418,020	1,542,972,299										69,445,721
Pass Throughs	2,744,191	2,744,191										
Non-Standard Mortgages	28,355,123	26,732,990										1,622,133
Commercial Mortgage Backed Securities	633,660,080	586,052,475										47,607,605
Corporate Bonds - Domestic	4,455,071,363	420,927,282	131,418,146	111,823,798	509,082,762	589,181,776	465,974,633	523,906,238	559,516,995	806,528,052	234,390,768	102,320,913
US Government Treasuries	1,077,210,113	1,077,210,113										
US Government Agencies	210,062,380	210,062,380										
Variable Rate Notes	62,784,053				20,053,606	34,997,834				7,732,613		
Total	$ 8,087,467,791	$ 3,871,864,198	$ 131,418,146	$ 111,823,798	$ 529,136,368	$ 624,179,610	$ 465,974,633	$ 523,906,238	$ 559,516,995	$ 814,260,665	$ 234,390,768	$ 220,996,372

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 L & I Funds' policy states no corporate fixed income issue's cost shall exceed 3% of the fund's market value at the time of purchase, nor shall its market value exceed 6% of the fund's market value at any time. There was no concentration of credit risk as of June 30, 2006.

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 L & I Funds do not have a formal policy to limit foreign currency risk. The L & I Funds had $321,622,002 invested in an international commingled equity index fund. As such, no currency denomination risk is presented.

Note 4. Securities Lending

Washington State law and WSIB policy permit the L & I Funds to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation (SSC) to act as agent for the WSIB in securities lending transactions. As SSC is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

In accordance with GASB Statement 28, the L & I Funds report securities lent (the underlying securities) as assets in the statement of net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the L & I Funds has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the statement of net assets. Securities lending transactions collateralized by securities that the L & I Funds do 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 L & I Funds' 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% 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% of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006 was $1,223,899,605 and $1,207,373,714, respectively.

During fiscal year 2006, securities lending transactions could be terminated on demand by either the L & I Funds or the borrower. The weighted average maturity of overall loans was 32 days.

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

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

During fiscal year 2006, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the L & I Funds incurred no losses during fiscal year 2006 resulting from a default by either the borrowers or the securities lending agents.

Note 5. Derivatives

The L & I Funds are 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 L & I Funds mitigate market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the L & I Funds' authority to invest in derivatives, international active equity managers may make limited investments in financial futures, forward contracts or other derivative securities to manage exposure to currency rate risk and equitize excess cash holdings. No such derivative securities were held as of June 30, 2006. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2006, the only derivative securities held directly by the L & I Funds were collateralized mortgage obligations of $1,612,418,020.

There were no repurchase agreements outstanding at June 30, 2006. Repurchase agreements are collateralized at 102%. The collateral is priced daily and held by WSIB's agent in WSIB's name.

State law permits the L & I Funds 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 L & I Funds or provide securities or cash of equal value, the L & I Funds 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 the year and there were no liabilities outstanding as of June 30, 2006.

Note 6. Summary of Investment Policy

Under RCW 43.33A.030, trusteeship of the L & I Funds is vested in the voting members of the WSIB. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes it investment decisions and seeks to meet the following investment objectives.

Strategic Objectives

In accordance with RCW 43.33.110, these portfolios are to be managed to limit fluctuations in the industrial insurance premiums, and subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the order of the objectives shall be:

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

Taken together, these objectives imply portfolios for which growth keeps pace with inflation over time (preservation of capital), and that are able to provide a stable level of income sufficient to meet each fund's constituent needs.

Performance Objectives

The performance objectives are intended to provide the WSIB and the L & I Funds with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost, the performance of the investment portfolios shall be judged relative to the Strategic Objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each fund. The CMI's are developed and calculated by the consultant with the goal to construct a hypothetical passive portfolio with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each L & I fund. The return for each fund's portfolio should not be significantly different from that of its CMI over the long term.

These funds' investments are to emphasize stability and maximize income to support its operations. Within the required accounting guidelines, the L & I Funds' portfolio is to be managed, so that its individual performance meets or exceeds the return of its specific benchmark with a volatility of returns that, over time, is similar to or less than the benchmarks for a similar level of returns. For the funds which have both equity and fixed income holdings, the performance benchmark shall be a combination of an equity index representative of the equity held in the fund and the Lehman Aggregate Index for the fixed income portion, in percentage allocations that represent the funds' target allocations. The WSIB will measure both the book value income return and the marked-to-market total rate of return on the fund.

Portfolio Constraints

1) All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140, which state, in Part, that the WSIB is to "...establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums, and subject to this purpose, to maximize return at a prudent level of risk."
2) No corporate fixed income issue's cost shall exceed 3% of the fund's market value at the time of purchase, nor shall its market value exceed 6% of the funds' market value at any time (RCW 43.33A.140).

Asset Allocation

	Fixed Income Target	Equity Target	Equity Range
Accident Fund	90%	10%	8%-12%
Pension Reserve Fund	90%	10%	8%-12%
Medical Aid Fund	70%	30%	24%-36%
Supplemental Pension Fund	100%	0%	

Asset allocation will be reviewed every three to four years or sooner if there are significant changes in funding levels or the liability durations.

Market conditions, funding status, and liability assumptions are dynamic, not static; therefore, WSIB staff will meet regularly with L & I staff to review the investment portfolio, the status of the funding levels, the liability durations and to evaluate the percentage of the supplemental pension fund that is to be considered non-cash.

Assets will be rebalanced across asset classes when market value of the assets falls outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

Asset Class Structure

Asset class structure is established by the WSIB with guidelines for staff to move assets in order to achieve the fund's overall objectives.

Equity

The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the Dow Jones-Wilshire 5000. The benchmark and structure for international equities will be the Morgan Stanley Capital Indexes Europe, Australia, Far East (MSCI EAFE) index. Both portfolios will be 100% passively managed in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.

Equity Allocation

	Target	Range
U.S. Equity	85%	80%-90%
International Equity	15%	10%-20%

Fixed Income

The fixed income portfolios' structure will vary widely among funds depending upon the required duration target.

Accident Fund (608): within plus or minus 20% of a duration target of 9.

Pension Reserve Fund (610): with plus or minus 20% of a duration target of 9.

Medical Aid Fund (609): within plus or minus 20% of a duration target of 6.

Supplemental Pension Fund (881): the non-cash portion of the portfolio will have a duration that is between 1.75-2.25.

The duration targets will be reviewed every three years, or sooner, if there are significant changes in the funding levels or the liability durations.

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time those differences should not be material.

Permissible Fixed Income Investments

- 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.

Sector Allocations

Sector Allocations are to be managed within the ranges presented below. 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.

Target allocations for the Fixed Income Sectors

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%
Total Bonds	100%

Total holdings of below investment grade credit bonds (rated BB+ or below by Standard & Poor's or rated Ba1 or below by Moody's) should not exceed 5% of total fixed income holdings.

PERMANENT FUNDS

As Managed by the Washington State Investment Board

June 30, 2006

PETERSON SULLIVAN PLLC
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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Permanent Funds (Millersylvania Park, Agricultural School, Normal School, Common School, Scientific School, and State University) of the state of Washington as managed by the Washington State Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Permanent Funds as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Permanent Funds of the other state agencies. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Permanent Funds as of June 30, 2006, and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Permanent Funds of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/S/ PETERSON SULLIVAN PLLC

October 12, 2006

Permanent Funds

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Permanent Funds of the state of Washington managed by the WSIB. The WSIB manages funds for other state of Washington departments. This section of this report represents only the Permanent Funds portion.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the Permanent Funds. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the Permanent Funds for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the Permanent Funds for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the Permanent Funds.

