Washington State Investment Board

TWENTY-SIXTH ANNUAL REPORT

2007

Introduction

The Agriculture building in Yakima, Washington was built in 1893 and it is the oldest building on the premises of the Central Washington State Fair.

Photo courtesy of:
Department of Archaeology & Historic Preservation

Letter of Transmittal

June 30, 2007

Excellent investment returns follow excellent ideas and implementation. In that regard, for the beneficiaries of the funds managed by the Washington State Investment Board (WSIB), 2007 was an excellent year.

The WSIB's strategic and disciplined management of assets entrusted to us, combined with favorable market conditions in virtually every region of the world produced the best returns we've seen in 10 years. The rate of return for the state's retirement Commingled Trust Fund (CTF) in 2007 was an outstanding 21.3%.

We are keenly aware of the risks and challenges that come with managing over $80 billion of retirement, trust, insurance and permanent funds. Our imperative is to manage investments and operations with impeccable integrity, sound strategies, a strong Board, capable staff, and a powerful dedication to serving the interests of our beneficiaries.

Our investment philosophy is that equity and fixed income markets in the developed economies are highly efficient and, accordingly, above average market returns are difficult to achieve on a long term basis. We believe information and skill can produce higher risk adjusted returns in private equity and real estate, as well as in the less efficient markets of emerging market countries. These beliefs are reflected in our asset allocations to private equity, real estate and international assets that are much higher than those of typical public pension funds. The past 3 years have rewarded this strategic asset allocation handsomely.

Excellent governance practices are also fundamental to maintaining the WSIB's capacity to continue to perform well. Governance is about education, sound process, independence and judgment. Informed Board members, many of whom represent the beneficiaries of the pension assets we manage, provide stronger oversight, make better decisions, and pass along a tradition of high integrity, as shown through 15 years of clean audits by the state auditor and our second external audit of our finances.

Risk management is also central to everything we do. Diversification is and will be the primary risk management tool of the investment program. Now, with the extension of enterprise risk management (ERM) from operations to investments, we are creating the mindset and systems to apply the ERM framework to all of our policies, strategies, programs, and execution of the work by the Board and staff.

While the Board and staff deserve most of the credit for our success, we are also fortunate to have outstanding investment management firms as partners in this endeavor. Many of these firms share insights, information and strategies that go beyond mere commercial relationships to reflect a mutual interest in seeing the WSIB thrive and generate excellent returns. We appreciate their support and intend to strengthen these relationships in the years ahead.

This report describes in detail all of our portfolios, performance, operations and finances. This letter provides an overview of the WSIB's work in the past year, our plans and our intention to keep improving.

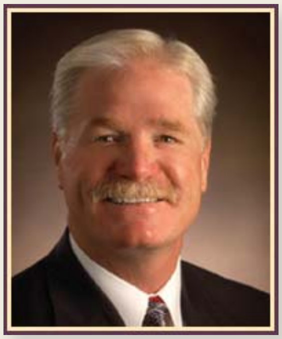
We are proud of our achievements in 2007. It was a good year. Yet we know our strategies and decisions will be tested in less favorable environments in the future. That's why we strive to improve our risk management, governance, operations and investment practices. And it's why our commitment to our beneficiaries is unwavering.

On behalf of the staff, it is my privilege to present this report and with it our profound gratitude for the honor of serving our beneficiaries and our determination to pursue a course of excellence as the best way to honor their contributions to our state and society.

Joseph A. Dear

Joseph A. Dear, Executive Director

Message from the Chair



June 30, 2007

On behalf of all board members and staff of the WSIB, I am pleased to present the 26th Annual Report documenting our progress and performance in managing state retirement and other public trust fund investments for the period ending June 30, 2007.

The "historical" theme of this report aptly emphasizes the fact that 2007 was an exceptional, record setting year that produced the strongest investment returns we've seen in a decade. As a result, the WSIB ended FY 2007 with:

- $82 billion in total assets under management
- A 21.3% rate of return for the state's CTF adding $10 billion in earnings and increasing the total fund to $63.9 billion
- A combined $1 billion in new earnings for the state's 5 industrial insurance funds to assist injured workers and their employers
- New money for the state's Permanent Funds for schools, colleges and universities including an additional $4 million for the Common School Fund, $5 million extra for the Normal School Fund, and another $8 million for the Scientific Fund
- A 5.3% on average rate of return for all of the Other Trust Funds managed by the WSIB including the pension stabilization, emergency reserve, and judicial retirement funds
- Investments for the Guaranteed Education Tuition Fund (GET) program for college tuition savings and the Developmental Disabilities Endowment Fund (DDEF) fund to assist people with developmental disabilities returning 14.8% and 7.3% respectively
- Significant total market value increases for all three of the state's defined contribution retirement plans, the Deferred Compensation Program, and the Judicial Retirement Account

To maintain and improve solid, long-term performance, the WSIB continues to learn about and capitalize on ways to expand our exposure to customary and emerging investment strategies and to practice and support ethical, transparent governance for sustainable growth. We also work to attract and retain the best possible talent, perspectives, and experience to better manage risk, strengthen internal accounting controls, and clarify our investment beliefs to give us the conviction and discipline needed to make rational and informed decisions.

In closing, I want to thank the entire Board and WSIB staff for another year of excellent work. As we reflect on the good fortunes of this year we all must remember things can and do change for better or worse. While institutional investors like the WSIB can't control market cycles, prevent meltdowns in investor confidence, or predict natural or political disasters, we can design and implement strategies that will enable us to more effectively cope with the risks and opportunities that lie ahead.

Patrick McElligott, Chair

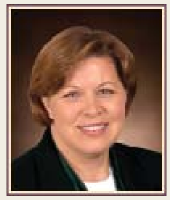
Board Members & Established Committees

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.

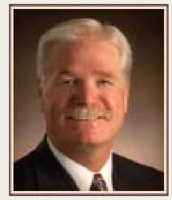
Voting members

Michael J. Murphy, State Treasurer

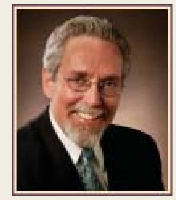
Sandra J. Matheson



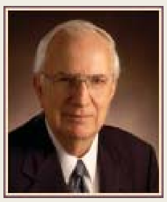
Judy Schurke



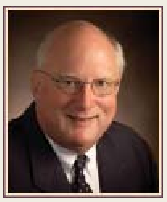
Patrick McElligott, Chair



Mason Petit

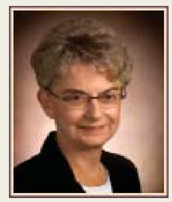


George Masten



David Scott

Glenn Gorton, Vice-Chair



Representative Helen Sommers

Senator Lisa Brown

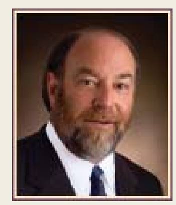
Non-voting members

Robert S. Nakahara, CPA

Charles A. Kaminski, CFA

John W. Magnuson, CPM, CRE

Jeffrey Seely



David Nierenberg

Individual Board members are appointed by the Chair to serve on any of the Board's four different committees 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 Private Markets Committee develops policy and structure for private market and real estate opportunities and reviews those investments for recommendations to the Board.
The Audit Committee nominates candidates for the non-voting members, develops and monitors the Board's Conflict of Interest Policy, reviews performance-reporting and audit requirements, and deals with corporate governance policies and issues.	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.

Executive Management, Structure, & Outside Help

Joseph A. Dear - Executive Director

Appointed in November 2002

The WSIB's executive director is appointed by the Board to oversee the staff, develop and recommend agency and investment policies for Board adoption, and ensure adherence to state policies and laws.

Gary Bruebaker, CFA, CPA - Chief Investment Officer

Appointed in February 2001

The Investment Division is comprised of investment professionals who manage investments in major asset classes including public equity, private equity, real estate and fixed income. The division is also served by a senior investment officer who develops asset allocation and risk budgeting strategies and a research director that provides research and analytic support. The division deploys both internal and external investment management strategies.

Theresa J. Whitmarsh - Chief Operating Officer

Appointed in September 2003

The Operations Division provides a number of services in support of the investment function, including trade settlement, cash management, private market funding, cash and stock distributions and foreign and domestic tax matters and investment compliance monitoring. It provides agency-wide risk management, information systems management, human resources, and administrative services.

Liz Mendizabal - Public Affairs Director

Appointed in March 2003

Public Affairs manages duties typically found in a client services division of an investment management agency-wide including performance reporting, annual report preparation, corporate governance and constituent communications. In addition, it manages functions unique to a public pension fund, including legislative affairs, public disclosure, and media.

Investment Accounting Data System

Financial Control Systems

Master Custodian Bank

State Street Corporation (SSC)

Insurance Portfolio Consultant

Conning Asset Management

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

Foster, Pepper & Shefelman

Goodwin Procter

Orrick

Paul Hastings

Proskauer Rose

Preston, Gates & Ellis

Song Mondress

Washington Attorney General

Private Equity Consultant

Capital Dynamics, Inc.

Real Estate Consultant

Courtland Partners

Partnerships

Private Equity Partnerships

Affinity Equity Partners
APAX Partners
Astorg Partners
Austin Ventures
Avenue Capital Group
Banc Funds
BC Partners
Blackstone Group
Boston Ventures
Bridgepoint Capital
Butler Capital Partners
Capital Resource Partners
CCMP Asia
Charterhouse Capital Partners
Cinven Ltd.
Clayton Dubilier & Rice
Code, Hennessy & Simmons
Contrarian Capital Management
Cornerstone Equity Investors
Cypress Group
Doughty Hanson & Co.
Elevation Partners
Endeavour Capital
Essex Woodlands
Evercore Capital Partners
First Reserve Corp.
Fisher Lynch Capital
Fortress Investment Group
Francisco Partners
Frazier & Co.
Gilbert Global Equity Partners
Green Mountain Partners
Gryphon Investors
GTCR Golder Rauner
HarbourVest Partners
Hellman & Friedman
Heritage Partners
Indigo Capital Partners
InterWest Partners
JLL Partners
Kohlberg Kravis Roberts & Co.
KSL Capital Partners
Leonard Green & Partners
Madison Dearborn Partners
MatlinPatterson Global Advisors
Menlo Ventures
Mobius Venture Capital
Morgan Stanley Venture Partners
New Enterprise Associates
Nordic Capital
Oak Investment Partners
Oaktree Capital Management
Olympus Partners
OVP Venture Partners
Palamon Capital Partners
Pathway Capital Management
Providence Equity Partners
Rice, Sangalis, Toole & Wilson
Silver Lake Partners
Spectrum Equity Investors
Sprout Group
TA Associates
Telecom Partners
Thomas Weisel Capital Partners
TPG Partners
TSG Capital Group
U.S. Venture Partners
Varde Partners
Vestar Capital Partners
Warburg Pincus LLC
Welsh Carson Anderson & Stowe

Real Estate Partnerships

Cherokee
Corporate Properties of the Americas
Emerging Markets Fund of Funds
Evergreen Investment Advisors
Fillmore Capital Partners
Hancock Timber
Hometown America
Hudson Advisors
Morgan Stanley
Pacific Realty
Principal Enterprise Capital
Terramar Retail Properties
The Campbell Group
Warburg Pincus LLC
Washington Holdings

Public Equity Fund Managers

Arrowstreet Capital, L.P.
Barclays Global Investors, N.A.
Capital Guardian Trust Co.
Capital International, Inc.
Goldman Sachs Asset Management
Grantham, Mayo, Van Otterloo & Co. LLC
JPMorgan Asset Management, Inc.
Julius Baer Investment Management
Lazard Asset Management LLC
LSV Asset Management
Mondrian Investment Partners Ltd.
Pictet Asset Management Ltd.
Pyramis Global Asset Trust Co.
State Street Global Advisors
Western Asset Management Co.
William Blair & Co.

