



MICHAEL J. MURPHY
State Treasurer

State of Washington
Office of the Treasurer

October 21, 2008

The Honorable Christine O. Gregoire, Governor
The Honorable Brian Sonntag, State Auditor
Members of the State Finance Committee
Members of the Joint Legislative Audit and Review Committee
Participants in the Local Government Investment Pool

I am pleased to submit this Comprehensive Annual Financial Report (CAFR) of the State of Washington Local Government Investment Pool (LGIP) for the fiscal year ended June 30, 2008. This report has been prepared by the Office of the State Treasurer (OST) as required by Revised Code of Washington (RCW) 43.250.080. It includes only activity of the LGIP and does not include data or information related to other state agencies or funds.

Responsibility for the accuracy of the data, as well as the completeness and fairness of the presentation, including all disclosures, rests with management of the Office of the State Treasurer. To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the LGIP.

Peterson Sullivan, PLLC has issued an unqualified ("clean") opinion on the financial statements for the fiscal year ended June 30, 2008. The independent auditor's report is included in the financial section of this report.

Management's Discussion and Analysis (MD&A), immediately following the independent auditor's report, provides a narrative introduction, overview and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

Profile of the LGIP

The LGIP, created by the Washington State Legislature in 1986, is managed and operated solely by OST. The State Finance Committee administers the statute that created the pool and adopts appropriate rules. The State Treasurer established the LGIP Advisory Committee to provide advice on the pool's operation. The advisory committee includes 12 members selected from active pool participants. Eight members are appointed by participant associations, and four are appointed by the State Treasurer.

The LGIP is operated as a business enterprise within the framework of state laws and regulations. The LGIP's primary purpose is to provide an investment tool for local governments. No general government functions are managed within the pool. Political subdivisions (local governments), public colleges and universities, the State Board for Community and Technical Colleges and the State Finance Committee may, at their option, invest temporary cash surpluses to take advantage of the volume and expertise of the state's investment program to earn a competitive rate of return while maintaining security and liquidity. The objectives of the State Treasurer's investment program, in priority order, are safety, liquidity and return on investment.

Investment Risk Profile

The LGIP is considered extremely low risk. It is operated in a manner consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940. Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The portfolio is made up of high-quality, highly liquid securities, and its relatively short average maturity reduces the pool's price sensitivity to market interest rate fluctuations. The LGIP also has a strong degree of asset diversification to minimize risk and maintain adequate rates of return.

The investment activity is guided by an investment policy, approved by the State Treasurer and operates under the standard of the prudent investor. OST operates the LGIP for investing cash in excess of daily requirements. Among the investments authorized by statute are: U.S. Treasury and agency securities, banker's acceptances, repurchase agreements, reverse repurchase agreements, commercial paper, and certificates of deposit with qualified public depositories.

The LGIP is managed diligently by professional treasury personnel to protect against losses from market and credit changes. However, the pool is not insured or guaranteed by any government. Therefore, the maintenance of principal is not fully assured.

Economic Condition and Outlook

The economic condition of the LGIP is based primarily upon investment earnings. With \$7 billion in assets as of June 30, 2008, the LGIP produced an average monthly portfolio yield of 4.04 percent. The LGIP exceeded its benchmark by 79 basis points, resulting in \$53 million in additional interest income for participants.

Fiscal year 2008 was marked by substantial easing of monetary policy by the Federal Open Market Committee (FOMC). The FOMC lowered its target for the federal funds rate seven times from September 2007 through April 2008. The targeted federal funds rate began the fiscal year at 5.25 percent and ended the period at two percent.

The FOMC carefully monitored economic and financial developments and acted to promote sustainable economic growth, foster price stability and mitigate adverse effects on the economy arising from the disruptions in financial markets. During the period, the FOMC noted that economic growth slowed, reflecting the intensification of the housing correction and softening in business and consumer spending. Moreover, strains in financial markets increased and elevated energy and commodity prices put upward pressure on inflation.

The FOMC continued to take action in view of a weakening of the economic outlook and increasing downside risks to growth. Throughout the fiscal year, financial markets remained under considerable stress, and tight credit conditions and the deepening housing contraction weighed on economic growth.

The FOMC expects inflation to moderate later this year and next year. However, in light of the continued increases in the prices of energy and some other commodities and the elevated state of some indicators of inflation expectations, uncertainty about the inflation outlook remains high. During fiscal year 2009, the FOMC has already lowered its target for the federal funds rate 50 basis points to one and one half percent pointing to a weakening of economic activity.

Due to the short-term nature of the LGIP portfolio, and the types of investments utilized, the LGIP yields will closely follow the targeted federal funds rate.

Internal Controls

Management is responsible for establishing and maintaining internal controls designed to ensure that the assets are protected from loss, theft, or misuse, and to ensure that adequate accounting data is compiled to allow for the preparation of financial statements in conformance with generally accepted accounting principles. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of controls should not exceed the benefits likely to be derived, and the evaluation of costs and benefits requires estimates and judgments by management. Management continues to assess the adequacy of its internal controls and make improvements when needed.

The State Treasurer maintains internal controls to protect against the loss of funds. Staff responsible for oversight of the pool receive daily reports monitoring investment operations to ensure compliance with the terms of the investment policy. In addition, a risk assessment and internal control evaluation is performed annually.

Additional Information

A section of the State Treasurer's website is dedicated to the LGIP. This CAFR, plus additional information for participants and interested parties, may be accessed through the OST website (<http://tre.wa.gov>).

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the LGIP for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2007. This was the eleventh consecutive year the LGIP achieved this prestigious award. In order to be awarded a Certificate of Achievement, OST had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. OST believes this CAFR continues to meet the Certificate of Achievement Program's requirements and will submit it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

The preparation of this report was accomplished due to the efficient and dedicated services of many individuals in OST's Accounting and Fiscal Services Division and its Investment Division. Due credit is given to State Treasurer Michael J. Murphy and Assistant State Treasurer Allan J. Martin for their commitment to operating the Office of the State Treasurer and the LGIP in a responsible and progressive manner.

This CAFR reflects our commitment to pool participants and citizens of the state of Washington to maintain financial statements in conformance with the highest professional standards.

Sincerely,



SHAD PRUITT
DEPUTY TREASURER