As shown in Table 1, the net assets of the Permanent Funds decreased by $22.7 million during the fiscal year ended June 30, 2006. The market value of the Permanent Funds assets is directly impacted by the activity of the various capital markets within which the WSIB is legislatively allowed to invest. Due to those restrictions, limited benefits of diversification can be gained. The WSIB makes the asset allocation decisions for the Permanent Funds. The WSIB staff rebalances between asset classes as markets move, pursuant to WSIB policy.

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Money Market Funds	$44,619,678	$36,328,078	$8,291,600	22.8%
Total Fixed Income Investments	654,434,530	686,559,802	(32,125,272)	(4.7%)
Total Equity Investments	9,836,909	8,941,364	895,545	10.0%
Total Investments	708,891,117	731,829,244	(22,938,127)	(3.1%)
Total Accruals	3,928,277	3,724,187	204,090	5.5%
Total Net Assets at Market Value	$712,819,394	$735,553,431	$(22,734,037)	(3.1%)

As reflected in Table 1, money market funds increased from $36.3 million to $44.6 million, for an increase of $8.3 million, or 22.8%. The primary reason for the increase was for portfolio management reasons. Fixed income investments decreased from $686.6 million to $654.4 million, for a decrease of $32.1 million, or 4.7%. This was primarily due to negative investment performance and a transfer of assets to fund beneficiary distributions.

As shown in Table 2, contributions decreased slightly from $14.1 million to $13.9 million, for a net decrease of 1.2%. Distributions increased from $31.3 million to $32.4 million, or by 3.5%, due to increased income. Investment earnings decreased by 109.6% due to unrealized market value losses. See Table 1 for information on changes at the asset level.

Statement of Net Assets - June 30, 2006

	Millersylvania Park	Agricultural School	Normal School	Common School	Scientific School	State University	Total	Percent of Total
ASSETS								
Investments:								
LIQUIDITY:								
Money Market Funds	$ 5,151	$ 11,032,505	$ 11,326,024	$ 7,334,353	$ 13,060,278	$ 1,861,367	$ 44,619,678	6.3%
FIXED INCOME INVESTMENTS:								
Asset Backed Securities				523,856			523,856	0.1%
Collateralized Mortgage Obligations		36,900,536	54,831,285	40,922,975	41,943,552	6,573,428	181,171,776	25.6%
Pass Throughs		730,750	1,290,130	1,059,056	655,706	138,557	3,874,199	0.5%
Commercial Mortgage Backed Securities		6,060,420	6,937,803	5,815,347	6,644,165	846,300	26,304,035	3.7%
Corporate Bonds - Domestic		55,162,829	79,318,807	61,290,683	60,556,242	9,283,676	265,612,237	37.5%
U.S. Government Treasuries		24,762,767	28,913,875	20,433,589	26,368,692	3,799,108	104,278,031	14.7%
U.S. Treasury Inflation Protected Securities		15,053,154	21,775,388	16,636,107	16,610,376	2,595,371	72,670,396	10.3%
Total Fixed Income Investments	-	138,670,456	193,067,288	146,681,613	152,778,733	23,236,440	654,434,530	92.3%
EQUITY INVESTMENTS:								
Commingled Index Fund - Domestic				9,836,909			9,836,909	1.4%
Total Investments	5,151	149,702,961	204,393,312	163,852,875	165,839,011	25,097,807	708,891,117	100.0%
Interest Receivable	21	1,632,948	2,173,337	1,652,460	1,753,711	269,182	7,481,659	
Receivable for Investments Sold		309	580	652	206	15	1,762	
Collateral Held Under Securities		44,180,931	55,035,034	40,224,463	48,247,048	8,298,150	195,985,626	
Total Assets	5,172	195,517,149	261,602,263	205,730,450	215,839,976	33,665,154	912,360,164	
LIABILITIES								
Obligations Under Securities		44,180,931	55,035,034	40,224,463	48,247,048	8,298,150	195,985,626	
Accounts Payable		181,622	222,060	168,474	193,340	31,766	797,262	
Due to Other Funds	21	591,186	802,862	606,047	659,346	98,420	2,757,882	
Total Liabilities	21	44,953,739	56,059,956	40,998,984	49,099,734	8,428,336	199,540,770	
Net Assets	$ 5,151	$ 150,563,410	$ 205,542,307	$ 164,731,466	$ 166,740,242	$ 25,236,818	$ 712,819,394	

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$735,553,431	$709,029,452	$26,523,979	3.7%
Net Amount Contributed (Withdrawn)	13,878,922	14,052,491	(173,569)	(1.2%)
Investment Earnings	(4,117,743)	43,875,307	(47,993,050)	(109.4%)
WSIB Operating Costs	(92,921)	(85,492)	(7,429)	8.7%
Net Investment Earnings	(4,210,664)	43,789,815	(48,000,479)	(109.4%)
Distributions to Beneficiary Funds	(32,402,295)	(31,318,327)	(1,083,968)	3.5%
Ending Total Net Assets at Market Value	$712,819,394	$735,553,431	$(22,734,037)	(3.1%)

Statement of Changes in Net Assets - June 30, 2006

	Millersylvania Park	Agricultural School	Normal School	Common School	Scientific School	State University	Total
Additions							
Investment Income:							
Interest, Dividends and	$ 213	$ 8,581,613	$ 11,633,274	$ 9,024,077	$ 9,447,834	$ 1,413,399	$ 40,100,410
Realized Capital Gains		279,886	160,543	292,751	123,770	24,911	881,861
Realized Capital Losses		(97,826)	(134,506)	(101,637)	(108,258)	(18,184)	(460,411)
Unrealized Gains and Losses		(8,050,843)	(11,047,152)	(7,881,564)	(8,888,588)	(1,332,689)	(37,200,836)
Less:							
Investment Expenses		(1,644,191)	(2,139,157)	(1,632,984)	(1,754,905)	(267,530)	(7,438,767)
WSIB Operating Costs		(19,558)	(26,956)	(21,669)	(21,478)	(3,260)	(92,921)
Total Investment Income (Loss)	213	(950,919)	(1,553,954)	(321,026)	(1,201,625)	(183,353)	(4,210,664)
Net Amount Contributed		3,839,559	2,938,956	48,668	6,214,477	837,262	13,878,922
Distributions to Beneficiary Funds	(213)	(6,918,858)	(9,469,302)	(7,198,741)	(7,672,511)	(1,142,670)	(32,402,295)
Net Decrease in Net Assets	-	(4,030,218)	(8,084,300)	(7,471,099)	(2,659,659)	(488,761)	(22,734,037)
Net Assets, Beginning of Year	5,151	154,593,628	213,626,607	172,202,565	169,399,901	25,725,579	735,553,431
Net Assets, End of Year	$ 5,151	$ 150,563,410	$ 205,542,307	$ 164,731,466	$ 166,740,242	$ 25,236,818	$ 712,819,394

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Funds

The Permanent Funds of the state of Washington include: the Agricultural School Permanent Fund; the Normal School Permanent Fund; the Common School Permanent Fund; the Scientific School Permanent Fund and the State University Permanent Fund. These funds were derived from the State Enabling Act. Originally, land was granted to the state by the federal government at statehood to establish these permanent funds. The Permanent Funds consist of proceeds from sales of these lands and related natural resources. The proceeds from these sales are deposited by the Department of Natural Resources in each respective Permanent Fund account for investment by the WSIB. An additional Permanent Fund known as the Millersylvania Park Permanent Fund was established in 1931 from a gift of cash and securities for the park maintenance upkeep. The financial statements present only the activity of the Permanent Funds as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in the Permanent Funds. The financial statements do not present the financial position and results of operations of the WSIB.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of GASB which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges, and security pricing services. The Permanent Funds have no investments of any commercial or industrial organization whose market value exceeds 5% of net assets. The assets of the Permanent Funds are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Capital losses are deferred and amortized against future income distributions to beneficiary funds and are not capitalized on the statement of net assets. This process is necessary to meet legal requirements that preclude capital losses from eroding the corpus of the invested funds. In addition, the loss is allocated over the weighted average life of the portfolio in order to alleviate any adverse impact on the current programs supported by these distributions. Interest earnings are distributed to beneficiary funds on a monthly basis. Capital gains are reinvested. Purchases and sales of investments are also recorded on a trade date basis.