Enterprise Risk Management

Key Risks

One strategic element of our organizational transition was establishing an Enterprise Risk Management (ERM) programs as a cornerstone of a successful investment strategy. 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. This risk stems from managing the 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 and improvements. 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 need 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, ERM team, and a business coordination group.
- **Governmental and Environment Risk** This is the risk of not 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 risk, the executive director and our legislative liaison monitor actual or proposed legislative changes that may affect our ability to accomplish our mission.
- **Operational Risk** This risk refers to losses that could arise from short-comings or failures in internal and external processes and people or systems on which the WSIB depends. We manage this risk by improving 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 the state. We continuously review, assess, and manage our risk-management categories and other practices to ensure that risk is managed effectively.

Corporate Governance

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.

We believes our goal to maximize investment returns includes vigilant oversight of the way companies in which we invest are managed. That includes the manner in which a company's CEO and board of directors carry out their corporate duties and responsibilities. The question needs to be asked: Are the CEO's performance goals aligned with maximizing shareholder value and are they practicing good corporate governance?

Increasingly, studies report that companies with good governance tend to produce higher returns on equity than poorly governed firms. A 2006 study by the Institutional Shareholder Services found that nearly 60% of institutional investors surveyed indicated they are able to increase investment returns by assessing the corporate governance efforts of companies in which they invest.

This year the WSIB voted approximately 4,000 proxy ballots. Proxy votes were cast on more than 24,000 individual proposals, dealing primarily with election of directors, ratification of auditor, compensation plans, and shareholder proposals.

Of the total director votes in 2007, the WSIB withheld its vote from more than 4,000 incumbent directors, primarily because of lack of board independence or unacceptable compensation practices. The WSIB's policy states that "Executive compensation should be linked directly with performance of the business the executive is charged with managing."

As a result, the WSIB:

- Voted against approximately 19% of the compensation plans proposed in 2007
- Voted against more that 542 compensation committee members for paying excessive compensation
- Voted in favor of approximately 41 proposals that would give shareholders an advisory vote on executive 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

The 38-foot tall Mukilteo lighthouse began operating in March, 1906. The Victorian style structure is wood-frame construction, which is a unique feature, as most lighthouses are built of concrete, brick or stone.

Plans Under Management

Retirement Plans

The WSIB manages investments for serveral separate pension plans including: Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), School Employees' Retirement System (SERS), Law Enforcement Officers' and Firefighters' (LEOFF), Judicial Retirement Account (JRA), Washington State Patrol (WSP), Public Service Employees' Retirement System (PSERS), and the Volunteer Firefighters (VFF). The active members by system increased from 290,142 one year ago to 293,001. The total of retired members by system is 162,145.

Retirement Fund Performance

To more efficiently manage investments, reduce administrative costs, and minimize investment fees, the defined benefit retirement fund assets are pooled into the CTF. Over the past 10 years, the fund has grown from $37.3 billion to $63.9 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 the performance of investment returns of each asset class in the CTF to appropriate benchmarks. Although quarterly and yearly returns change, our long-term realizations should exceed the 8% actuarially assumed rate of return.

It is important to remember that individual asset classes differ in their behavior and volatility from one year to the next. The fair market value of most public market investments can be determined and priced instantly. However, real estate and private equity investments are very illiquid and not easily priced so it may take years before expected returns are apparent and realized.

Strategic Asset Allocation

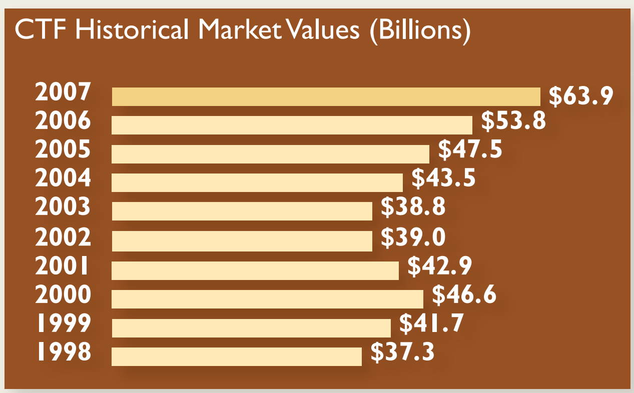
Strategic asset allocation is the process of selecting a mix of asset classes, such as stocks and bonds, and determining their proportions within an investment portfolio. Asset allocation decisions account for nearly 92% of the variation between returns on different portfolios and it is often considered to be the most important driver of investment performance. Portfolio assets are diversified to help offset declines in any one class, smooth out marketplace ups and downs, and reduce overall investment risk.

The CTF is invested in five 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 also sets acceptable ranges for those targets to vary. The WSIB formally reviews its strategic asset allocations at least every 2-4 years. The last asset allocation study for the CTF was officially completed in 2005. During 2007 the Board was in the process of discussing different asset allocation targets and ranges for some CTF asset classes, but no changes were made as of June 30, 2007.

U.S. and International Equity Program

Because U.S. equity markets are generally efficient the majority of the WSIB's investments in this asset class are in a low-cost, broad-based index fund. Enhanced index products are also used to capture other opportunities and potentially boost investment performance. A program review during 2007 determined that the structure of the current U.S. Equity program should not be changed. However, active U.S. investment opportunities, such as global, small cap, and 130/30 strategies, will be added through the WSIB's new Innovation Portfolio.

International equity markets continued to perform well in 2007, completing a fifth straight year of above-average returns. The WSIB's international portfolio returned nearly 31% compared to a 20% return for the U.S. portfolio. Inefficiencies in international equity markets provide a greater opportunity to add value with active management. Accordingly, the WSIB's developed markets international equity program uses a combination of passive (20%) and active (80%) mandates and the entire emerging markets equity program is actively managed.



To provide the necessary flexibility to meet higher returns for international equity, the Board approved a range of 5% to 10% of the total international equity allocation for dedicated emerging markets, with a fixed goal set each year. For 2007, the dedicated target was increased from 9% to 10% of the total international equity portfolio.

Highlights

- The WSIB's U.S. equity return of 20% underperformed the Dow Jones Wilshire(DJW) 5000 index by 19 basis points (bps) due in part to the risk that the WSIB assumed by assigning the DJW 5000 as the overall U.S. equity benchmark
- International equity was the CTF's best performing asset class for FY 2007 with the portfolio outperforming the MSCI ACWI ex U.S. benchmark return by 59 bps
- The WSIB's developed markets portfolio returned 29%, outperforming the MSCI EAFE + Canada benchmark return of 27% by over 200 bps
- Emerging markets portfolio returned 46% outperforming the MSCI Emerging Markets benchmark of 45% by 100 bps

Fixed Income Program

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).

Believing the Federal Reserve had finished tightening interest rates during 2007, the portfolio's duration (a measure of the sensitivity of market value to changes in the level of interest rates) was gradually lengthened relative to the duration of the Lehman Universal Index. This helps the portfolio in times of stable and falling interest rates but not in times of rising rates. During the past year, the yield on the 10 year treasury decreased from 5.1% to 5%.

	1 Year	3 Year	5 Year	10 Year
Retirement Fund Returns	21.33%	16.97%	13.99%	9.73%
U.S. Equity	20.27%	12.69%	11.95%	7.85%
International Equity	30.74%	25.17%	19.46%	8.32%
Fixed Income	6.61%	4.61%	5.70%	6.51%
Private Equity	28.97%	30.23%	20.46%	15.76%
Real Estate	25.20%	25.02%	19.37%	15.87%

Highlights

- The portfolio underperformed the Lehman Universal Index by 1 bp
- Treasuries, agencies, mortgages, CMBS and ABS were underweighted for the portfolio, while credits were overweighted
- The portfolio's quality remained the same at Aa2, as high yield holdings continued to be underweighted relative to the index
- Transactions included $2.4 billion in sales and $3.2 billion in purchases
- The best performing major sector for the portfolio was credits, which returned just over 8%, followed by treasuries with their long duration of nearly 7%
- Mortgages returned 6%, CMBS 5%, TIPS 4% and cash returned 5%
- The more risky index sectors, emerging markets and high yield, both returned 12%
- The portfolio's emerging markets returned 27% and its small high yield portfolio returned nearly 11%

Private Equity Program

During the fiscal year, the private equity portfolio increased in value by $2.7 billion, reflecting another year of strong returns and a continued brisk pace of investment. As of June 30, 2007, the portfolio represented approximately 18% of the CTF, exceeding its asset allocation target of 17%.

Leveraged buyout activity was particularly robust during the year, fueled by very liquid financing markets and favorable terms for borrowers. Several very large public companies were taken private by private equity firms. Many of these transactions involved funds in which the WSIB is invested.

The Board continued to diversify the private equity portfolio geographically, including commitments of $625 million to funds focused on investing in Asia. The Board also committed $750 million to distressed debt funds during the year. These funds generally perform well when financial conditions deteriorate and provide the portfolio with some down-side protection in the event of an economic slowdown.

Fiscal Year 2007 was a very active year for the industry as a whole. The pace of investments and exits were very strong. The WSIB's commitments to new funds, capital drawn for investments, and distributions received back, were all at or near record levels.

Highlights

- ✪ $4.9 billion in commitments to funds were closed compared to $3.8 billion in the prior year
- ✪ $3.2 billion of committed capital was drawn for investment during FY 2007 compared to $2.6 billion in FY 2006
- ✪ $3.2 billion in distributions were returned to the WSIB nearly matching the distributions received in the prior year

Real Estate Program

The WSIB's real estate program focuses on creating high-quality, long-term, stable income streams for the CTF. Our partnership investments target risk-adjusted returns consistent with our long-term 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.

Real estate markets, particularly in the U.S., were subject to extraordinary capital inflows. Larger allocations from numerous institutional investors globally resulted in a sharp increase in investment activity. This resulted in continued upward pressure on commercial property prices. The WSIB's real estate partners benefited from this situation, both through the long-term ownership of high-quality investments and through the selective selling of some properties.

Many of the WSIB's partnerships don't involve co-investment with other financial investors. This provides us 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, diversification is enhanced by our partners investing at different points in the real estate capital structure, as well as at different times in the property life cycle.

Highlights

- ✪ For the 1 year period ending March 31, 2007, the portfolio outperformed the National Council of Real Estate Invetsment Fiduciaries (NCREIF) Index, by nearly 30% compared to 17% for FY 2006
- ✪ The two strongest drivers of these high returns were the WSIB's investments in real estate operating companies (REOCs) and investments outside the U.S.
- ✪ In a continuing trend, more relatively attractive investment opportunities were found outside the U.S.
- ✪ The WSIB continues to overweight growth markets in the U.S., especially in the southern and western regions

Innovation Portfolio

The primary investment strategy of our new innovation portfolio gives staff the ability to make investments that fall outside the traditional asset classes currently used by the Board. Secondly, this portfolio provides the Board with comfort and demonstrated success before committing large dollar amounts to different investment strategies.

Highlights

- ✪ Staff reviewed two new investment strategies: infrastructure and commodities
- ✪ The first investment commitment was made to infrastructure
- ✪ Initial money was invested in June 2007

Private equity investments range from leveraged buyouts of mature companies to venture capital in start-up enterprises. These are illiquid, long-term investments that offer higher expected returns than traditional public equity investments. Private equity uses March 31, 2007, market values, adjusted for cash flows in the second quarter of 2007.

