NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2007

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Local Government Investment Pool (LGIP) have been prepared in conformity with generally accepted accounting principles (GAAP). 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 Governmental Accounting Standards Board (GASB) which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. The more significant of the LGIP's accounting policies are as follows:

Reporting Entity – The LGIP was created by Chapter 294, Laws of 1986 and began operations in July 1986. The LGIP is a short-term investment pool of the state of Washington, available to Washington State counties, cities, towns, municipal corporations, special-purpose taxing districts, community and technical colleges, four-year public institutions of higher education, the State Board for Community and Technical Colleges, and the State Finance Committee. Participation in the LGIP is voluntary.

The LGIP is managed and operated by the Office of the State Treasurer (OST). The State Finance Committee is the administrator of the statute that created the pool and adopts appropriate rules. The State Treasurer is responsible for establishing the investment policy for the pool, and reviews it annually. Any proposed changes are reviewed by the LGIP Advisory Committee. The terms of the policy are designed to ensure the safety and liquidity of the funds deposited in the LGIP.

The assets and liabilities of the LGIP are included in the Comprehensive Annual Financial Report of the state of Washington. However, the accompanying financial statements present only the LGIP and are not intended to present fairly the financial position of the state of Washington and the results of its operations in conformity with GAAP.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation – The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Earnings on investments are recognized as revenue when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Investment and Certificates of Deposit Activity – The OST adopted a formal investment policy for the LGIP in 1994. The policy is to invest in high-quality, short-term instruments. All money market securities are required to be rated A-1 by Standard and Poor's Corporation and P-1 by Moody's Investors Services, Inc. Investments are restricted to fixed rate securities that mature in 397 days or less, floating and variable rate securities that mature in 762 days or less, and the portfolio maintains a weighted average maturity of 90 days or less. The State Treasurer has the sole responsibility to set investment strategy for the LGIP.

Investments are valued at amortized cost, which approximates fair value. Certificates of deposit are valued at historical cost, which also approximates fair value. Security transactions are reported on a trade date basis in accordance with GAAP. Pending purchases, as of June 30, 2007, settled at a total cost of $98,769,722 on July 2, 2007.

Deductions and Penalties – An administrative deduction is assessed for the administration of the LGIP in accordance with WAC 210-01-120. The deduction is set so as to cover costs associated with the LGIP. The deduction is calculated at 0.035 percent of each participant's average daily balance of the funds in the LGIP and is reflected on the participant's monthly statement. The deduction is subtracted from the pool participant's earnings prior to the earnings posting to the account. The amount assessed for administration of the LGIP totaled $2,012,221 for Fiscal Year 2007.

On a monthly basis, the LGIP determines the total dollar amount necessary to reimburse the state treasurer's office for actual expenses as provided in RCW 43.250.060. Administrative deductions collected in excess of these expenses are rebated to pool participants at the end of each fiscal year. The proportionate share of the rebate is based on the participant's average daily balance for the fiscal year. The rebate to participants of fees in excess of expenses totaled $1,468,237 for Fiscal Year 2007.

The net administrative deduction for Fiscal Year 2007 was 0.010 percent of each participant's average daily balance of the funds in the LGIP.

Overdraft penalties due to failure to wire funds by a pool participant (after notification to the state treasurer of an intended transfer) are assessed to the pool participant responsible for the overdraft. Overdraft penalties collected (miscellaneous income) are allocated and distributed to participants on an annual basis, based on the participant's average daily balance for the fiscal year. Overdraft penalties totaled $4,160 for Fiscal Year 2007. Combined with fees in excess of expenses, the total rebated to participants for Fiscal Year 2007 was $1,472,397.

Participant Transactions – Participants can invest and withdraw their investments on a daily basis with a limit of one transaction per business day. The minimum transaction amount is five thousand dollars. There is no maximum transaction amount. For an investment or withdrawal of ten million dollars or more, a one-day notification prior to the transfer date is requested. An investment or withdrawal greater than one million dollars requires notification prior to 9 A.M. on the transfer date. An investment or withdrawal of one million dollars or less requires notification prior to 10 A.M. on the transfer date. All participants are required to file with the state treasurer a certified copy of an ordinance or resolution containing the names and titles of the officials authorized to invest or withdraw funds in the LGIP.