Securities Lending

The Permanent Funds report collateral received under securities lending agreements where the funds have the ability to spend, pledge, or sell the collateral without borrower default. Liabilities resulting from these transactions are also reported. Additionally, costs associated with securities lending transactions, including broker commissions paid, are reported as investment management expenses in the accompanying statements. The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Note 2. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid by the Permanent Funds are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the funds. These fees include investment management fees and commissions, investment consultant fees, legal fees, and other investment management related expenses. The WSIB operating costs are charged against the funds based upon actual costs incurred by the WSIB to manage the investments.

Note 3. Deposit and Investment Risk Disclosures

Custodial Credit Risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure the Permanent Funds deposits may not be returned to Permanent Funds. The Permanent Funds do not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risks – Investments

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

The WSIB is authorized by statute as having the investment management responsibility for the Permanent Funds. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored corporation eligible for collateral purposes at the Federal Reserve) securities; non-dollar bond; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leverage buy-outs, real estate, or other forms of private equity; asset backed securities and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The Permanent Funds' fixed income investments are to be actively managed to exceed the return of the Lehman Aggregate Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2006, the Funds' durations of the various fixed income classes were within the duration targets of the Lehman Aggregate Index.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the Permanent Funds' investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations, and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

The Permanent Funds hold both U.S. agencies and corporate debt variable-rate securities, most of which reset periodically to the market interest rate. Because these securities frequently reprice to prevailing market rates, interest rate risk is substantially reduced at each periodic reset date. In Schedule 1, variable-rate securities are presented according to the length of time until the next reset date rather than the stated maturity.

Schedule 1

		Maturity					
Investment Type	Total Fair Value	Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Asset backed Securities	$ 523,856	$ 523,856	$ -	$ -	$ -	0.04	AAA
Mortgages:							
Collateralized Mortgage Obligations	181,171,776	3,188,625	9,837,627	130,932,842	37,212,682	6.09	Multiple
Pass Throughs	3,874,199		3,871,099			2.08	AAA
Commercial Mortgage Backed Securities	26,304,035	3,100	9,727,233	16,576,802		4.89	Multiple
Corporate Bonds - Domestic	265,612,237	40,825,746	122,885,840	69,263,961	32,636,690	4.45	Multiple
Government Securities-Domestic:							
US Government Treasuries	104,278,031	13,971,019	27,577,203	30,496,959	32,232,850	6.67	AAA
Treasury Inflation Protected Securities	72,670,396	26,776,916	31,804,040	14,089,440		2.12	AAA
	654,434,530	$ 85,289,262	$ 205,703,042	$ 261,360,004	$ 102,082,222		
Investments Not Requried to be Catergorized Under GASB Statement No. 3:							
Commingled Index Funds-Domestic	9,836,909						
Money Market Funds	44,619,678						
Total Investments Not Categorized	54,456,587						
Total Permanent Funds Investments	$ 708,891,117						

Schedule 2

		Moody's Equivalent Credit Rating									
Investment Type	Total Fair Value	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Not Rated
Asset backed Securities	$ 523,856	$ 523,856	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collateralized Mortgage Obligations	181,171,776	178,458,078										2,713,698
Pass Throughs	3,874,199	3,874,199										
Commercial Mortgage Backed Securities	26,304,035	19,525,973										6,778,062
Corporate Bonds - Domestic	265,612,237	47,084,179	9,620,425	23,341,341	58,349,699	39,430,593	21,540,558	27,673,326	9,057,095	23,032,490	4,577,524	1,905,007
US Government Treasuries	104,278,031	104,278,031										
Treasury Inflation Protected Securities	72,670,396	72,670,396										
Total	$ 654,434,530	$ 426,414,712	$ 9,620,425	$ 23,341,341	$ 58,349,699	$ 39,430,593	$ 21,540,558	$ 27,673,326	$ 9,057,095	$ 23,032,490	$ 4,577,524	$ 11,396,767

Credit Risks

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Permanent Funds' rated debt investments as of June 30, 2006, were rated by Moody's and/or an equivalent national rating organization. Investments types with multiple ratings are presented in Schedule 2 using the Moody's rating scale.

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 Permanent Funds' policy states no corporate fixed income issue's cost shall exceed 3% of the fund's market value at the time of purchase, nor shall its market value exceed 6% of the fund's market value at any time (RCW 43.33A.140). There was no concentration of credit risk that exceeded these limits as of June 30, 2006.

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 Permanent Funds have no formal policy to limit foreign currency risk. The Permanent Funds had no investments with currency risk exposure.

Note 4. Securities Lending

Washington State law and WSIB policy permit the Permanent Funds to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation (SSC) to act as agent for the WSIB in securities lending transactions. As SSC is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

In accordance with GASB Statement 28, the Permanent Funds report securities lent (the underlying securities) as assets in the statement of net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Permanent Funds have the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the statement of net assets. Securities lending transactions collateralized by securities that the Permanent Funds do 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 Permanent Funds' 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, where securities whose primary trading market was located in the United States or were sovereign debt issued by foreign governments, the collateral requirement was 102% 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% of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006, was $195,985,626 and $192,872,528 respectively.

During fiscal year 2006, securities lending transactions could be terminated on demand by either the Permanent Funds or the borrower. The weighted average maturity of overall loans was 32 days.

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

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

During fiscal year 2006, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Permanent Funds incurred no losses during fiscal year 2006 resulting from a default by either the borrowers or the securities lending agents.

Note 5. Derivatives

Permanent Funds are 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. Permanent Funds mitigate market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the Permanent Funds' authority to invest in derivatives, international active equity managers may make limited investments in financial futures, forward contracts or other derivative securities to manage exposure to currency rate risk and equitize excess cash holdings. No such derivative securities were held as of June 30, 2006. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2006, the only derivative securities held directly by the Permanent Funds were collateralized mortgage obligations of $181,171,776.

There were no repurchase agreements outstanding at June 30, 2006. Repurchase agreements are collateralized at 102%. The collateral is priced daily and held by WSIB's agent in WSIB's name.

State law permits the Permanent Funds to enter into reverse repurchase agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers' margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the state or provide securities or cash of equal value, The Permanent Funds 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 the year and there were no liabilities outstanding as of June 30, 2006.

Note 6. Summary of Investment Policy

Under RCW 43.33A.030, trusteeship of the Permanent Funds is vested in the voting members of the WSIB. The Legislature has established a standard of care for investment of this fund in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes it investment decisions and seeks to meet the following investment objectives.

Strategic Objectives

These funds investments are to be managed to achieve the highest return possible consistent with the desire to emphasize high current yield to maturity opportunities and to add value through active management. The objectives include:

1) Safety of principal
2) Current income
3) Long-term stability of purchasing power
4) Preservation of the public's trust

Taken together, these objectives imply portfolios for which growth keeps pace with inflation over time (preservation of capital), and that are able to provide a stable level of income sufficient to meet each fund's constituent needs.