Real estate uses March 31, 2007, market values, adjusted for cash flows in the second quarter of 2007.

Other Plans Under Management

Defined Contribution Retirement Plans

PERS 3 - $1.3 Billion

SERS 3 - $1.0 Billion

TRS 3 - $3.9 Billion

As trustee of the Plan 3 retirement systems for PERS, SERS, and TRS, the WSIB is responsible for the investment of plan assets of the self-directed investment options. The administrative, accounting, and record-keeping work for these plans is provided by the Department of Retirement Systems (DRS).

Deferred Compensation Program (DCP) and Judicial Retirement Account

Deferred Compensation Program - $2.5 Billion

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 - $20.3 Million

The JRA is a defined contribution supplemental retirement fund for state judges. Investments are self-directed by participants in the JRA program utilizing the DCP investment options. 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 - $432.4 Million

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 to meet these objectives.

Bond Market Fund - $446.6 Million

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 the WSIB 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 - $730.0 Million

The savings pool is intended as a conservative, short-term investment opportunity where the primary objective is to protect current income and preserve principal. The Savings Pool is a diversified portfolio of guaranteed investment contracts (GICs) and short-term cash funds.

Labor and Industries' Funds

$11.1 Billion

The WSIB manages Industrial Insurance funds on behalf of the Department of Labor and Industries (L & I). The L & I portfolio consists of four separate funds.

- The Accident Fund primarily pays disability benefits
- The Medical Aid Fund pays for services required by injured workers and L & I 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 supplements time loss and compensates for cost-of-living increases

Permanent Funds

$739.8 Million

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. Five 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 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.

Investing in Washington

Other Funds

$757.0 Million

These funds were created by the Legislature to fund various mandates and can be liquidated as needed. These funds are invested by the WSIB until they are completely liquidated or closed by legislation.

Guaranteed Education Tuition Fund

$936.0 Million

The 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.

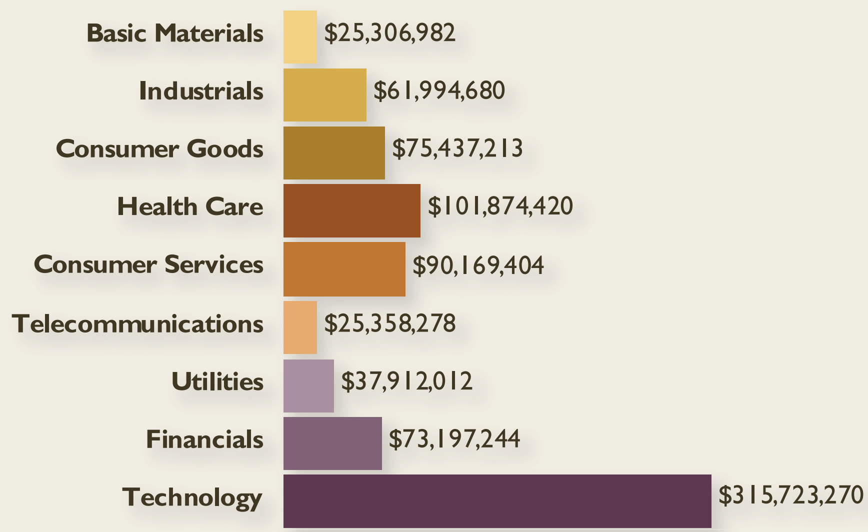
Developmental Disabilities Endowment Trust Fund

$15.9 Million

The Developmental Disabilities Endowment Trust Fund supports 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.

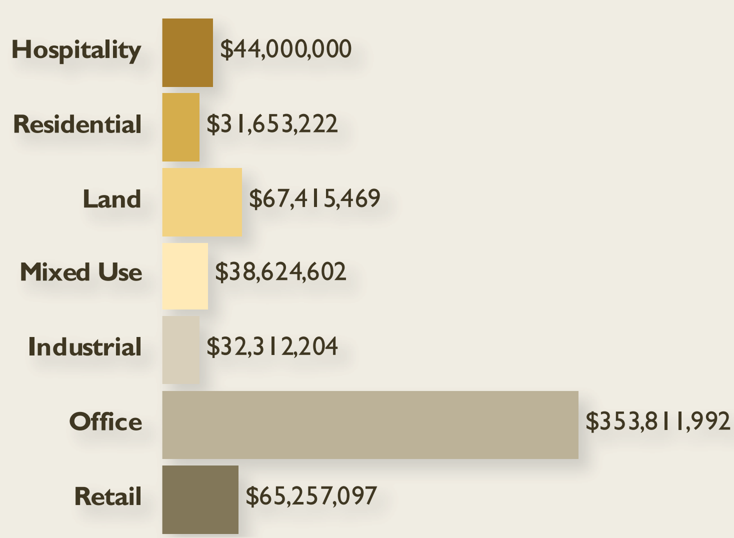
The WSIB seeks the best investment opportunities no matter where they might be located. Washington is home to many successful companies. In-state investments can be found in all of the WSIB's portfolios. For FY 2007, the fair market value for public equity was $575.0 million, fixed income $126.6 million, private equity $105.4 million, and real estate was at $633.1 million. The combined total for 2007 in-state investments was $1.4 billion, up $100 million from last year.

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

The 1890 Interurban Building was formerly known as the Seattle National Bank Building. It served as the northern-most stop on the electric interurban railway that once linked Seattle and Tacoma.

Photo courtesy of:
Department of Archaeology & Historic Preservation

Overview of the Financial Statements

This discussion and analysis serves as an introduction to the WSIB's basic financial statements and notes to the financial statements. The statements included are for the retirement systems' CTF, L & I Funds, Permanent Trust Funds, Other Funds, GET, and DDEF. 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, 2007.

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

PO Box 40916, Olympia, WA 98504-0916

Phone: 360-956-4600

Website: http://www.sib.wa.gov

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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, 2007, 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. 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, 2007, 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 $18,781,487,234 (29% 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

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, 2007, with those at June 30, 2006. 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, 2007. 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, 2007, with those of the year ended June 30, 2006. 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 WSIB's management within the Retirement Funds increased by approximately $10.2 billion during the fiscal year ended June 30, 2007. 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 rebalances the Retirement Funds' assets between asset classes as markets move pursuant to WSIB policy.

As reflected in Table 1, liquidity assets increased from almost $1.4 billion to nearly $2.5 billion, for an increase of over $1.0 billion or 79.5%. The primary reason for the increase was for cash raised at year end to fund General Partner capital calls that were scheduled for the first week in July 2007. Fixed income investments decreased from $13.2 billion to $13.1 billion, for a decrease of $128.0 million or 1.0%. Fixed income declined slightly as monies invested in cash increased, offsetting more than the positive earnings from fixed income. Public equity investments increased from $24.4 billion to almost $30.3 billion, for an increase of over $5.8 billion or 24.0%. This was due to increases in market values of equity investments despite liquidating $1.8 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 nearly $5.7 billion to $7.0 billion, for an increase of more than $1.3 billion or 24.5%. This was due to new investments of $2.0 billion and increases in market values of 25.2%, less distributions from our partners of $2.1 billion. Private equity investments increased from $9.0 billion to almost $11.7 billion, for an increase of $2.7 billion or 29.5%. This was due to draws from additional funding of existing investments, new investments of $3.2 billion, and increases in market values of 29.0%, less distributions from our partners of close to $3.2 billion. The new Innovation portfolio was funded this year for the first time with investments of $46.2 million, less

Table 1 - Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Liquidity Investments	$2,448,656,726	$1,364,253,761	$1,084,402,965	79.5%
Total Fixed Income Investments	13,107,009,223	13,235,045,155	(128,035,932)	-1.0%
Total Public Equity Investments	30,263,550,129	24,402,533,571	5,861,016,558	24.0%
Total Real Estate Investments	7,044,491,839	5,656,672,459	1,387,819,380	24.5%
Total Innovation Investments	43,018,509		43,018,509	100.0%
Total Private Equity Investments	11,693,976,886	9,028,773,108	2,665,203,778	29.5%
Total Investments	64,600,703,312	53,687,278,054	10,913,425,258	20.3%
Total Accruals, Net	(523,699,065)	193,778,760	(717,477,825)	-370.3%
Total Net Assets at Market Value	$64,077,004,247	$53,881,056,814	$10,195,947,433	18.9%

Table 2 - Summarized Changes in Net Assets			
	2007	2,006	Dollar Change
Beginning Total Net Assets at Market Value	$53,881,056,814	$47,471,601,759	$6,409,455,055
Net Amount Withdrawn	(1,132,531,324)	(1,394,504,967)	261,973,643
Investment Earnings	11,334,602,344	7,810,042,256	3,524,560,088
WSIB Operating Costs	(6,123,587)	(6,082,234)	(41,353)
Net Investment Earnings	11,328,478,757	7,803,960,022	3,524,518,735
Ending Total Net Assets at Market Value	$64,077,004,247	$53,881,056,814	$10,195,947,433

Statement of Net Assets

June 30, 2007

See notes to financial statements

	Commingled Trust Fund	Plan-Specific Investments	Total	Percent of Plan Assets
ASSETS				
Investments:				
LIQUIDITY:				
Money Market Funds	$ 1,719,473,505	$ 139,219,096	$ 1,858,692,601	
Cash Overlay	497,073,890		497,073,890	
Foreign Currency	92,890,235		92,890,235	
Total Liquidity	2,309,437,630	139,219,096	2,448,656,726	3.8%
FIXED INCOME INVESTMENTS:				
Asset Backed Securities	1,022,965		1,022,965	
Collateralized Mortgage Obligations	1,858,825,988		1,858,825,988	
Pass Throughs	2,317,472,703		2,317,472,703	
Non-Standard Mortgages	3,280,873		3,280,873	
Commercial Mortgage Backed Securities	577,570,628		577,570,628	
Corporate Bonds - Domestic	5,659,103,577		5,659,103,577	
Corporate Bonds - Foreign	270,541,845		270,541,845	
U.S. Government Treasuries	1,076,656,498		1,076,656,498	
U.S. Treasury Inflation Protected Securites	1,342,534,146		1,342,534,146	
Total Fixed Income Investments	13,107,009,223		13,107,009,223	20.3%
EQUITY INVESTMENTS - Domestic:				
Commingled Equity Index Funds	11,367,100,023		11,367,100,023	
Enhanced Equity Index Funds	2,511,448,943		2,511,448,943	
Commingled Enhanced Equity Index Fund	1,161,889,263		1,161,889,263	
Total Equity Investments - Domestic	15,040,438,229		15,040,438,229	23.3%
EQUITY INVESTMENTS - Foreign:				
Corporate Stock	9,783,325,298		9,783,325,298	
Commingled Index Funds	5,439,786,602		5,439,786,602	
Total Equity Investments - Foreign	15,223,111,900		15,223,111,900	23.6%
ALTERNATIVE INVESTMENTS:				
Private Equity	11,693,976,886		11,693,976,886	
Real Estate	7,044,491,839		7,044,491,839	
Innovation	43,018,509		43,018,509	
Total Alternative Investments	18,781,487,234		18,781,487,234	29.1%
Total Investments	64,461,484,216	139,219,096	64,600,703,312	100.0%
Investment Earnings Receivable	197,446,831	1,064,813	198,511,644	
Due From Other Agencies	6,113		6,113	
Receivables for Investments Sold	171,608,607		171,608,607	
Collateral Held Under Securities Lending Agreements	5,745,329,666		5,745,329,666	
Total Assets	70,575,875,433	140,283,909	70,716,159,342	
LIABILITIES				
Obligations Under Securities Lending Agreements	5,745,329,666		5,745,329,666	
Investment Management Fees Payable	38,834,640		38,834,640	
Payable for Investments Purchased	854,990,789		854,990,789	
Total Liabilities	6,639,155,095		6,639,155,095	
Net Assets	$ 63,936,720,338	$ 140,283,909	$ 64,077,004,247	

management and other expenses of $3.2 million.