Distributions to local governments for state, federal, and local revenues electronically transferred utilizing the Treasury Management System can be directly invested in the LGIP. These investments are in addition to the one transaction per business day limit.

Income Distribution to Participants – Net investment income is allocated monthly to participants and is based on their average proportionate share of net assets in relation to the total net investment income of the LGIP for that month. Allocations are reinvested in the LGIP.

Service Providers – The state treasurer oversees the operations of the LGIP and provides portfolio management and record keeping services. The costs for these services, together with professional fees, custodian fees, and other operating costs, are accrued and charged to the LGIP as an expense on a monthly basis.

From October 1, 2000 through September 30, 2007, the Bank of New York provided securities lending services for the LGIP and served as securities custodian, maintaining custody of all LGIP-owned investments other than certificates of deposit and interest bearing bank deposits. Effective October 1, 2007, Union Bank of California replaced the Bank of New York to serve as the securities custodian and provide securities lending services for the LGIP.

Risk Management – The state of Washington continues to operate a risk management liability program pursuant to RCW 4.92.130. The state manages its tort claims as an insurance business activity rather than a general governmental activity. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state management believes it is more economical to manage its risks internally and set aside assets for claims settlement in an Internal Service Fund. A limited amount of commercial insurance is purchased for employee bonds and to limit the exposure to catastrophic losses. Otherwise, the risk management liability program services all claims against the state for injuries and property damage to third parties. The OST participates in the risk management liability program.

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

2a7 – Like Pool – In accordance with GASB Statement 31, the accounting and financial reporting standards in paragraphs 7, 8, and 10 through 15 apply to all investments of governmental external investment pools, except that 2a7-like pools may report their investments at amortized cost. The LGIP is a 2a7-like pool; therefore, investments are reported at amortized cost.

NOTE 2 – INVESTMENTS AND DEPOSITS

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The portfolio is managed in a manner consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940, i.e., money market funds. Much of the Rule 2a-7 investment guidelines are directed towards limiting interest rate risk, in order to maintain a stable net asset value. For example, the LGIP's policy places a 90 day maximum on the weighted average maturity. Further, the maximum maturity of any security will not exceed 397 days, except for securities utilized in repurchase agreements and US Agency floating or variable rate notes may have a maximum maturity of 762 days, provided that they have reset dates within one year and which on any reset date can reasonably be expected to have a market value that approximates its amortized cost. As of June 30, 2007, the LGIP had a weighted average maturity of 46 days.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The LGIP investment policy limits the types of securities available for investment to obligations of the U.S. government or its agencies, obligations of government-sponsored corporations, banker's acceptances, commercial paper, certificates of deposit, or obligations of the state of Washington or its political subdivisions. Banker's acceptances and commercial paper must be rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. The LGIP currently does not have any banker's acceptances or commercial paper in its portfolio. All securities utilized in repurchase agreements are rated AAA.

Custodial Credit Risk – Custodial credit risk is the risk that, in the event of a failure of the counter party, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The OST investment policy requires that securities purchased by the office are to be held by the master custodian, acting as an independent third party, in its safekeeping or trust department. Securities utilized in repurchase agreements are subject to additional restrictions. These restrictions are designed to limit the OST's exposure to risk and insure the safety of the investment. All securities utilized in repurchase agreements were rated AAA. The market value of securities utilized in repurchase agreements must be at least 102% of the value of the repurchase agreement.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The OST mitigates concentration of credit risk by limiting the percentage of the portfolio invested with any one issuer.