Performance Objectives

The Permanent Funds' investments are to emphasize stability and maximize income to support the operations of its irreducible principal. These Permanent Funds do have a small equity allocation which incorporates limited exposure to portfolio growth. Within the required accounting guidelines, the Funds' portfolio is to be managed, so that its individual performance meets or exceeds the return of its specific benchmark with a volatility of returns that, over time, is similar to or less than the benchmarks for a similar level of returns. For the Permanent Funds, which have both equity and fixed income holdings, the performance benchmark shall be a combination of an equity index representative of the equity held in Permanent Funds and the Lehman Aggregate Index, in percentage allocations that represent Permanent Funds' target allocations. The WSIB will measure both the book value income return and the marked-to-market total rate of return on the fund.

Risk Tolerance

Risk will be managed in a prudent manner. Since the stakeholder only receives the current income and net capital appreciation of the assets, Permanent Funds have a below average ability to tolerate volatility in current income.

Portfolio Constraints

1) All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140, which state, in Part, that the WSIB is to "invest and manage the assets entrusted to it with reasonable care, skill, prudence and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose."
2) Duration of Fixed Income Portfolios – The fixed income portfolio duration range will not exceed the Lehman Government Index's duration by more than 5%.

Permissible Investments

- Any WSIB managed fund that meets a fund's investment objectives and its permissible investment constraints.
- U.S. and non-U.S. public equity.
- Investment Grade Fixed Income – defined as rated Baa3 or higher by Moody's Investor Service.

Although fixed income securities that are rated below investment grade may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held.

Permissible Fixed Income Market Segments

1) U.S. Treasuries and Government Agencies
2) Credit Bonds
3) Mortgage Backed Securities
4) Asset Backed Securities
5) Commercial Backed Mortgage Securities
6) Convertible Securities
7) Eurodollar Bonds
8) Non-Dollar Bonds
9) Other fixed income segments and instruments may be added from time to time as they are developed or deemed appropriate.

Sector Allocations

Portfolio allocations are to be managed with the ranges presented below. 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 portfolio must be rebalanced to the target allocations, as soon as it is practical.

Duration Target

The fixed income portfolio's duration is to be targeted within plus or minus 20% of the duration of the portfolio's performance benchmark, the Lehman Aggregate Index.

Target allocations for the Fixed Income Sectors

U.S. Treasuries and Government Agencies	10 – 50%
Credit Bonds	10 – 50%
Asset Backed Securities	0 – 10%
Commercial Mortgage Backed Securities	0 – 10%
Mortgage Backed Securities	5 – 40%
Total Bonds	100%

OTHER FUNDS

As Managed by the Washington State Investment Board

June 30, 2006

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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Other Funds (Emergency Reserve, Reclamation Revolving, Game & Special Wildlife, Pension Stabilization, Health Insurance, and Radiation Perpetual) of the state of Washington as managed by the Washington State Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Other Funds as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Trust Funds of the other state agencies. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Other Funds as of June 30, 2006, and the change in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Other Funds of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/S/ PETERSON SULLIVAN PLLC

October 12, 2006

Other Funds

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Other Funds of the state of Washington managed by the WSIB. The WSIB manages funds for other state of Washington departments. This section of this report represents only the Other Funds portion.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the Other Funds. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the Other Funds for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the Other Funds for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the Other Funds.

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Money Market Funds	$507,472,656	$85,747,661	$421,724,995	491.8%
Total Fixed Income Investments	218,324	263,508	(45,184)	(17.1%)
Total Investments	507,690,980	86,011,169	421,679,811	490.3%
Total Accruals	2,063,660	212,773	1,850,887	869.9%
Total Net Assets at Market Value	$509,754,640	$86,223,942	$423,530,698	491.2%

As shown in Table 1, the net assets of the Other Funds increased by $423.5 million during the fiscal year ended June 30, 2006. The market value of Other Funds assets is directly impacted by the activity of the various capital markets within which the WSIB is legislatively allowed to invest. Due to those restrictions, limited benefits of diversification can be gained. The WSIB makes the asset allocation decisions for these assets. WSIB staff rebalances pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $85.7 million to $507.4 million, for an increase of $421.7 million, or 491.8%. The primary reason for the increase was the addition of a new fund with short term cash needs. Fixed income investments decreased from $263.5 thousand to $218.3 thousand, for a decrease of $45.2 thousand, or 17.1%. This was due to negative investment performance and maturing assets.

As shown in Table 2, the net amount contributed was $416.6 million, or a growth of 1,491.0%. Investment earnings grew in line with the growth in assets and the higher returns on money market securities. Operating expenses grew in line with the growth in assets.

Statement of Net Assets - June 30, 2006

	Emergency Reserve	Reclamation Revolving	Game & Special Wildlife	Pension Stabilization	Health Insurance	Radiation Perpetual	Total Other Trust Funds	Percent of Total
ASSETS								
Investments:								
Money Market Funds	$ 67,804,188	$ 155,904	$ 9,406,491	$ 350,470,581	$ 79,338,055	$ 297,437	$ 507,472,656	100.0%
Municipal Bonds		218,324					218,324	0.0%
Total Investments	67,804,188	374,228	9,406,491	350,470,581	79,338,055	297,437	507,690,980	100.0%
Interest Receivable	272,371	6,492	37,786	1,427,115	318,702	1,195	2,063,661	
Total Assets	68,076,559	380,720	9,444,277	351,897,696	79,656,757	298,632	509,754,641	
LIABILITIES								
Accounts Payable		1					1	
Total Liabilities		1					1	
Net Assets	$ 68,076,559	$ 380,719	$ 9,444,277	$ 351,897,696	$ 79,656,757	$ 298,632	$ 509,754,640	

Statement of Changes in Net Assets - June 30, 2006

	Emergency Reserve	Reclamation Revolving	Game & Special Wildlife	Pension Stabilization	Health Insurance	Radiation Perpetual	Total Other Trust Funds
Additions							
Investment Income:							
Interest, Dividends and Other Investment Income	$ 1,527,219	$ 18,082	$ 373,851	$ 1,897,696	$ 3,153,209	$ 11,822	$ 6,981,879
Unrealized gains		916					916
Less:							
Investment Expenses		(9)	(151)		(1,272)	(5)	(1,437)
WSIB Operating Expenses	(655)	(48)	(1,190)		(9,847)	(36)	(11,776)
Total Investment Income	1,526,564	18,941	372,510	1,897,696	3,142,090	11,781	6,969,582
Net Amount Contributed	66,549,995	48	1,190	350,000,000	9,847	36	416,561,116
Net Increase in Net Assets	68,076,559	18,989	373,700	351,897,696	3,151,937	11,817	423,530,698
Net Assets, Beginning of Year		361,730	9,070,577		76,504,820	286,815	86,223,942
Net Assets, End of Year	$ 68,076,559	$ 380,719	$ 9,444,277	$ 351,897,696	$ 79,656,757	$ 298,632	$ 509,754,640

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$86,223,942	$58,483,889	$27,740,053	47.4%
Net Amount Contributed (Withdrawn)	416,561,116	26,182,742	390,378,374	1491.0%
Investment Earnings	6,981,358	1,564,310	5,417,048	346.3%
WSIB Operating Costs	(11,776)	(6,999)	(4,777)	68.3%
Net Investment Earnings	6,969,582	1,557,311	5,412,271	347.5%
Ending Total Net Assets at Market Value	$509,754,640	$86,223,942	$423,530,698	491.2%

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Funds

The Other Funds of the state of Washington consist of: the Emergency Reserve, Reclamation Revolving, Game and Special Wildlife, Pension Stabilization, Health Insurance, and the Radiation Perpetual funds. These funds were created by Washington State legislation over the years to fund various mandates and can be liquidated as needed to fund those mandates. These funds are invested by the WSIB until they are completely liquidated or legislation closes the funds. The financial statements present only the activity of the Other Funds as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in the Other Funds. The financial statements do not present the financial position and results of operations of the WSIB.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of GASB, which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges and security pricing services. The Other Funds have no investments of any commercial or industrial organization whose market value exceeds 5% of each plan's net assets. The assets of the Other Funds are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Purchases and sales of investments are also recorded on a trade date basis.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Note 2. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid by the Other Funds are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the funds. These fees include investment management fees and commissions, investment consultant fees, legal fees and other investment management related expenses. The WSIB operating costs are charged against the funds based upon actual costs incurred by the WSIB to manage the investments.