As shown in Table 2, benefit withdrawals less retirement contributions, or net withdrawals by retirement plans, decreased from nearly $1.4 billion to a bit more than $1.1 billion, for a decrease of $261.9 million. 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 earnings increased from $7.8 billion to $11.3 billion, for an increase of over $3.5 billion of which unrealized investment gains were a significant portion. See Table 1 for information on changes at the asset level.

Notes to Financial Statements

Note 1. Description of Funds and Significant Accounting Policies

Description of Funds

The Retirement Funds consist of retirement contributions from participants in the Washington State Retirement System. The Retirement System is administered by 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, innovation 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

Statement of Changes in Net Assets

June 30, 2007

See notes to financial statements

	Commingled Trust Fund	Plan-Specific Investments	Total
Additions			
Investment Income:			
Interest, Dividends, and Other Investment Income	$ 2,699,370,390	$ 12,038,383	$ 2,711,408,773
Realized Capital Gains	3,792,813,797		3,792,813,797
Realized Capital Losses	(350,180,412)		(350,180,412)
Unrealized Gains	5,739,343,905		5,739,343,905
Less:			
Investment Expenses	(247,428,328)	(268,245)	(247,696,573)
Securities Lending Broker Rebates Paid	(311,087,146)		(311,087,146)
WSIB Operating Costs		(6,123,587)	(6,123,587)
Total Investment Income	11,322,832,206	5,646,551	11,328,478,757
Net Withdrawal by Retirement Plans		(1,132,531,324)	(1,132,531,324)
Investments in Commingled Funds	730,201,068	(730,201,068)	
Withdrawals from Commingled Funds	(1,930,396,528)	1,930,396,528	
Increase in Net Assets	10,122,636,746	73,310,687	10,195,947,433
Net Assets, Beginning of Year	53,814,083,592	66,973,222	53,881,056,814
Net Assets, End of Year	$ 63,936,720,338	$ 140,283,909	$ 64,077,004,247

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 as investment expenses 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 and Plan Specific Investments

The CTF is a diversified pool of investments which is used as an investment vehicle for 14 separate retirement plans, excluding 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 PERS 1 and 2/3; TRS Plans 1 and 2/3; SERS Plans 2/3; LEOFF Plans 1 and 2; WSP Retirement Systems Plan 1 and 2; VFF, and PSERS Plan 2. 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," 2 different types of plans.

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.

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, 2007, the Retirement Funds had the following unfunded investment commitments:

Private Equity	$ 8,111,998,340
Real Estate	$ 6,702,752,445

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 it. The Retirement Funds do not have a deposit policy for custodial credit risk. As of June 30, 2007, 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-U.S. 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 2007.

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 Retirement Funds' 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, 2007, the Retirement 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, 2007. The schedule displays

Schedule of Investment Expenses

PUBLIC EQUITY SECURITIES:	Fees	Assets Under Management
U.S. Active Equity Manager	$ 3,102,204	$ 3,673,338,206
U.S. Passive Equity Manager	5,932,799	11,367,100,023
International Active Equity Managers	43,841,210	9,783,325,298
International Passive Equity Managers	1,600,637	5,439,786,602
ALTERNATIVE INVESTMENTS:		
Private Equity	148,114,591	11,693,976,886
Real Estate	29,842,059	7,044,491,839
Innovation		43,018,509
OTHER FEES:		
Consultants and Advisors	514,986	
Accounting	601,996	
Custodians	12,432,939	
Legal Fees	846,934	
Miscellaneous Fees	866,218	
Total Investment Expenses	$ 247,696,573	$ 49,045,037,363

Schedule of Participation

RETIREMENT PLANS:	Commingled Trust Fund	Plan-Specific Investments	Total Plan Assets	Percent of Plan Assets
PERS 1	$ 11,504,571,192	$ 12,681,045	$ 11,517,252,237	18.0%
PERS 2/3 (DC and DB Plans)	18,290,269,136	26,516,026	18,316,785,162	28.6%
TEACHERS 1	9,675,393,866	54,757,343	9,730,151,209	15.2%
TEACHERS 2/3 (DC and DB Plans)	8,492,351,965	21,078,672	8,513,430,637	13.3%
VOLUNTEER FIREFIGHTERS	138,547,008	712	138,547,720	0.2%
WSP 1/2	963,027,520	523,289	963,550,809	1.5%
LEOFF 1	6,416,367,193	311,136	6,416,678,329	10.0%
LEOFF 2	5,159,195,739	14,168,122	5,173,363,861	8.1%
SCHOOL EMPLOYEES 2/3 (DC and DB Plans)	3,285,979,801	8,182,830	3,294,162,631	5.1%
PUBLIC SAFETY EMPLOYEES 2	11,016,918	1,607,218	12,624,136	0.0%
JUDICIAL		457,516	457,516	0.0%
Total Net Assets at June 30, 2007	**$ 63,936,720,338**	**$ 140,283,909**	**$ 64,077,004,247**	**100.0%**

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.

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, 2007, 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 Retirement Funds' 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, 2007.

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 Retirement Funds do 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 $5,439,786,602 invested in an international commingled equity index fund. As such, these currency denominations are not presented in this schedule.

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 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 Retirement 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 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, 2007, was $5,745,329,666 and $5,646,101,113, respectively.

During fiscal year 2007, securities lending transactions could be terminated on demand by either the Retirement Funds or the borrower. The weighted average maturity of overall loans was 28 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 220 days) or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made

Schedule 1

Investment Type	Total Market 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	$ 1,022,965	$ -	$ 1,022,965	$ -	$ -	1.12	AAA
Mortgages:							
Collateralized Mortgage Obligations	1,858,825,988		424,555,770	879,596,011	554,674,207	5.85	AAA
Pass Throughs	2,317,472,703	926,759	1,142,050,204	1,174,495,740		4.21	AAA
Non-Standard Mortgages	3,280,873			2,263,802	1,017,071	5.07	AAA
Commercial Mortgage Backed Securities	577,570,628		296,293,449	281,277,179		4.81	Multiple
Corporate Bonds - Domestic	5,659,103,577	235,984,757	1,853,356,215	2,507,548,275	1,062,214,330	5.91	Multiple
Corporate Bonds - Foreign	270,541,845		37,334,621	101,074,708	132,132,516	7.38	Multiple
Government Securities - Domestic:							
U.S. Government Treasuries	1,076,656,498		326,765,450	624,891,951	124,999,097	5.90	AAA
Treasury Inflation Protected Securities	1,342,534,146		674,891,883	667,642,263		3.46	AAA
Enhanced Equity Index Fund - Domestic:							
Asset Backed Securities	40,638,685				40,638,685	14.53	Multiple
Collateralized Mortgage Obligations	102,137,631				102,137,631	14.73	Multiple
Commercial Mortgage Backed Securities	2,408,629				2,408,629	11.39	NR
Pass Throughs	152,226,215				152,226,215	17.70	Multiple
Corporate Bonds - Domestic	129,147,847		95,998,897	5,530,027	27,618,923	5.13	Multiple
U.S. Government Agencies	2,189,463		2,189,463			1.14	AAA
U.S. Treasury Inflation Protected Securities	51,532,695			47,419,389	4,113,306	7.06	AAA
Variable Rate Notes	623,696,456	10,336,192	132,387,991	53,583,119	427,389,154	11.14	Multiple
Total Retirement Funds Investments Categorized	14,210,986,844	$ 247,247,708	$ 4,986,846,908	$ 6,345,322,464	$ 2,631,569,764		

Investments Not Required to be Catergorized Under GASB Statement No. 3	
Commingled Equity Index Funds - Domestic	11,367,100,023
Enhanced Equity Index Funds - Domestic	1,407,471,322
Commingled Enhanced Equity Index Funds - Domestic	1,161,889,263
Corporate Stock - Foreign	9,783,325,298
Commingled Index Funds - Foreign	5,439,786,602
Money Market Funds	1,858,692,601
Cash Overlay	497,073,890
Currency - Foreign	92,890,235
Private Equity	11,693,976,886
Real Estate	7,044,491,839
Innovation	43,018,509
Total Retirement Funds Investments Not Catergorized	50,389,716,468
Total Retirement Funds Investments	$ 64,600,703,312

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 2007, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Retirement Funds incurred no losses during fiscal year 2007 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

Schedule 2

Investment Type	Total Market Value	Moody's Equivalent Credit Rating			
		Aaa	Aa1	Aa2	Aa3
Commercial Mortgage Backed Securities	$ 577,570,628	$ 554,467,803	$ 23,102,825	$ -	$ -
Corporate Bonds - Domestic	5,659,103,577	840,631,750	155,136,393	484,096,322	830,021,850
Corporate Bonds - Foreign	270,541,845	56,597,473			
Enhanced Equity Index - Domestic:					
Asset Backed Securities	40,638,685	17,812,126			
Collateralized Mortgage Obligations	102,137,631	86,838,491			
Pass Throughs	152,226,215	68,569,499			
Corportate Bonds - Domestic	129,147,847	23,279,857			
Variable Rate Notes	623,696,456	270,612,216	15,189,147	6,257,815	25,348,308
Total	$ 7,555,062,884	$ 1,918,809,215	$ 193,428,365	$ 490,354,137	$ 855,370,158

Schedule 3

Foreign Currency Denomination	Investment Type In U.S. Dollar Equivalent						
	Liquidity	Fixed Income	Equity	Private Equity	Real Estate	Total	% of Total Retirement Funds Investments
Australia-Dollar	$ 2,831,934	$ -	$ 467,673,184	$ -	$ -	$ 470,505,118	0.7%
Brazil-Real	6,310	175,945,371	79,909,567			255,861,248	0.4%
Britain-Pound	16,140,723		1,698,430,979	67,733,225	71,000,000	1,853,304,927	2.9%
Canada-Dollar	5,293,817		371,285,234		573,277	377,152,328	0.6%
China-Renmimbi	41,139					41,139	0.0%
Denmark-Krone	2,019		47,732,525			47,734,544	0.1%
E.M.U.-Euro	36,336,165		3,514,913,208	1,049,131,504	1,162,812,173	5,763,193,050	8.9%
Egypt-Pound	135,978		10,536,558			10,672,536	0.0%
Hong Kong-Dollar	985,292		284,181,835			285,167,127	0.4%
Hungary-Forint	37,713		48,812,965			48,850,678	0.1%
Indonesia-Rupiah			13,084,744			13,084,744	0.0%
Israel-Shekel			5,216,482			5,216,482	0.0%
Japan-Yen	28,756,332		1,517,464,767		1,910,878,990	3,457,100,089	5.4%
Lithuania-Litas	138,428					138,428	0.0%
Malaysia-Ringgit	498,808		14,562,158			15,060,966	0.0%
Mexico-Peso	152	37,602,102	37,232,496		1,148,538	75,983,288	0.1%
New Zealand-Dollar	15,157		23,337,846			23,353,003	0.0%
Norway-Krone	38,408		126,605,831			126,644,239	0.2%
Pakistan-Rupee	5,058		11,804,082			11,809,140	0.0%
Philippines-Peso	29,868		226,202			256,070	0.0%
Poland-Zloty	1		60,103,581			60,103,582	0.1%
Singapore-Dollar	270,873		218,105,727			218,376,600	0.3%
South Africa-Rand	867		40,764,081			40,764,948	0.1%
South Korea-Won	141,781		53,295,827		2,208,662,355	2,262,099,963	3.5%
Sweden-Krona	1,077,332		192,094,627	62,054,499		255,226,458	0.4%
Switzerland-Franc	56,707		547,318,325			547,375,032	0.8%
Taiwanese-Dollar					15,669,727	15,669,727	0.0%
Thailand-Baht	44,572		2,195,831			2,240,403	0.0%
Turkey-Lira	4,801	56,994,372	33,907,654			90,906,827	0.1%
	92,890,235	270,541,845	9,420,796,316	1,178,919,228	5,370,745,060	16,333,892,684	25.3%
Foreign Investments Denominated in U.S. Dollars			362,528,982		289,866,781	652,395,763	1.0%
	$ 92,890,235	$ 270,541,845	$ 9,783,325,298	$ 1,178,919,228	$ 5,660,611,841	$ 16,986,288,447	26.3%

excess cash holdings. No such derivative securities were held as of June 30, 2007. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2007, the only derivative securities held directly by the Retirement Funds were collateralized mortgage obligations of $1,858,825,988.