As of June 30, 2007, the LGIP had the following investments and maturities:

			Maturity	
Investment Type	**Book Value**	**Fair Value**	**Less than 1 year**	**1-5 years**
U.S. Government Obligations	$ 67,551,610	$ 67,551,610	$ 67,551,610	
U.S. Government Obligations – On Loan	82,243,361	82,243,361	82,243,361	
U.S. Agency Obligations	1,579,047,063	1,579,047,063	1,564,608,821	$ 14,438,242
U.S. Agency Obligations – On Loan	6,510,740	6,510,740	1,238,072	5,272,668
Repurchase Agreements	3,911,777,070	3,911,777,070	3,911,777,070	
Interest Bearing Bank Deposits	378,726,446	378,726,446	378,726,446	
Certificates of Deposit	255,350,000	255,350,000	255,350,000	
Total	$ 6,281,206,290	$ 6,281,206,290	$ 6,261,495,380	$ 19,710,910

Securities Lending – State statutes permit the LGIP to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The LGIP, which has contracted with a lending agent to lend securities in the LGIP, earns a fee for this activity. The lending agent lends securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent. The cash is invested by the lending agent in repurchase agreements or money market instruments, in accordance with investment guidelines approved by the LGIP. The securities held as collateral and the securities underlying the cash collateral are held by the LGIP's custodian. On June 30, 2007, the average life of both the loans and the investment of cash received as collateral was two days.

The LGIP investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the LGIP. During Fiscal Year 2007, the LGIP had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the LGIP. Furthermore, the contract with the lending agent requires them to indemnify the LGIP if the borrowers fail to return the securities (and if collateral is inadequate to replace the securities lent) or if the borrower fails to pay the LGIP for income distribution by the securities' issuers while the securities are on loan. The LGIP cannot pledge or sell collateral securities received unless the borrower defaults. The LGIP investment policy limits the amount of reverse repurchase agreements and securities lending to 30% of the total portfolio. There were no violations of legal or contractual provisions nor any losses resulting from a default of a borrower or lending agent during the year.

Repurchase Agreements – The market value, plus accrued income, of mortgage-backed securities utilized in repurchase agreements with more than seven days remaining until maturity will be 105 percent of the value of the repurchase agreement. The market value, plus accrued income, of securities utilized in all other repurchase agreements will be 102 percent of the value of the repurchase agreement. The securities utilized in repurchase agreements are priced daily and held by the LGIP's custodian in the state's name. Collateralized Mortgage Obligations (CMO) utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency.

Reverse Repurchase Agreements – State law also permits the LGIP to enter into reverse repurchase agreements, which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the LGIP underlying the reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers default on their obligations to resell these securities to the LGIP or to provide equal value in securities or cash, the LGIP would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. On June 30, 2007, there were no obligations under reverse repurchase agreements.

Derivatives – A derivative is a futures, forward, swap, or option contract, or other financial instrument with similar characteristics. The LGIP did not own, buy, or sell derivatives during the fiscal year.

Deposits – All LGIP's deposits are either insured or collateralized. The LGIP's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (PDPC). The PDPC, created by the Legislature per Title 39.58 of the Revised Code of Washington, constitutes a multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool.

NOTE 3 – SUMMARY OF ACTIVITY

A summary of LGIP activity, including reporting required by RCW 43.250.080, is as follows:

		FY 2007
Total Investment Purchases	$	200,597,043,989
Total Sales	$	1,324,757,969
Total Maturities	$	198,379,244,968
Total Net Investment Income	$	301,083,119
Administrative Expenses	$	543,983
Portfolio Yield (360-Day Basis)		5.25 percent
Average Weighted Maturity		46 days
Pool Participant Contributions	$	13,138,867,890
Pool Participant Distributions	$	12,618,725,114

NOTE 4 – RELATED PARTY TRANSACTIONS

Pursuant to Chapter 43.250 RCW, certain funds of the State of Washington's public colleges, universities and agencies may be invested in the LGIP. Activity and balances for these funds in Fiscal Year 2007 were as follows:

Change in Net Assets	
Income Distributed and Deposited to Participant Accounts, Net of Administrative Deductions of $85,926	$ 12,840,099
Contributions from Participants	1,026,478,939
Distributions to Participants	(949,996,997)
Total Change in Net Assets	89,322,041
Net Assets – Beginning of Year	213,682,060
Net Assets – End of Year	$ 303,004,101