Note 3. Deposit and Investment Risk Disclosures

Custodial Credit Risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure the Other Funds deposits may not be returned to it. The Other Funds do not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risks – Investments

The securities lending collateral balances included are from securities required to be listed under GASB Statement 3 Category 3 – Uninsured and unregistered with securities held by the counterparty, or by its trust department or agent but not in the government's name. (This includes the amount of any repurchase agreement that exceeds the market value of the underlying securities). The Other Funds had no security lending activity for the fiscal year ending June 30, 2006.

The WSIB has been authorized by statute as having the investment management responsibility for the Other Funds. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored

Schedule 1

Investment Type	Total Fair Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Municipal Bonds	$ 218,324	$ 39,226	$ 158,161	$ 20,937	$ -	2.36	Multiple
Money Market Funds	507,472,656	507,472,656	-	-	-	-	N/A
Total Investments	507,690,980	507,511,882	158,161	20,937	-		

Schedule 2

Investment Type	Total Fair Value	Moody's Equivalent Credit Rating: Aaa	NR	Total
Municipal Bonds	$ 218,324	$ 113,790	$ 104,533	$ 218,324
Total	$ 218,324	$ 113,790	$ 104,533	$ 218,324

corporation eligible for collateral purposes at the Federal Reserve) securities; non-dollar bond; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leverage buy-outs, real estate, or other forms of private equity; asset backed securities and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. As of June 30, 2006 the Funds' durations of the various fixed income classes were within the duration targets of the Lehman Aggregate Index.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the Other Funds' investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

Credit Risks

Investments with multiple ratings are presented in Schedule 2.

Concentration of Credit Risk

The WSIB has a formal investment policy that limits the amount these funds may invest in any one issuer to no more than 3%. The Reclamation Revolving fund was created prior to this investment policy. The Reclamation Revolving funds municipal bond investments are approximately 31% in Chelan County, Entiat Irrigation District, 33% in Chelan County, Lower Stemilt Irrigation District, 22% in Okanogan County, Aeneas Lake Irrigation District and 14% in Spokane County MOAB Irrigation District.

Highly Sensitive Investments

There are no investments that are highly subject to interest rate changes as of June 30, 2006.

Foreign Currency Risk

The WSIB does not have a policy regarding foreign currency risk, which is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. There was no foreign investment risk exposure in any of theses funds as of June 30, 2006.

Note 4. Investment Policy

Under RCW 43.33A.030, trusteeship of the Other Funds is vested in the voting members of the WSIB. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes its investment decisions and seeks to meet the following investment objectives.

Strategic Objectives

These Funds' investments are to be managed to achieve the highest return possible consistent with the desire to emphasize current income. The objectives include:

1) Safety of Principal
2) Current Income
3) Preservation of the Public's Trust

Performance Objectives

These Funds' investments are to emphasize stability and maximize income to support the operations of each program.

Risk Tolerance

Risk will be managed in a prudent manner. The funds have a below average ability to tolerate volatility.

Permissible Investments

- Government agencies and U.S. Treasuries
- Short-term Investment Funds (STIF) that invest strictly in U.S. Government or Government Agency instruments, including Repurchase Agreements for U.S. Government and Agency instruments. The Pension Stabilization Fund is currently invested in the Blackrock TempCash short-term investment funds which hold various top rated money market instruments, including repurchase agreements.
- Cash collateral for security lending and collateral for repurchase agreements is restricted to U.S. Government and Government Agency securities.

Portfolio Constraints

1) All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140, which state, in Part, that the WSIB is to "invest and manage the assets entrusted to it with reasonable care, skill, prudence and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose."
2) Duration of Fixed Income Portfolios – The fixed income portfolio duration range will not exceed the Lehman Government Index's duration by more than 5%.

GUARANTEED EDUCATION TUITION FUND

As Managed by the Washington State Investment Board

June 30, 2006

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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Guaranteed Education Tuition Fund of the state of Washington as managed by the Washington State Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Guaranteed Education Tuition Fund as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Washington Guaranteed Education Tuition Program. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Guaranteed Education Tuition Fund as of June 30, 2006, and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Guaranteed Education Tuition Fund of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/S/ PETERSON SULLIVAN PLLC

October 12, 2006

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Money Market Funds	$1,153,849	$6,073,904	$(4,920,055)	(81.0%)
Total Fixed Income Investments	284,122,556	210,456,924	73,665,632	35.0%
Total Equity Investments	419,348,436	329,424,361	89,924,075	27.3%
Total Investments	704,624,841	545,955,189	158,669,652	29.1%
Total Accruals	3,374,909	2,261,399	1,113,510	49.2%
Total Net Assets at Market Value	$707,999,750	$548,216,588	$159,783,162	29.1%

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$548,216,588	$405,265,896	$142,950,692	35.3%
Net Amount Contributed (Withdrawn)	110,163,806	99,166,147	10,997,659	11.1%
Investment Earnings	49,692,796	43,832,132	5,860,664	13.4%
WSIB Operating Costs	(73,440)	(47,587)	(25,853)	54.3%
Net Investment Earnings	49,619,356	43,784,545	5,834,811	13.3%
Ending Total Net Assets at Market Value	$707,999,750	$548,216,588	$159,783,162	29.1%

Guaranteed Education Tuition Fund

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Guaranteed Education Tuition Fund of the state of Washington (the GET Fund) managed by the Washington State Investment Board. The WSIB manages funds for other state of Washington departments. This section of this report represents only the GET Fund portion.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the GET Fund. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the GET Fund for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the GET Fund for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the GET Fund.

As shown in Table 1, the net assets of the GET Fund increased by $159.8 million during the fiscal year ended June 30, 2006. The market value of the GET Fund assets is directly impacted by the activity of the various capital markets within which the WSIB invests. However, one of the benefits of diversification gained by investing across various investment types as well as broadly within an asset class is the reduction in aggregate volatility of the total investment portfolio. The WSIB, after discussions with the GET Committee, makes the asset allocation decisions for the GET assets. WSIB staff rebalances between asset classes as markets move pursuant to WSIB policy.

As reflected in Table 1, money market funds decreased from $6.1 million to $1.2 million, for a decrease of $4.9 million, or 81.0%. The reduction was due to the cash being invested in other asset classes. Fixed income investments increased from $210.4 million to $284.1 million, for an increase of $73.7 million, or 35.0%. Negative investment performance was offset by contributions made during the year. Public Equity investments increased from $329.4 million to $419.3 million, for an increase of $89.9 million, or 27.3%. This was due to increases in market values of equity investments and contributions to the asset class through out the year.

As shown in Table 2, contributions grew by 11.1% from the previous year. Investment earnings grew in line with the growth due to contributions. See Table 1 for information on changes at the asset level.