There were no repurchase agreements outstanding at June 30, 2007. 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

A1	A2	A3	Baa1	Baa2	Baa3&Lower
$ -	$ -	$ -	$ -	$ -	$ -
480,383,109	443,532,856	504,326,607	491,016,668	629,547,676	800,410,346
37,334,621			36,736,644		139,873,107
					22,826,559
					15,299,140
					83,656,716
70,984	7,000,001	7,171,789	15,912,460	26,249,342	49,463,414
8,900,402	20,053,933	13,710,151	24,665,146	11,714,130	227,245,208
$ 526,689,116	$ 470,586,790	$ 525,208,547	$ 568,330,918	$ 667,511,148	$ 1,338,774,490

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, 2007.

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 2-4 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 75% passively managed with the rest in an active enhanced 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 portfolio is constrained by policy from investing more than 1% of the portfolio's par holdings in any single issuer with a quality rating below investment grade, and from having a duration (the sensitivity of the portfolio's market value to changes in the level of interest rates) that is more than 20% different than the duration of the Lehman Universal Index. In addition, the major sector allocations are limited to the following ranges:

Range	
U.S. Treasuries and Government Agencies	10% – 45%
Credit Bonds	10% – 60%
Asset Backed Securities	0% – 10%
Commercial Mortgage-Backed Securities	0% – 10%
Mortgage-Backed Securities	5% – 45%
Below Investment Grade Credit Bonds	0% – 15%

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 National Council of Real Estate Investment Fiduciaries (NCREIF) property index.

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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, 2007, 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. 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, 2007, 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

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, 2007, with those at June 30, 2006. 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, 2007. 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, 2007, with those of the year ended June 30, 2006. 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 increased by $829.2 million during the fiscal year ended June 30, 2007. 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 rebalances the L & I Funds' assets between asset classes as markets move pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $177.0 million to $188.8 million, for an increase of $11.8 million or 6.7%. The primary reason for the increase was positive investment performance. Fixed income investments increased from nearly $8.1 billion to over $8.7 billion, for an increase of $649.7 million or 8.0%. This was primarily due to positive investment performance of 6.2%. Public equity investments increased from $1.9 billion to almost $2.1 billion, for an increase of $151.4 million or 7.9%. This was due to increases in market values of equity investments offset partially by $251.0 million of asset transfers to fixed income for rebalancing.

As shown in Table 2, premiums less benefit payouts, or net amount withdrawn, increased from $(12.6) million to $(136.8) million, for a net increase of $124.2 million. This was due to increased insurance claim payouts. Total net investment earnings increased from $(34.3) million to $965.9 million, for an increase of $1.0 billion of which a significant portion is from unrealized investment gains. See Table 1 for information on changes at the asset level.

Table 1 - Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Money Market Funds	$188,793,364	$176,990,000	$11,803,364	6.7%
Total Fixed Income Investments	8,737,170,697	8,087,467,791	649,702,906	8.0%
Total Equity Investments	2,057,448,600	1,906,029,210	151,419,390	7.9%
Total Investments	10,983,412,661	10,170,487,001	812,925,660	8.0%
Total Accruals, Net	112,599,165	96,362,709	16,236,456	16.8%
Total Net Assets at Market Value	$11,096,011,826	$10,266,849,710	$829,162,116	8.1%

Table 2 Summarized Changes in Net Assets

	2007	2006	Dollar Change
Beginning Total Net Assets at Market Value	$10,266,849,710	$10,313,753,226	$(46,903,516)
Net Amount Withdrawn	(136,772,294)	(12,622,712)	(124,149,582)
Investment Earnings	967,156,883	(32,957,874)	1,000,114,757
WSIB Operating Costs	(1,222,473)	(1,322,930)	100,457
Net Investment Earnings	965,934,410	(34,280,804)	1,000,215,214
Ending Total Net Assets at Market Value	$11,096,011,826	$10,266,849,710	$829,162,116

Statement of Net Assets
June 30, 2007
See notes to financial statements

	Accident Fund	Medical Aid Fund	Pension Reserves Fund	Supplemental Pension Fund	Total	Percent of Total
ASSETS						
Investments:						
LIQUIDITY:						
Money Market Funds	$ 38,712,347	$ 57,855,363	$ 54,493,840	$ 37,731,814	$ 188,793,364	1.7%
FIXED INCOME INVESTMENTS:						
Collateralized Mortgage Obligations	765,716,017	557,576,903	396,674,136	285,907	1,720,252,963	
Pass Throughs	618,462	1,121,680	305,052		2,045,194	
Non-Standard Mortgages	17,063	9,716,716	1,357,305		11,091,084	
Commercial Mortgage Backed Securities	255,699,444	212,008,719	172,579,007		640,287,170	
Corporate Bonds - Domestic	1,780,366,258	1,559,757,090	1,357,051,041	35,619,209	4,732,793,598	
U.S. Government Treasuries	438,938,531	312,470,782	168,273,638	28,549,200	948,232,151	
U.S. Government Agencies	112,325,618		97,481,278		209,806,896	
U.S. Treasury Inflation Protected Securities	212,064,217	135,244,651	125,352,773		472,661,641	
Total Fixed Income Investments	3,565,745,610	2,787,896,541	2,319,074,230	64,454,316	8,737,170,697	79.5%
EQUITY INVESTMENTS:						
Commingled Index Funds - Domestic	383,637,558	1,114,526,612	242,401,467		1,740,565,637	
Commingled Index Funds - Foreign	71,515,799	200,241,456	45,125,708		316,882,963	
Total Equity Investments	455,153,357	1,314,768,068	287,527,175		2,057,448,600	18.8%
Total Investments	4,059,611,314	4,160,519,972	2,661,095,245	102,186,130	10,983,412,661	100.0%
Interest Receivable	48,169,981	33,917,379	31,622,693	1,276,558	114,986,611	
Receivable for Investments Sold	10,536	3,914,859	445,952		4,371,347	
Collateral Held Under Securities Lending Agreements	731,042,682	491,588,702	334,285,998	23,468,331	1,580,385,713	
Total Assets	4,838,834,513	4,689,940,912	3,027,449,888	126,931,019	12,683,156,332	
LIABILITIES						
Obligations Under Securities Lending Agreements	731,042,682	491,588,702	334,285,998	23,468,331	1,580,385,713	
Accounts Payable	3,166,474	1,989,111	1,488,674	114,534	6,758,793	
Total Liabilities	734,209,156	493,577,813	335,774,672	23,582,865	1,587,144,506	
Net Assets	$ 4,104,625,357	$ 4,196,363,099	$ 2,691,675,216	$ 103,348,154	$ 11,096,011,826	

Statement of Changes in Net Assets
June 30, 2007
See notes to financial statements

	Accident Fund	Medical Aid Fund	Pension Reserves Fund	Supplemental Pension Fund	Total
Additions					
Investment Income:					
Interest, Dividends and Other Investment Income	$ 261,971,563	$ 186,640,264	$ 154,542,600	$ 8,899,605	$ 612,054,032
Realized Capital Gains	99,453,851	100,863,680	35,403,574	145,753	235,866,858
Realized Capital Losses	(9,150,673)	(2,871,067)	(4,620,183)	(509,728)	(17,151,651)
Unrealized Gains	8,160,102	166,617,235	35,473,081	1,463,661	211,714,079
Less:					
Investment Expenses	(39,998,122)	(14,847,701)	(17,630,777)	(2,849,835)	(75,326,435)
WSIB Operating Costs	(466,907)	(451,240)	(289,443)	(14,883)	(1,222,473)
Total Investment Income	319,969,814	435,951,171	202,878,852	7,134,573	965,934,410
Net Amount Contributed (Withdrawn)	(104,495,633)	(54,847,079)	49,805,535	(27,235,117)	(136,772,294)
Residual Equity Transfers	21,324,000		(21,324,000)		
Increase (Decrease) in Net Assets	236,798,181	381,104,092	231,360,387	(20,100,544)	829,162,116
Net Assets, Beginning of Year	3,867,827,176	3,815,259,007	2,460,314,829	123,448,698	10,266,849,710
Net Assets, End of Year	$ 4,104,625,357	$ 4,196,363,099	$ 2,691,675,216	$ 103,348,154	$ 11,096,011,826

Notes to Financial Statements

Note 1. Description of Funds and 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 State of 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 L & I 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 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 it. The L & I Funds do not have a deposit policy for custodial credit risk. As of June 30, 2007, 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 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

Schedule 2

Investment Type	Total Market Value	Moody's Equivalent Credit Rating		
		Aaa	Aa1	Aa2
Non-Standard Mortgages	$ 11,091,084	$ 11,062,369	$ -	$ 28,715
Commercial Mortgage Backed Securities	640,287,170	582,341,045	57,946,125	
Corporate Bonds - Domestic	4,732,793,598	494,085,793	83,021,843	193,678,888
Total	$ 5,384,171,852	$ 1,087,489,207	$ 140,967,968	$ 193,707,603

Schedule 1

Investment Type	Total Market Value	Maturity: Less than 1 year	Maturity: 1-5 years	Maturity: 6-10 years	Maturity: More than 10 years	Effective Duration	Credit Rating
Mortgages:							
Collateralized Mortgage Obligations	$ 1,720,252,963	$ -	$ 158,435,407	$ 280,228,944	$ 1,281,588,612	7.83	AAA
Pass Throughs	2,045,194	135,626	1,620,627	288,941		2.08	AAA
Non-Standard Mortgages	11,091,084		9,380,566		1,710,518	2.18	Multiple
Commercial Mortgage Backed Securities	640,287,170	13,958,138	230,567,505	395,761,527		5.11	Multiple
Corporate Bonds - Domestic	4,732,793,598	202,090,502	882,665,912	1,388,601,837	2,259,435,347	8.22	Multiple
Government Securities-Domestic:							
US Government Treasuries	948,232,151	16,973,534	259,815,119		671,443,498	10.00	AAA
US Government Agencies	209,806,896				209,806,896	9.77	AAA
US Treasury Inflation Protected Securities	472,661,641			227,350,279	245,311,362	9.19	AAA
	8,737,170,697	$ 233,157,800	$ 1,542,485,136	$ 2,292,231,528	$ 4,669,296,233		

Investments Not Required to be Catergorized Under GASB Statement No. 3:	
Commingled Index Funds-Domestic	1,740,565,637
Commingled Index Funds-Foreign	316,882,963
Money Market Funds	188,793,364
Total Investments Not Categorized	2,246,241,964
Total L & I Funds Investments	$ 10,983,412,661

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- US 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, 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 2007.

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 Comparable Market Index (CMI), with volatility as measured by duration to be similar to or less than the index. As of June 30, 2007, the L & I Funds' durations of the various fixed income classes were within the duration targets of the CMI.

The following schedule (Schedule 1) provides information about the interest rate risks associated with the L & I Funds' investments as of June 30, 2007. 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 following schedule, variable-rate securities are presented according to the length of time until the next reset date rather than the stated maturity.

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, 2007, were rated by Moody's and/or an equivalent national rating organization. Investment types with multiple ratings are presented in the schedule below (Schedule 2) using the

Aa3	A1	A2	A3	Baa1	Baa2	Baa3
$ -	$ -	$ -	$ -	$ -	$ -	$ -
718,820,674	553,967,816	494,672,832	614,321,638	407,074,836	821,683,681	351,465,597
$ 718,820,674	$ 553,967,816	$ 494,672,832	$ 614,321,638	$ 407,074,836	$ 821,683,681	$ 351,465,597

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 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, 2007.

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 $316,882,963 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 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, 2007 was $1,580,385,713 and $1,553,082,522, respectively.

During fiscal year 2007, 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 28 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 220 days) or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. 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 2007, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the L & I Funds incurred no losses during fiscal year 2007 resulting from a default by either the borrowers or the securities lending agents.

Note 5. Derivatives

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. 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, 2007. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2007, the only derivative securities held directly by L & I Funds were collateralized mortgage obligations of $1,720,252,963.

There were no repurchase agreements outstanding at June 30, 2007. Repurchase agreements are collateralized at 102%. The collateral is priced daily and held by WSIB's agent in WSIB's name.

State law permits 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 the L & I Funds or provide securities or cash of equal value, 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, 2007.

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 its 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:

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

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 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 consulting firm Conning Asset Management 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

- 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."
- 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 3-4 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

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

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.

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): within 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 and 2.25.

The duration targets will be reviewed every 3 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 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.

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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, 2007, 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. 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, 2007, 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

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, 2007, with those at June 30, 2006. 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, 2007. 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, 2007, with those of the year ended June 30, 2006. 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 increased by $26.9 million during the fiscal year ended June 30, 2007. 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 the Permanent Funds' assets between asset classes as markets move, pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $44.6 million to $84.7 million, for an increase of $40.1 million, or 89.9%. The primary reason for the increase was for portfolio management reasons. Fixed income investments decreased from $654.4 million to $644.1 million, for a decrease of $10.3 million, or 1.6%. This was primarily due to the transfer of assets to money market funds for portfolio management reasons offset somewhat by positive investment performance.

As shown in Table 2, contributions increased slightly from $13.9 million to $16.6 million, for a net increase of $2.7 million. Distributions increased from $32.4 million to $34.7 million, or by $2.3 million due to increased income. Net investment earnings increased from ($4.1) million to $45.0 million for an increase of $49.2 million of which unrealized investment gains were a significant portion. See Table 1 for information on changes at the asset level.

Table 1 Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Money Market Funds	$84,711,258	$44,619,678	$40,091,5780	89.9%
Total Fixed Income Investments	644,122,777	654,434,530	(10,311,753)	-1.6%
Total Equity Investments	11,839,496	9,836,909	2,002,587	20.4%
Total Investments	740,673,531	708,891,117	31,782,414	4.5%
Total Accruals, Net	(909,684)	3,928,277	(4,837,961)	-123.2%
Total Net Assets at Market Value	$739,763,847	$712,819,394	$26,944,453	3.8%

Table 2 Summarized Changes in Net Assets

	2007	2006	Dollar Change
Beginning Total Net Assets at Market Value	$712,819,394	$735,553,431	$(22,734,037)
Net Amount Contributed	16,568,7456	13,878,922	2,689,824
Investment Earnings	45,129,178	(4,117,743)	49,246,921
WSIB Operating Costs	(82,568)	(92,921)	10,353
Net Investment Earnings	45,046,610	(4,210,664)	49,257,274
Distributions to Beneficiary Funds	(34,670,903)	(32,402,295)	(2,268,608)
Ending Total Net Assets at Market Value	$739,763,847	$712,819,394	$26,944,453

Statement of Net Assets
June 30, 2007

See notes to financial statements

	Millersylvania Park	Agricultural School	Normal School	Common School	Scientific School	State University	Total	Percent of Total
ASSETS								
Investments:								
LIQUIDITY:								
Money Market Funds	$ 5,151	$ 21,923,448	$ 20,683,797	$ 12,815,881	$ 25,160,313	$ 4,122,668	$ 84,711,258	11.4%
FIXED INCOME INVESTMENTS:								
Asset Backed Securities				183,265			183,265	
Collateralized Mortgage Obligations		38,887,054	58,127,205	44,612,175	44,861,679	6,964,090	193,452,203	
Pass Throughs		513,450	914,080	743,068	473,834	85,227	2,729,659	
Commercial Mortgage Backed Securities		6,525,341	9,325,417	7,182,975	7,036,945	1,095,725	31,166,403	
Corporate Bonds - Domestic		58,912,264	84,188,589	64,814,469	63,487,025	9,884,536	281,286,883	
U.S. Government Treasuries		24,660,128	29,121,568	20,635,677	27,797,153	4,168,334	106,382,860	
U.S. Treasury Inflation Protected Securities		5,990,883	8,650,130	6,636,951	6,610,629	1,032,911	28,921,504	
Total Fixed Income Investments	-	135,489,120	190,326,989	144,808,580	150,267,265	23,230,823	644,122,777	87.0%
EQUITY INVESTMENTS:								
Commingled Index Fund - Domestic				11,839,496			11,839,496	1.6%
Total Investments	5,151	157,412,568	211,010,786	169,463,957	175,427,578	27,353,491	740,673,531	100.0%
Interest Receivable	22	1,674,415	2,226,044	1,663,080	1,825,740	293,453	7,682,754	
Receivable for Investments Sold		263	416	305	182	9	1,175	
Collateral Held Under Securities Lending Agreements		33,458,918	41,141,825	29,076,925	35,709,818	7,114,347	146,501,833	
Total Assets	5,173	192,546,164	254,379,071	200,204,267	212,963,318	34,761,300	894,859,293	
LIABILITIES								
Obligations Under Securities Lending Agreements		33,458,918	41,141,825	29,076,925	35,709,818	7,114,347	146,501,833	
Accounts Payable		149,097	178,524	129,881	160,032	31,219	648,753	
Payables for Investments Purchased		1,048,446	1,497,780	1,148,299	1,123,335	174,741	4,992,601	
Due to Other Funds	22	637,910	852,624	638,403	712,821	110,479	2,952,259	
Total Liabilities	22	35,294,371	43,670,753	30,993,508	37,706,006	7,430,786	155,095,446	
Net Assets	$ 5,151	$ 157,251,793	$ 210,708,318	$ 169,210,759	$ 175,257,312	$ 27,330,514	$ 739,763,847	

Statement of Changes in Net Assets
June 30, 2007

See notes to financial statements

	Millersylvania Park	Agricultural School	Normal School	Common School	Scientific School	State University	Total
Additions							
Investment Income:							
Interest, Dividends and Other Investment Income	$ 268	$ 9,869,823	$ 12,944,474	$ 9,903,950	$ 10,851,774	$ 1,728,506	$ 45,298,795
Realized Capital Gains		164,597	225,586	445,486	160,225	28,535	1,024,429
Realized Capital Losses		(136,379)	(193,837)	(147,902)	(148,635)	(25,406)	(652,159)
Unrealized Gains and Losses		1,706,986	2,482,074	3,437,102	1,888,683	281,886	9,796,731
Less:							
Investment Expenses	(1)	(2,332,760)	(2,894,513)	(2,152,142)	(2,523,628)	(435,574)	(10,338,618)
WSIB Operating Costs		(17,564)	(23,686)	(18,988)	(19,328)	(3,002)	(82,568)
Total Investment Income	267	9,254,703	12,540,098	11,467,506	10,209,091	1,574,945	45,046,610
Net Amount Contributed	1	4,952,714	2,651,435	540,345	6,615,941	1,808,310	16,568,746
Distributions to Beneficiary Funds	(268)	(7,519,034)	(10,025,522)	(7,528,558)	(8,307,962)	(1,289,559)	(34,670,903)
Net Increase in Net Assets	-	6,688,383	5,166,011	4,479,293	8,517,070	2,093,696	26,944,453
Net Assets, Beginning of Year	5,151	150,563,410	205,542,307	164,731,466	166,740,242	25,236,818	712,819,394
Net Assets, End of Year	$ 5,151	$ 157,251,793	$ 210,708,318	$ 169,210,759	$ 175,257,312	$ 27,330,514	$ 739,763,847

Notes to Financial Statements

Note 1. Description of Funds and 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 establishment, maintenance, and upkeep of the Millersylvania State Park. 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 value 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 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 Permanent 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 Permanent Funds deposits may not be returned to it. The Permanent Funds do not have a deposit policy for custodial credit risk. As of June 30, 2007, 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 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-U.S. 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, 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 2007.

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, 2007, the Permanent 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, 2007. 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.

Credit Risk

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, 2007, 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. There was no concentration of credit risk that exceeded these limits as of June 30, 2007.

Schedule 1

		Maturity					
Investment Type	Total Market Value	Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Asset backed Securities	$ 183,265	$ 183,265	$ -	$ -	$ -	0.04	AAA
Mortgages:							
Collateralized Mortgage Obligations	193,452,203	406,218	29,675,794	110,287,101	53,083,090	6.34	AAA
Pass Throughs	2,729,659	37,815	2,691,844			2.11	AAA
Commercial Mortgage Backed Securities	31,166,403		6,856,191	24,310,212		6.18	AAA
Corporate Bonds - Domestic	281,286,883	45,540,063	124,075,719	89,758,412	21,912,689	4.45	Multiple
Government Securities-Domestic:							
US Government Treasuries	106,382,860	7,010,386	28,265,996	30,659,811	40,446,667	7.56	AAA
Treasury Inflation Protected Securities	28,921,504		14,461,249	14,460,255		3.90	AAA
	644,122,777	$ 53,177,747	$ 206,026,793	$ 269,475,791	$ 115,442,446		
Investments Not Required to be Catergorized Under GASB Statement No. 3:							
Commingled Index Funds-Domestic	11,839,496						
Money Market Funds	84,711,258						
Total Investments Not Categorized	96,550,754						
Total Permanent Funds Investments	$ 740,673,531						

Schedule 2

		Moody's Equivalent Credit Rating	
Investment Type	Total Market Value	Aaa	Aa1
Corporate Bonds - Domestic	$ 281,286,883	$ 55,246,098	$ 14,822,080

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 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, 2007, was $146,501,833 and $143,970,824 respectively.

During fiscal year 2007, securities lending transactions could be terminated on demand by either the Permanent Funds or the borrower. The weighted average maturity of overall loans was 28 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 220 days) or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. 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 2007, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Permanent Funds incurred no losses during fiscal year 2007 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

Aa2	Aa3	A1	A2	A3	Baa1	Baa2
$ 35,412,498	$ 50,297,054	$ 45,363,769	$ 23,942,536	$ 23,541,688	$ 8,938,810	$ 23,722,350

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, 2007. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2007, the only derivative securities held directly by the Permanent Funds were collateralized mortgage obligations of $193,452,203.

There were no repurchase agreements outstanding at June 30, 2007. 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, 2007.

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 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 high current yield to maturity opportunities and to add value through active management. The objectives include:

- Safety of principal
- Current income
- Long-term stability of purchasing power
- 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

- 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."