Statement of Net Assets - June 30, 2006

	Total	Percent of Total
ASSETS		
Investments:		
Money Market Funds	$ 1,153,849	0.2%
Treasury Inflation Protected Securities	284,122,556	40.3%
Commingled Index Funds - Domestic	280,261,704	39.8%
Commingled Index Funds - Foreign	139,086,732	19.7%
Total Investments	704,624,841	100.0%
Interest Receivable	4,585,051	
Collateral Held Under Securities Lending Agreements	268,883,495	
Total Assets	978,093,387	
LIABILITIES		
Obligations Under Securities Lending Agreements	268,883,495	
Accounts Payable	1,210,142	
Total Liabilities	270,093,637	
Net Assets	$ 707,999,750	

Statement of Changes in Net Assets - June 30, 2006

	Total
Additions	
Investment Income:	
Interest, Dividends and Other Investment Income	$ 25,178,341
Realized Capital Gains	5,035,577
Realized Capital Losses	(69,267)
Unrealized Market Gains and Losses	29,741,074
Less:	
Investment Expenses	(10,192,929)
WSIB Operating Costs	(73,440)
Total Investment Income	49,619,356
Net Amount Contributed	110,163,806
Net Increase in Net Assets	159,783,162
Net Assets, Beginning of Year	548,216,588
Net Assets, End of Year	$ 707,999,750

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Fund

The Guaranteed Education Tuition Fund of the state of Washington (the GET Fund) consists of contributions from participants planning on attending advanced education programs in the state of Washington. This Fund is invested by the WSIB until participants begin to withdraw funds as needed to pay for educational expenses. The financial statements present only the activity of the GET Fund as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in the GET Fund. The financial statements do not present the financial position and results of operations of the WSIB or Washington Guaranteed Education Tuition Program.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of GASB which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges, and security pricing services. The GET Fund has no investments of any commercial or industrial organization whose market value exceeds 5% of net assets. The assets of the GET Fund are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Purchases and sales of investments are also recorded on a trade date basis.

Securities Lending

The GET Fund records collateral received under securities lending agreements where the GET Fund has the ability to spend, pledge or sell the collateral without borrower default. Liabilities resulting from these transactions are also recorded. Additionally, costs associated with securities lending transactions, including broker commissions paid, are reported as investment management expenses in the accompanying statements. The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Note 2. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid by the GET Fund are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the GET Fund. These fees include investment management fees and commissions, investment consultant fees, legal fees and other investment management related expenses. The WSIB operating costs are charged against the funds based upon actual costs incurred by the WSIB to manage the investments.

Note 3. Deposit and Investment Risk Disclosures

Custodial Credit Risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure the GET Fund deposits may not be returned to it. The GET Fund does not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risks – Investments

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

The WSIB has been authorized by statute as having the investment management responsibility for the GET Fund. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored corporation eligible for collateral purposes at the Federal Reserve) securities; non-dollar bond; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leverage buy-outs, real estate, or other forms of private equity; asset backed securities and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as

Schedule 1

Investment Type	Total Fair Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Treasury Inflation Protected Securities	$ 284,122,556	$ 25,756,844	$ 88,021,921	$ 97,286,333	$ 73,057,458	7.51	AAA
Investments Not Required to be Categorized Under GASB Statement No. 3:							
Commingled Index Funds-Domestic	280,261,704						
Commingled Index Funds-Foreign	139,086,732						
Money Market Funds	1,153,849						
Total Investments Not Categorized	420,502,285						
Total Investments	704,624,841						

a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. As of June 30, 2006, the Fund's durations of the various fixed income classes were within the duration targets of the Lehman Aggregate Index.

Schedule 1 provides information about the interest rate risks associated with the GET Fund investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

Credit Risks

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The GET Fund debt investments in U.S. Treasury Inflation Protected Securities as of June 30, 2006 were rated Aaa by Moody's and AAA by S&P.

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 GET Fund policy states no corporate fixed income issue's cost shall exceed 3% of the market value at the time of purchase, nor shall its market value exceed 6% of the market value at any time (RCW 43.33A.140). There was no concentration of credit risk that exceeded these limits as of June 30, 2006.

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 GET Fund has no formal policy to limit foreign currency risk. The GET Fund had no investments with currency risk exposure. The GET Fund had $139,086,732 invested in an international commingled equity index fund. As such, no currency risk denomination is presented.

Note 4. Securities Lending

Washington State law and Board policy permit the GET Fund to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation (SSC) to act as agent for the WSIB in securities lending transactions. As SSC is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

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

Securities were loaned and collateralized by the GET Fund'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, where securities whose primary trading market was located in the United States or were sovereign debt issued by foreign governments, the collateral requirement was 102% 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% of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006, was $268,883,495 and $265,013,382 respectively.

During fiscal year 2006, securities lending transactions could be terminated on demand by either the GET Fund or the borrower. The weighted average maturity of overall loans was 32 days.

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

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

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

Note 5. Summary of Investment Policy

Under RCW 43.33A.030, trusteeship of the GET Fund is vested in the voting members of the WSIB. The Legislature has established a standard of care for investment of these funds in RCS 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes its investment decisions and seeks to meet the following investment objectives.

In accordance with RCW 43.33.110, the portfolio is managed to achieve a maximum return at a prudent level of risk. The key determinate is identifying the prudent level of risk for the program considering the program's need to meet or exceed the growth rate of tuition costs. Based on this requirement the order of the objectives shall be:

1) Maintain the solvency of the fund and the financial stability of the program as measured by the external actuary.
2) Ensure sufficient assets are available to fund the expected college tuition payments.
3) Subject to one and two above, achieve a maximum return that will meet or exceed the rate of growth in college tuition cost over a ten-year period, at a prudent level risk.
4) Invest in a manner that will not compromise public confidence in the program.

Risk Constraint Standards

1) All assets under management by the WSIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of RCW 43.33A110 and RCW 43.33A.140.
2) No corporate fixed income issue's cost shall exceed 3% of the Fund's market value at the time of purchase, nor shall its market value exceed 6% of the Fund's market value at any time (RCW 43.33A.140).
3) Diversify the assets at a prudent level to moderate fluctuations in the market value of the program.

Permissible Investments

- International Equity
- U.S. Equity
- Inflation Indexed Bonds
- U.S. Treasuries and Government Obligations
- Credit Bonds
- WSIB Bond Market Fund
- Cash equivalent funds managed on behalf of the WSIB

State law and WSIB policy permit the WSIB to participate in securities lending transactions. The WSIB has entered into agreements with State Street Corporation (SSC) to act as agent for the WSIB in securities lending transactions. As SSC is the custodian bank for the WSIB, it is counterparty to securities lending transactions. Therefore, all cash collateral reinvested by SSC is reflected as Category 3 for custodial credit risk disclosure purposes.

DEVELOPMENTAL DISABILITIES ENDOWMENT TRUST FUNDS

As Managed by the Washington State Investment Board

June 30, 2006

PETERSON SULLIVAN PLLC
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Independent Auditors' Report

To the Members of the Washington State Investment Board

We have audited the accompanying statement of net assets for the Developmental Disabilities Endowment Trust Fund of the state of Washington as managed by the state of Washington Investment Board as of June 30, 2006, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Washington State Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The financial statements referred to in the first paragraph present only the investment activity of the Developmental Disabilities Endowment Trust Fund as managed by the Washington State Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Washington State Investment Board or of the state of Washington.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the Developmental Disabilities Endowment Trust Fund as of June 30, 2006, and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Developmental Disabilities Endowment Trust Fund of the state of Washington. Management's Discussion and Analysis preceding the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated October 12, 2006, on our consideration of the Washington State Investment Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

/S/ PETERSON SULLIVAN PLLC

October 12, 2006

Developmental Disabilities Endowment Trust Fund

Management's Discussion and Analysis

June 30, 2006

Management's Discussion and Analysis provides general information on the financial activities of the Developmental Disabilities Endowment Trust Fund of the state of Washington (the DDEF) managed by the WSIB. The WSIB manages funds for other state of Washington departments. This section of this report represents only the DDEF portion.

Following this section of the report are the financial statements and footnotes. The Statement of Net Assets provides information on the types of investments and the liabilities of the DDEF. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2006, with those at June 30, 2005. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of the DDEF for the year ended June 30, 2006. This information is summarized in Table 2 below. Table 2 also compares the financial activities of the DDEF for the year ended June 30, 2006, with those of the year ended June 30, 2005. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements of the DDEF.