- 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

- U.S. Treasuries and Government Agencies
- Credit Bonds
- Mortgage Backed Securities
- Asset Backed Securities
- Commercial Backed Mortgage Securities
- Convertible Securities
- Eurodollar Bonds
- Non-US Dollar Bonds
- 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.

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%

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.

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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, 2007, 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. 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 Other Funds of 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, 2007, 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

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, 2007, with those at June 30, 2006. 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, 2007. 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, 2007, with those of the year ended June 30, 2006. 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.

As shown in Table 1, the net assets of the Other Funds increased by $247.3 million during the fiscal year ended June 30, 2007. 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 the Other Funds' assets pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $507.5 million to $754.8 million, for an increase of $247.3 million, or 48.7%. The primary reason for the increase was the additional funds being added to the Emergency Reserve Fund, the Pension Stabilization Fund, and the State Employee Insurance Reserve. Fixed income investments decreased from $218.3 thousand to $179.2 thousand, for a decrease of $39.0 thousand, or 17.9%. This was due to maturing fixed income assets that were reinvested in money market funds.

As shown in Table 2, the net amount contributed decreased from $416.6 million to $221.9 million for a total decrease of $194.6 million. Operating expenses grew in line with the growth in assets. Net investment earnings grew from $7.0 million to $25.4 million for an increase of $18.4 million which is attributable to the additional funds being added.

Table 1 Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Money Market Funds	$754,811,514	$507,472,656	$247,338,858	48.7%
Total Fixed Income Investments	179,283	218,324	(39,041)	-17.9%
Total Investments	754,990,797	507,690,980	247,299,817	48.7%
Total Accruals, Net	2,021,812	2,063,662	(41,850)	-2.0%
Total Net Assets at Market Value	$757,012,609	$509,754,642	$247,257,967	48.5%

Table 2 Summarized Changes in Net Assets

	2007	2006	Dollar Change
Beginning Total Net Assets at Market Value	$509,754,642	$86,223,942	$423,530,700
Net Amount Contributed	221,930,860	416,561,116	(194,630,256)
Investment Earnings	25,379,383	6,981,358	18,398,025
WSIB Operating Costs	(52,276)	(11,774)	(40,502)
Net Investment Earnings	25,327,107	6,969,584	18,357,523
Ending Total Net Assets at Market Value	$757,012,609	$509,754,642	$247,257,967

Statement of Net Assets

June 30, 2007

See notes to financial statements

	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	$ 226,846,003	$ 100	$ 9,896,671	$ 434,283,376	$ 83,472,427	$ 312,937	$ 754,811,514	100.0%
Municipal Bonds		179,283					179,283	0.0%
Total Investments	226,846,003	179,383	9,896,671	434,283,376	83,472,427	312,937	754,990,797	100.0%
Interest Receivable	226,245	5,248	41,588	1,396,650	350,766	1,315	2,021,812	
Net Assets	$ 227,072,248	$ 184,631	$ 9,938,259	$ 435,680,026	$ 83,823,193	$ 314,252	$ 757,012,609	

Statement of Changes in Net Assets

June 30, 2007

See notes to financial statements

	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	$ 3,221,342	$ 19,952	$ 494,168	$ 17,464,903	$ 4,168,005	$ 15,626	$ 25,383,996
Unrealized Market Gains		2,360					2,360
Less:							
Investment Expenses	(404)	(9)	(186)	(4,799)	(1,569)	(6)	(6,973)
WSIB Operating Expenses	(7,249)	(41)	(1,076)	(34,787)	(9,087)	(36)	(52,276)
Total Investment Income	3,213,689	22,262	492,906	17,425,317	4,157,349	15,584	25,327,107
Net Amount Contributed	155,782,000	(218,351)	1,076	66,357,012	9,087	36	221,930,860
Net Increase (Decrease) in Net Assets	158,995,689	(196,089)	493,982	83,782,329	4,166,436	15,620	247,257,967
Net Assets, Beginning of Year	68,076,559	380,720	9,444,277	351,897,697	79,656,757	298,632	509,754,642
Net Assets, End of Year	$ 227,072,248	$ 184,631	$ 9,938,259	$ 435,680,026	$ 83,823,193	$ 314,252	$ 757,012,609

Notes to Financial Statements

Note 1. Description of Funds and 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 are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to the Other Funds. 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 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, 2007, 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 Fund'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, 2007.

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 corporation eligible for collateral purposes at the Federal Reserve) securities; non-U.S. 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, 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 2007.

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 Other 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, 2007 there were no bonds held in the funds which are included in 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, 2007. 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 Risk

Schedule 1

Investment Type	Total Market Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Municipal Bonds	$ 179,283	$ 37,290	$ 131,191	$ 10,802	$ -	1.95	AAA
Money Market Funds	754,811,514						N/A
Total Investments	$ 754,990,797	$ 37,290	$ 131,191	$ 10,802	$ -		

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2007, the investments in municipal bonds were rated AAA by S&P and Aaa by Moody's.

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 Other Funds have 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 34% in Chelan County, Entiat Irrigation District, 35% in Chelan County, Lower Stemilt Irrigation District, 20% in Okanogan County, Aeneas Lake Irrigation District, and 11% 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, 2007.

Foreign Currency Risk

The Other Funds do 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, 2007.

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:

- Safety of Principal
- Current Income
- 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

- 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."
- Duration of Fixed Income Portfolios – The fixed income portfolio duration range will not exceed the Lehman Government Index's duration by more than 5%.

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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, 2007, 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. 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, 2007, 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

Management's Discussion and Analysis provides general information on the financial activities of GET managed by the WSIB. 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 GET. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2007, with those at June 30, 2006. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of GET for the year ended June 30, 2007. This information is summarized in Table 2 below. Table 2 also compares the financial activities of GET for the year ended June 30, 2007, with those of the year ended June 30, 2006. 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 GET.

As shown in Table 1, the net assets of GET increased by $228.0 million during the fiscal year ended June 30, 2007. 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 GET assets. WSIB staff rebalances the GET Funds' assets between asset classes as markets move pursuant to WSIB policy.

As reflected in Table 1, money market funds increased from $1.1 million to $3.4 million, for an increase of $2.3 million, or 198.8%. This increase was due to program receipts received at year end that had not yet been invested in fixed income and equity investments. Fixed income investments increased from $284.1 million to $363.9 million, for an increase of $79.8 million, or 28.1%. This increase was primarily due to net contributions made during the year. Public Equity investments increased from $419.3 million to $564.9 million, for an increase of $145.5 million, or 34.7%. This increase was primarily due to net contributions made during the year along with strong investment performance in public equities.

As shown in Table 2, contributions grew by $9.1 million from the previous year. Total net investment earnings grew from $49.7 million to $108.8 million for an increase of $59.1 million of which unrealized investment gains were a significant portion.

Table 1 Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Money Market Funds	$3,447,447	$1,153,849	$2,293,598	198.8%
Total Fixed Income Investments	363,943,093	284,122,556	79,820,537	28.1%
Total Equity Investments	564,869,143	419,348,436	145,520,707	34.7%
Total Investments	932,259,683	704,624,841	227,634,842	32.3%
Total Accruals, Net	3,700,329	3,374,909	325,420	9.6%
Total Net Assets at Market Value	$935,960,012	$707,999,750	$227,960,262	32.2%

Table 2 Summarized Changes in Net Assets

	2007	2006	Dollar Change
Beginning Total Net Assets at Market Value	$707,999,750	$548,216,588	$159,783,162
Net Amount Contributed (Withdrawn)	119,270,956	110,163,806	9,107,150
Investment Earnings	108,775,844	49,692,796	59,083,048
WSIB Operating Costs	(86,538)	(73,440)	(13,098)
Net Investment Earnings	108,689,306	49,619,356	59,069,950
Ending Total Net Assets at Market Value	$935,960,012	$707,999,750	$227,960,262

Statement of Net Assets
June 30, 2007
See notes to financial statements

	Total	Percent of Total
ASSETS		
Investments:		
Money Market Funds	$ 3,447,447	0.4%
Treasury Inflation Protected Securities	363,943,093	39.0%
Commingled Index Funds - Domestic	375,201,502	40.2%
Commingled Index Funds - Foreign	189,667,641	20.4%
Total Investments	932,259,683	100.0%
Interest Receivable	5,248,629	
Collateral Held Under Securities Lending Agreements	372,822,938	
Total Assets	1,310,331,250	
LIABILITIES		
Obligations Under Securities Lending Agreements	372,822,938	
Accounts Payable	1,548,300	
Total Liabilities	374,371,238	
Net Assets	$ 935,960,012	

Statement of Changes in Net Assets
June 30, 2007
See notes to financial statements

	Total
Additions	
Investment Income:	
Interest,Dividends and Other Investment Income	$ 36,088,114
Realized Capital Gains	7,872,356
Realized Capital Losses	(2,345,975)
Unrealized Gains	83,646,720
Less:	
Investment Expenses	(16,485,371)
WSIB Operating Costs	(86,538)
Total Investment Income	108,689,306
Net Amount Contributed	119,270,956
Net Increase in Net Assets	227,960,262
Net Assets, Beginning of Year	707,999,750
Net Assets, End of Year	$ 935,960,012

Notes to Financial Statements

Note 1. Description of Fund and Significant Accounting Policies

Description of Fund

GET 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 GET as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in GET. 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. GET has no investments of any commercial or industrial organization whose market value exceeds 5% of net assets. The assets of GET 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

GET records collateral received under securities lending agreements where GET 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 expenses in the accompanying statements. The statement of net assets does not include detailed holdings of securities lending collateral by investment classification.

Schedule 1

Investment Type	Total Market Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Treasury Inflation Protected Securities	$ 363,943,093	$ -	$ 88,091,450	$ 180,334,682	$ 95,516,962	6.45	AAA
Investments Not Required to be Categorized Under GASB Statement No. 3:							
Commingled Index Funds-Domestic	375,201,502						
Commingled Index Funds-Foreign	189,667,641						
Money Market Funds	3,447,447						
Total Investments Not Categorized	568,316,590						
Total Investments	$ 932,259,683						

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 GET are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to GET. 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 GET deposits may not be returned to it. GET does not have a deposit policy for custodial credit risk. As of June 30, 2007, 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 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 GET. 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-U.S. 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, 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 2007.

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. GET's fixed income investments are to be actively managed to exceed the return of the Lehman Custom TIPS Index, with volatility as measured by duration to be similar to or less than the index. As of June 30, 2007, the GET Fund's durations of the various fixed income classes were within the duration targets of the Lehman Custom TIPS Index.

The following schedule provides information about the interest rate risks associated with GET investments as of June 30, 2007. 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 Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GET debt investments in U.S. Treasury Inflation Protected Securities as of June 30, 2007 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. GET 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, 2007.

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. GET has no formal policy to limit foreign currency risk. The GET Fund had no investments with currency risk exposure. GET had $189,667,641 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 GET to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with 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, GET 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 GET 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 GET 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 GET'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, 2007, was $372,822,938 and $366,381,943 respectively.

During fiscal year 2007, securities lending transactions could be terminated on demand by either GET or the borrower. The weighted average maturity of overall loans was 28 days.

Cash collateral was invested by GET's agent in securities issued or guaranteed by the U.S. government, in the WSIB's short-term investment pool (average final maturity of 220 days) or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. 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 2007, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, GET incurred no losses during fiscal year 2007 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 GET 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.

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:

- ✪ Maintain the solvency of the fund and the financial stability of the program as measured by the external actuary.
- ✪ Ensure sufficient assets are available to fund the expected college tuition payments.
- ✪ 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.
- ✪ Invest in a manner that will not compromise public confidence in the program.

Risk Constraint Standards

- ✪ 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.
- ✪ 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).
- ✪ 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.

PETERSON SULLIVAN PLLC
CERTIFIED PUBLIC ACCOUNTANTS
601 UNION STREET, SUITE 2300
SEATTLE, WASHINGTON 98101
TEL 206.382.7777 • FAX 206.382.7777
http://www.pscpa.com

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 Washington State Investment Board as of June 30, 2007, 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. 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 Trust Funds of 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 Developmental Disabilities Endowment Trust Fund as of June 30, 2007, 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.

/s/ Peterson Sullivan PLLC

October 19, 2007

Management's Discussion and Analysis

Management's Discussion and Analysis provides general information on the financial activities of 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 DDEF. This information is summarized in Table 1 below. Table 1 also compares the investment balances at June 30, 2007, with those at June 30, 2006. The Statement of Changes in Net Assets provides information on investment performance and other increases and decreases in the net assets of DDEF for the year ended June 30, 2007. This information is summarized in Table 2 below. Table 2 also compares the financial activities of DDEF for the year ended June 30, 2007, with those of the year ended June 30, 2006. 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 DDEF.

As shown in Table 1, the assets under management within DDEF increased by $2.9 million during the fiscal year ended June 30, 2007. 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 DDEF assets. WSIB staff rebalances the DDEF's assets between asset classes as markets move, pursuant to WSIB policy.

As reflected in Table 1, money market funds decreased from $2.1 million to $2.0 million, for a decrease of $133.3 thousand, or 6.2%. The primary reason for the decrease was a reduction in cash investments in DDEF Private Funds. Fixed income investments increased slightly from $4.2 million to $4.3 million, for an increase of $117.8 thousand, or 2.8%. This was primarily due to positive investment performance. Public equity investments increased from $6.6 million to $9.5 million, for an increase of $2.9 million, or 44.3%. This was primarily due to increases in market values of equity investments plus new net contributions.

As shown in Table 2, net contributions decreased from $2.4 million to $1.4 million for a net decrease of $1.0 million. Total net investment earnings increased from $395.8 thousand to $1.5 million of which a significant portion was unrealized investment gains.

Table 1 Summarized Net Assets

	2007	2006	Dollar Change	% Change
Total Money Market Funds	$2,019,739	$2,153,059	$(133,320)	-6.2%
Total Fixed Income Investments	4,310,415	4,192,589	117,826	2.8%
Total Equity Investments	9,533,079	6,604,986	2,928,093	44.3%
Total Investments	15,863,233	12,950,634	2,912,599	22.5%
Total Accruals, Net	50,931	48,986	1,945	4.0%
Total Net Assets at Market Value	$15,914,164	$12,999,620	$2,914,544	22.4%

Table 2 Summarized Changes in Net Assets

	2007	2006	Dollar Change
Beginning Total Net Assets at Market Value	$12,999,620	$10,138,366	$2,861,254
Net Amount Contributed	1,444,474	2,465,489	(1,021,015)
Investment Earnings	1,470,885	396,646	1,074,239
WSIB Operating Costs	(815)	(881)	66
Net Investment Earnings	1,470,070	395,7645	1,074,3065
Ending Total Net Assets at Market Value	$15,914,164	$12,999,620	$2,914,544

Statement of Net Assets
June 30, 2007
See notes to financial statements

	Developmental Disabilities Endowment Trust Fund State	Developmental Disabilities Endowment Trust Fund Private	Total	Percent of Total
ASSETS				
Investments:				
LIQUDITY:				
Money Market Funds	$ 2,009,288	$ 10,451	$ 2,019,739	12.7%
FIXED INCOME INVESTMENTS:				
Treasury Inflation Protected Securities	2,687,294		2,687,294	16.9%
Commingled Balanced Trust	1,623,121		1,623,121	10.2%
EQUITY INVESTMENTS:				
Commingled Index Funds - Domestic	1,197,539		1,197,539	7.5%
Mutual Fund - Domestic		8,335,540	8,335,540	52.7%
Total Investments	7,517,242	8,345,991	15,863,233	100.0%
Interest Receivable	62,857	45	62,902	
Collateral Held Under Securities Lending Agreements	2,777,834		2,777,834	
Total Assets	10,357,933	8,346,036	18,703,969	
LIABILITIES				
Obligations Under Securities Lending Agreements	2,777,834		2,777,834	
Accounts Payable	11,971		11,971	
Total Liabilities	2,789,805		2,789,805	
Net Assets	$ 7,568,128	$ 8,346,036	$ 15,914,164	

Statement of Changes in Net Assets
June 30, 2007
See notes to financial statements

	Developmental Disabilities Endowment Trust Fund State	Developmental Disabilities Endowment Trust Fund Private	Total
Additions			
Investment Income:			
Interest, Dividends and Other Investment Income	$ 356,985	$ 226,901	$ 583,886
Realized Capital Gains	25,838		25,838
Unrealized Gains	273,920	731,855	1,005,775
Less:			
Investment Expenses	(144,482)	(132)	(144,614)
WSIB Operating Costs	(815)		(815)
Total Investment Income	511,446	958,624	1,470,070
Net Amount Contributed	815	1,443,659	1,444,474
Net Increase in Net Assets	512,261	2,402,283	2,914,544
Net Assets, Beginning of Year	7,055,867	5,943,753	12,999,620
Net Assets, End of Year	$ 7,568,128	$ 8,346,036	$ 15,914,164

Notes to Financial Statements

Note 1. Description of Funds and Significant Accounting Policies

Description of Funds

The Developmental Disabilities Endowment Fund of the State of Washington consists of two funds. The first fund, DDEF State, was originally created from a grant by the State of Washington, and the second fund, DDEF Private, consists of contributions by private individual participants of the program. These funds are invested by the WSIB until participants withdraw these funds as needed. The financial statements present only the activity of DDEF as managed by the WSIB. The WSIB has exclusive control of the investments of all money invested in 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. DDEF has no investments of any commercial or industrial organization whose market value exceeds 5% of each plan's net assets. The assets of 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

DDEF reports collateral received under securities lending agreements where 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 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 DDEF are reported on the statement of changes in net assets. These fees are accounted for as a reduction of investment income to DDEF. 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, DDEF deposits may not be returned to it. DDEF does not have a deposit policy for custodial credit risk. As of June 30, 2007, 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 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 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-U.S. 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, 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

Schedule 1

Investment Type	Total Market Value	Maturity: Less than 1 year	1-5 years	6-10 years	More than 10 years	Effective Duration	Credit Rating
Government Securities-Domestic:							
Treasury Inflation Protected Securities	$ 2,687,294	$ -	$ 2,687,294	$ -	$ -	2.78	AAA
Investments Not Required to be Categorized Under GASB Statement No. 3							
Commingled Index Funds-Domestic	1,197,539						
Commingled Balanced Trust	1,623,121						
Money Market Funds	2,019,739						
Mutual Funds	8,335,540						
Total Investments Not Categorized	13,175,939						
Total Investments	$ 15,863,233						

restrictions during fiscal year 2007.

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. 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, 2007, 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 DDEF investments as of June 30, 2007. 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 Risk

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, 2007.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. DDEF policy states no corporate fixed income issue's cost shall exceed 3% of DDEF's market value at the time of purchase, nor shall its market value exceed 6% of 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, 2007.

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

Note 4. Securities Lending

Washington State law and WSIB policy permit DDEF to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with 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, 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 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 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 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, 2007 was $2,777,834 and $2,729,844 respectively.

During fiscal year 2007, securities lending transactions could be terminated on demand by either DDEF or the borrower. The weighted average maturity of overall loans was 28 days.

Cash collateral was invested by 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 220 days) or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. 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 2007, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, DDEF incurred no losses during fiscal year 2007 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. 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 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, 2007. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2007, DDEF held no derivatives.

There were no repurchase agreements outstanding at June 30, 2007. 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 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:

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

Risk Constraint Standards

- 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.

✪ 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. 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

OBJECTS OF EXPENDITURE	Budget to Date	Expenditures to Date		Budget Variance
Appropriated				
Salaries	$ 5,737,655	$ 5,164,717		$ 572,938
Benefits	$ 1,230,966	$ 1,091,430		139,536
Personal Services	$ 489,418	$ 443,386		46,032
Goods & Services	$ 1,255,220	$ 1,446,182		(190,962)
Travel	$ 213,300	$ 491,009		(277,709)
Equipment	$ 7,480	$ 246,603		(239,123)
Subtotal Appropriated	$ 8,934,039	$ 8,883,327		$ 50,712
Non-Appropriated Retirement Funds		**Fees**	**Netted Fees**	**Total Fees**
U.S. Equity		$ 6,206,962	639,805	6,846,766
International Equity		36,859,229	11,321,244	48,180,473
Private Equity		1,664,539	143,816,310	145,480,849
Real Estate		0	29,545,307	29,545,307
General Consultants		3,902,545	-	3,902,545
Legal Fees		846,935	-	846,935
Directed Brokerage Fees		0	281,691	281,691
Cash Overlay		222,500	-	222,500
Custodian Bank Fees		2,501,628	-	2,501,628
Securities Lending		0	9,517,843	9,517,843
Investment Acctg Data Systems		601,996		601,996
Misc Expenses		894,523	-	894,523
Total Retirement		$ 53,700,857	$ 195,122,200	$ 248,823,057
Self-Directed Defined Contribution Funds				
Self-Direct Managers - PERS, SERS & TERS 3 Non US		-	126,777	126,777
Self Direct Managers - PERS, SERS & TERS 3 US		-	645,149	645,149
U.S. Fixed Income			311,061	311,061
Securities Lending		-	522,333	522,333
Investment Acctg Data System		15,620		15,620
Misc Expenses		35,449		35,449
Total DC-Self-Direct*		$ 51,069	$ 1,605,320	$ 1,656,388
Labor & Industries Funds				
General Consultants		$ 220,371	-	220,371
U.S. Equity		65,225	125,928	191,154
International Equity		-	185,691	185,691
Custodian Bank Fees		72,572	-	72,572
Securities Lending		-	1,609,165	1,609,165
Cash Management Fees		-	388,635	388,635
Investment Acctg Data System		117,398	-	117,398
Misc Expenses		306,139	-	306,139
Total L & I		$ 781,705	$ 2,309,420	$ 3,091,124
Deferred Compensation Funds				
Fixed Income- Active		-	268,499	268,499
US Equity- Active		-	6,892,757	6,892,757
International Equity		-	747,137	747,137
Securities Lending and Other Fees		-	137,450	137,450
Cash Management Fees		-	108,639	108,639
Total Deferred Compensation Funds*		$ -	$ 8,154,483	$ 8,154,483
Permanent/Other Funds				
General Consultants		$ 2,960	-	2,960
US Equity		3,485	24,384	27,870
International Equity		-	114,821	114,821
Custodian Bank Fees		5,771	-	5,771
Securities Lending		-	555,574	555,574
Cash Management Fees		-	1,063,730	1,063,730
Investment Acctg Data System		7,886	-	7,886
Misc Expenses		53,263	-	53,263
Total Permanent Funds		$ 73,365	$ 1,758,510	$ 1,831,875
Subtotal Non-Appropriated		**54,606,996**	**208,949,931**	**$ 263,556,927**
TOTAL		$ 272,440,254		

* Expenses are paid by participants

2100 EVERGREEN PARK DRIVE SW
P.O. BOX 40916
OLYMPIA, WA 98504

WWW.SIB.WA.GOV