Table 1 - Summarized Net Assets

	2006	2005	Dollar Change	Percent Change
Total Money Market Funds	$2,153,059	$1,821,231	$331,828	18.2%
Total Fixed Income Investments	4,192,589	4,256,833	(64,244)	(1.5%)
Total Equity Investments	6,604,986	3,996,514	2,608,472	65.3%
Total Investments	12,950,634	10,074,578	2,876,056	28.5%
Total Accruals	48,985	63,788	(14,803)	(23.2%)
Total Net Assets at Market Value	$12,999,619	$10,138,366	$2,861,253	28.2%

As shown in Table 1, the assets under management within the DDEF increased by $2.9 million during the fiscal year ended June 30, 2006. The market value of DDEF assets is directly impacted by the activity of the various capital markets within which the WSIB invests. However, one of the benefits of diversification gained by investing across various investment types as well as broadly within an asset class is the reduction in aggregate volatility of the total investment portfolio. The WSIB, with concurrence from the Developmental Disabilities Life Opportunities Trust Governing Board, makes the asset allocation decisions for the DDEF assets. WSIB staff rebalances between asset classes as markets move, pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $1.8 million to $2.1 million, for an increase of $332 thousand, or 18.2%. The primary reason for the increase was contributions received during the month of June 2006 that were allocated to the equity and fixed income investments in July 2006. Fixed income investments decreased slightly from $4.3 million to $4.2 million, for a decrease of $64 thousand, or 1.5%. This was primarily due to negative investment performance. Public equity investments increased from $4.0 million to $6.6 million, for an increase of $2.6 million, or 65.3%. This was due to increases in market values of equity investments plus contributions.

As shown in Table 2, net contributions increased from $2.3 million to $2.5 million, for a net increase of 6.3%. This was due to new participants in the program. Total net investment income decreased 18.4% primarily from a reduction in realized capital gains.

Table 2 - Summarized Changes in Net Assets

	2006	2005	Dollar Change	Percent Change
Beginning Total Net Assets at Market Value	$10,138,366	$7,334,317	$2,804,049	38.2%
Net Amount Contributed	2,465,489	2,318,899	146,590	6.3%
Investment Earnings	396,646	486,043	(89,397)	(18.4%)
WSIB Operating Costs	(882)	(893)	11	(1.2%)
Net Investment Earnings	395,764	485,150	(89,386)	(18.4%)
Ending Total Net Assets at Market Value	$12,999,619	$10,138,366	$2,861,253	28.2%

Statement of Net Assets - June 30, 2006

	Developmental Disabilities Endowment Trust Fund - State	Developmental Disabilities Endowment Trust Fund - Private	Total	Percent of Total
ASSETS				
Investments:				
LIQUDITY:				
Money Market Funds	$ 1,819,703	$ 333,356	$ 2,153,059	16.6%
FIXED INCOME INVESTMENTS:				
Treasury Inflation Protected Securities	2,661,066		2,661,066	20.5%
Commingled Balanced Trust	1,531,523		1,531,523	11.8%
EQUITY INVESTMENTS:				
Commingled Index Funds - Domestic	994,982		994,982	7.7%
Mutual Fund - Domestic		5,610,004	5,610,004	43.3%
Total Investments	7,007,274	5,943,360	12,950,634	100.0%
Interest Receivable	60,008	393	60,401	
Collateral Held Under Securities Lending Agreements	2,747,625		2,747,625	
Total Assets	9,814,907	5,943,753	15,758,660	
LIABILITIES				
Obligations Under Securities Lending Agreements	2,747,625		2,747,625	
Accounts Payable	11,416		11,416	
Total Liabilities	2,759,041		2,759,041	
Net Assets	$ 7,055,866	$ 5,943,753	$ 12,999,619	

Statement of Changes in Net Assets - June 30, 2006

	Developmental Disabilities Endowment Trust Fund - State	Developmental Disabilities Endowment Trust Fund - Private	Total
Additions			
Investment Income:			
Interest, Dividends and Other Investment Income	$ 293,261	$ 141,213	$ 434,474
Realized Capital Gains	13,379		13,379
Realized Capital Losses	(247)		(247)
Unrealized Gains and Losses	(4,577)	67,024	62,447
Less:			
Investment Expenses	(113,337)	(70)	(113,407)
WSIB Operating Costs	(882)		(882)
Total Investment Income	187,597	208,167	395,764
Net Amount Contributed	882	2,464,607	2,465,489
Net Increase in Net Assets	188,479	2,672,774	2,861,253
Net Assets, Beginning of Year	6,867,387	3,270,979	10,138,366
Net Assets, End of Year	$ 7,055,866	$ 5,943,753	$ 12,999,619

Notes to Financial Statements

Note 1. Significant Accounting Policies

Description of Funds

The DDEF consists of two funds. The first fund was originally created from a grant by the state of Washington (DDEF – State) and the second fund consists of contributions by private individual participants of the program (DDEF – Private). These funds are invested by the WSIB until participants withdraw these funds as needed. The financial statements present only the activity of the DDEF as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in the DDEF. The financial statements do not present the financial position and results of operations of the WSIB.

Basis of Accounting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States for governments prescribed by the Governmental Accounting Standards Board (GASB) on the accrual basis of accounting. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of the GASB, which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally.

Valuation of Investments

Investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges, and security pricing services. The DDEF has no investments of any commercial or industrial organization whose market value exceeds 5% of each plan's net assets. The assets of the DDEF are adjusted to fair market values monthly. Unrealized gains and losses are included as investment earnings in the statement of changes in net assets.

Revenue Recognition

Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade date basis. Purchases and sales of investments are also recorded on a trade date basis.

Securities Lending

The DDEF reports collateral received under securities lending agreements where the DDEF has the ability to spend, pledge, or sell the collateral without borrower default. Liabilities resulting from these transactions are also recorded. Additionally, costs associated with securities lending transactions, including broker commissions paid, are reported as investment management expenses in the accompanying statements. The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts

Note 2. Fees and Expenses

Investment fees and expenses are paid from non-appropriated funds or are netted directly from the asset value of the invested funds. The fees paid by the DDEF are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the DDEF. These fees include investment management fees and commission, investment consultant fees, legal fees and other investment management related expenses. The WSIB operating costs are charged against the funds based upon actual costs incurred by the WSIB to manage the investments.

Note 3. Deposit and Investment Risk Disclosures

Custodial Credit Risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the DDEF deposits may not be returned to the DDEF. The WSIB does not have a deposit policy for custodial credit risk. As of June 30, 2006, there were no deposits with the custodial bank.

Custodial Credit Risks – Investments

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

The WSIB has been authorized by statute as having the investment management responsibility for the DDEF. The WSIB is authorized to invest as provided by statute (Chapter 43.33A RCW) and WSIB policy. The WSIB is authorized and invests in the following: U.S. Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. Government and Agency (government sponsored corporation eligible for collateral purposes at the Federal Reserve) securities; non-dollar bond; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leverage buy-outs, real estate, or other forms of private equity; asset backed securities and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There have been no violations of these investment restrictions during fiscal year 2006.

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. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted for those flows as a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The DDEF's fixed income investments are to be actively managed to exceed the return of the Lehman Aggregate Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2006, the duration of the fixed income classes were within the duration targets of the Lehman Aggregate Index.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the DDEF investments as of June 30, 2006. The schedule displays various asset classes held by maturity in years, effective durations, and credit ratings. The investment types are presented consistent with their separately issued financial statements by investment type.

Credit Risks

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All debt investments were rated Aaa by Moody's at June 30, 2006.

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 DDEF policy states no corporate fixed income issue's cost shall exceed 3% of the DDEF's market value at the time of purchase, nor shall its market value exceed 6% of

Schedule 1

Investment Type	Total Fair Value	Maturity: Less than 1 year	Maturity: 1-5 years	Maturity: 6-10 years	Maturity: More than 10 years	Effective Duration	Credit Rating
Government Securities-Domestic:							
Treasury Inflation Protected Securities	$ 2,661,066	$ -	$ 2,540,914	$ 120,152	$ -	3.41	AAA
Investments Not Required to be Categorized							
Under GASB Statement No. 3							
Commingled Index Funds-Domestic	994,982						
Commingled Balanced Trust	1,531,523						
Money Market Funds	2,153,059						
Mututal Funds	5,610,004						
Total Investments Not Categorized	10,289,568						
Total Investments	$ 12,950,634						

the DDEF's market value at any time (RCW 43.33A.140). There was no concentration of credit risk that exceeded these limits as of June 30, 2006.

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 DDEF has no formal policy to limit foreign currency risk. The DDEF had no investments with currency risk exposure.

Note 4. Securities Lending

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

In accordance with GASB Statement 28, the DDEF reports securities lent (the underlying securities) as assets in the statement of net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the DDEF has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the statement of net assets. Securities lending transactions collateralized by securities that the DDEF 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 DDEF'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, where securities whose primary trading market was located in the United States or were sovereign debt issued by foreign governments, the collateral requirement was 102% 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% of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2006 was $2,781,150 and $2,747,625 respectively.

During fiscal year 2006, securities lending transactions could be terminated on demand by either the DDEF or the borrower. The weighted average maturity of overall loans was 32 days.

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

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

During fiscal year 2006, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the DDEF incurred no losses during fiscal year 2006 resulting from a default by either the borrowers or the securities lending agents.

Note 5. Derivatives

DDEF 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 DDEF mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the DDEF authority to invest in derivatives, international active equity managers may make limited investments in financial futures, forward contracts or other derivative securities to manage exposure to currency rate risk and equitize excess cash holdings. No such derivative securities were held as of June 30, 2006. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2006, the DDEF held no derivatives.

There were no repurchase agreements outstanding at June 30, 2006. Repurchase agreements are collateralized at 102%. The collateral is priced daily and held by WSIB's agent in WSIB's name.

Note 6. Summary of Investment Policy

Under RCW 43.33A.030, trusteeship of the DDEF is vested within the voting members of the WSIB. The legislature has established a standard of care for investment of these funds in RCS 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, RCW 42.52, as it makes its investment decisions and seeks to meet the following investment objectives.

In accordance with RCW 43.33.110, the portfolio is managed to achieve a maximum return at a prudent level of risk. The key determinate is identifying the prudent level of risk for a program relative to the needs of the Developmental Disabilities Endowment Governing Board and the participants. Based on this requirement the order of the objectives shall be:

1) Maximize return at a prudent level of risk based on identified investment time horizons.
2) Ensure sufficient assets are available to fund the expected needs.
3) Invest in a manner that will not comprise public confidence in the program.

1) Risk Constraint Standards
2) All assets under management by the WSIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of RCW 43.33A.110 and RCW 43.33A.140.
3) Diversify the assets at a prudent level to moderate fluctuations in the market value of the program.

Permissible Investments

- Fixed Income: The fixed income portfolio will be limited to the Bond Market Fund (WSIB Policy 2.15.500). The Treasury Inflation Protection Securities portfolio will be invested in U.S. Inflation Indexed Bonds.
- U.S. Equities: The equity portfolio will be invested in a passive commingled fund managed to track a U.S. broad market index. The DDEF – Private will invest in the Vanguard Balanced Index – Institutional Share's mutual fund.
- Cash: The cash portfolio will be invested in Short-term Investment Funds and Money Market Funds.

WSIB ANNUAL BUDGET

	Budget to Date	Expenditures to Date		Budget Variance
APPROPRIATED				
Salaries	$ 4,901,424	$ 4,369,891		$ 531,533
Benefits	$ 983,130	$ 873,729		109,401
Personal Services	$ 128,800	$ 33,182		95,618
Goods & Services	$ 1,224,588	$ 1,343,764		(119,176)
Travel	$ 256,300	$ 358,318		(102,018)
Fixed Assets	$ 442,621	$ 495,263		(52,642)
Grants, Benefits & Client Services	$ -	$ 17,032		(17,032)
Interagency Reimbursements				-
Subtotal Appropriated	$ 7,936,863	$ 7,491,179		$ 445,684
NON-APPROPRIATED RETIREMENT FUNDS		Total Fees	Netted Fees	Fees
U.S. Equity- Passive		$ 3,605,592	690,940	2,914,652
Non - U.S. Equity- Active		27,845,179	-	27,845,179
Non- U.S. Emerging Markets- Passive		0	-	-
Non- U.S. Emerging Markets- Active		7,604,048	6,016,080	1,587,968
Non- U.S. Equity- Passive		1,150,387	1,150,387	-
Private Equity		120,169,275	117,589,562	2,579,713
Real Estate		26,520,676	26,520,676	-
General Pension Consultants		4,264,017	-	4,264,017
Legal Fees - Private Equity		448,331	-	448,331
Legal Fees - Real Estate		275,322	-	275,322
Custodian Bank Fees		2,389,761	-	2,389,761
Securities Lending and Other Fees		7,725,647	7,725,647	-
Investment Acctg/Portfolio Verification		433,241	-	433,241
POMS and Misc Expenses		791,504	-	791,504
Total Retirement		$ 203,222,980	$ 159,693,292	$ 43,529,688
SELF-DIRECTED DEFINED CONTRIBUTION FUNDS				
Self-Direct Managers - PERS, SERS & TERS 3 Non US		$88,347	$88,347	-
Self Direct Managers - PERS, SERS & TERS 3 US		197,633	197,633	-
U.S. Fixed Income		292,479	292,479	-
Securities Lending and Other Fees		354,598	348,560	6,038
Total DC-Self-Direct*		$ 933,056	$ 927,019	$ 6,038
LABOR & INDUSTRIES FUNDS				
Consultants		$ 209,905	-	209,905
U.S. Equity		192,818	131,984	60,834
Non - U.S. Equity		175,162	175,162	0
Custodian Bank Fees		83,344	-	83,344
Securities Lending		1,212,057	1,212,057	-
Provident Liquidity Fees		406,511	406,511	-
Investment Acctg/Portfolio Verification		81,272	-	81,272
POMS and Misc Expenses		315,059	-	315,059
Total L & I		$ 2,676,128	$ 1,925,714	$ 750,415
DEFERRED COMPENSATION FUNDS				
Fixed Income- Active		13,994	13,994	-
US Equity- Active		6,344,846	6,344,846	-
Non US Equity- Active		455,949	455,949	-
US Equity- Passive		72,282	72,282	-
Securities Lending and Other Fees		110,302	77,009	33,293
Provident Liquidity Fees		106,133	106,133	-
Total Deferred Compensation Funds*		$ 7,103,505	$ 7,070,212	$ 33,293
PERMANENT / OTHER FUNDS				
Consultants		$ 5,026	-	5,026
US Equity		29,820	20,676	9,144
Non- US Equity- Passive		69,345	69,345	-
Custodian Bank Fees		9,112	-	9,112
Securities Lending		470,228	470,228	-
Provident Liquidity Fees		441,003	441,003	-
Investment Acctg/Portfolio Verification		10,449	-	10,449
POMS and Misc Expenses		29,529	-	29,529
Total Permanent Funds		$ 1,064,512	$ 1,001,252	$ 63,260
Subtotal Non-Appropriated		215,000,181	170,617,488	$ 44,382,693
TOTAL		$ 222,491,360		

* Expenses are paid by participants

Appropriated balance will be carried over to FY2007

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